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The comparison of Two Succession Ways in Chinese Family Business: Family CEOs and Professional CEOs

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Summary

Family business is the most prevalent type of firms in the world, and one crucial topic around it is the succession issue. Considering that family business in China differs from other regions in terms of performance, the purpose of this thesis is to discuss which one is the optimal succession choice in Chinese family business, family CEOs, or professional CEOs?

Some previous researches show that family business managed by family CEOs have worse management quality and economic outcome. These early researches provide four reasons to explain the inferiority of family CEOs, which are (1) perception: family CEOs lack awareness of their poor performance; (2) nonpecuniary benefits the family CEOs enjoyed which impede the growth of business; (3) the cost incurred by the implicit commitment of family CEOs drag down the performance. (4) passing down the business only to offspring narrow down the CEO choices. Knowing the worse performance of family CEOs, why do the outgoing controllers of family business still appoint family CEOs rather than professional CEOs? It is because of (1) cultural reasons such as family value within the family business; (2) limited access to outside capable professional manager; and (3) institutional constraints such as weak legal protection.

The literatures mentioned above contend that family businesses with separation of ownership and

management are more efficient than those having family CEOs in firms, but none of these researches analyze China’s case specifically. Some Chinese researchers who study the performance of Chinese family businesses find a different result. Their researches show that family CEOs in China outperform non-family CEOs. The better performance of family CEOs in China could be explained as (1) size, because smaller size business has advantages in current china’s context, and family businesses in China are still in their early stage; (2) China’s one-child policy bring less infighting; (3) undeveloped talent pool in China; (4) political connection plays an important role in running business in China.

Even though these researches reveal that family CEOs outperform outside CEOs in China, it does not necessarily mean handing down the family business to family members is the optimal option. Because the context which favors family CEOs is dynamic and will change in the future. For example (1) along with the growing size of business, family business may need more help from outside; (2) the talent market might be developed in the future; (3) if the transparency of government goes up, the political connection might be less important. Therefore, the hypothesis can be concluded as: family CEOs is suitable for small business in China at the current stage, but it is better to have professional CEOs for big companies; in the future, hiring outside CEOs will be more widely applied even in small business along with social and economic development; thus, hiring professional CEOs to separate ownership and management is still the ultimate goal. However, merely hiring professional CEOs does not ensure better performance since one crucial issue of professional CEOs is agency problem; therefore, a functional corporate governance structure should be in place.

As a successful and traditional Chinese family business managed by an outsider, Midea is an excellent example of how a big family business led by a professional CEO could achieve huge success under the supervising of functional corporate governance. The data collected from Wind Financial Database show that Midea's equity market performance and financial performance improved dramatically after succession to the outside CEO. Midea’s governance structure proves how a family business could leverage the talent of professional CEOs with minimizing the agency problem and tunneling activities. Midea’s success consists with the hypothesis that the separation of ownership and management under monitoring of well-designed corporate governance is the optimal goal for big

Chinese family business.

In conclusion, the outperformance of family CEOs in Chinese family firms is a temporary result caused by certain contexts. The family business succession is a complicated topic that one solution does not fit all different types of family businesses. Therefore, from both size dimension and development phase dimension, the final statements include three situations: (1) the small family firms have no necessary to separate ownership and management at the current stage in China because of the advantages of family CEOs such as less cost and quick reaction to market; hence complete corporate governance is not essential for them; (2) for big Chinese family business especially for those have business over the world, they are less impacted by political factor and have a large amount resources to access capable professional managers, so it is better for them to have professional CEOs because of efficiency improvement; (3) along with the social and economic development, if the problems of corruption and unmatured talent market are alleviated in the future, hiring outside CEO become less risky and cost, finally the separation of ownership then is easier and more necessary to achieve even for some small businesses.

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1. Introduction

Family firms are a predominate business organization type in the world, and it plays an important role in the world economy. Based on Tharawat Magazine (2014), the family firms contribute over 70% of global GDP if defining family businesses as businesses are majority-owned by a single family's members. The data from Family Business Year Book (Ernst & Young, 2014) shows that 85% of the companies in Asia-pacific region are family-owned businesses. Besides, family business also creates numerous job opportunities. For example, family businesses in the United States employ 63% of the workforce (Family Enterprise USA, 2011). According to European Family Businesses Organisation (2020), the number of jobs created by European family business accounts for 40%-50% of all jobs in Europe. In China, family business is also a force to be reckoned with in the economy. Due to China's special economy system, political context, and Confucianism culture, family business in China shows some different characteristics compared to its counterpart in the rest of the world.

Just as family business in other regions in the world. The significance of family business in Chinese economic development cannot be neglected. As a middle-income country, China has a high ratio of family business. According to People's Daily (2012), private enterprises account for 96% of total enterprises in China, and 85.4% of these private enterprises are family businesses. The data from Forbes China (2017) shows that by April 30, 2017, among 3,204 listed companies in China, 1,112 companies are family businesses, accounting for 34.7%. Besides the importance of family business in China, its succession is frequently mentioned.

Since the Chinese government has deployed the economic reform and opening-up policy from the late 1970s, Chinese economy has experienced huge growth over the past forty years. The private economy as one pillar of the economy booming in China, its succession is frequently discussed because the founders of most private companies are confronting retirement recently (most of the first-generation Chinese entrepreneurs are in their 60s and 70s). China's particular demographic statistic also shows some interesting facts about the succession process. Lemos and Scur (2018) state the gender of next-generation highly relates to family control (family member as managers). The data from Central Intelligence Agency (2020) shows the sex ratio in China is 1.11 male to female, which ranks number 3rd high among all the countries in the world, only behind Liechtenstein and Northern Mariana Islands (US). The high male-female ratio in China suggests a potentially high possibility to hand down the family firm to next-generation compare to other countries, which makes it interesting to analyze the Chinese family business succession issue.

Two different succession ways are usually considered when the current family firm owner decides to pass down the business. One is passing down both management and ownership, which means the next generation is both owner and manager of the family business. Another one is handing over just ownership, which means the next generation only keeps the ownership and hiring professionals to manage the business. The early literatures generally find that the family businesses which chose the first succession way usually have lower efficiency and worse financial performance, while the firms chose the latter one outperforms the first one. However, most of the hypotheses and evidence from these literatures are based on family firms in non-Chinese countries. Some Chinese scholars contend that for several reasons, Chinese family firms with having the second-generation control the business have better performance. The inconsistency between the early researches makes identifying an appropriate corporate governance and organization structure among two succession ways very interesting to study.

This thesis aims to discuss the best solution of family business succession choice among two options (family CEOs and professional CEOs) in China through some literature review and case discussion. Based on the analysis of the previous studies and a case of a successful family business, Midea Group, the thesis concludes that even though family CEOs fits small family business in China at the current stage, the ultimate goal is still applying professional CEOs under the monitoring of functional corporate governance in the succession of Chinese family business.

The rest of this thesis is organized as follows: Chapter 2 reviews the earlier literature to compare two different family business succession choices: professional CEOs and family CEOs. With understanding the better management practice and financial performance of family business with professional CEOs in the rest of world, Chapter 3 analyzes a unique case, family business in China, and proposes that family CEOs works best for small business at the current stage, professional CEOs under functional corporate governance is an ultimate goal even in China’s context. Chapter 4 uses the case of Midea Group, a successful Chinese family business led by a professional CEO, to prove the last chapter's argument. Chapter 5 presents the concluding remark.

2. Comparison between two models: professional CEOs and family CEOs

Based on literature review, section 2.1 states the management efficiency differences between family CEOs and non-family CEOs, then section 2.2 describes the reasons for worse management quality and economic outcomes caused by family CEOs. Section 2.3 of this chapter discusses that with knowing the superior of professional CEO, why do the outgoing CEOs of family businesses not pass down business to professional CEOs.

Section 2.1. Management efficiency between two different types of CEOs

Many researches show, family business managed by family CEOs have worse management quality and economic outcome. In these studies, one frequently used dataset is called World Management Survey (WMS) which is an international dataset designed to measure the quality of management practice of medium and large manufacturing companies across different countries. So far, WMS has conducted more than 20,000 interviews in 35 countries. Lemos and Scur (2018) studied the relationship between dynastic family control (appointing a family CEO in family business), internal firm organization and firm outcome. In their paper, with analyzing the sample of 12,548 companies from WMS dataset, their test shows that the distribution of management quality of dynastic family firm (owned and led by a family member) is statistically different from the management quality of family firm with professional CEO as well as non-family business. By applying and correlation evidence from ordinary least square and casual evidence from instrumental variables approach, the researchers prove the worse management of dynastic family business is caused by the succession of family CEO.

Based on a sample with 13,436 companies across 32 countries in the world, including both developed and developing countries, Bennett et al. (2016) also generate a similar conclusion. Their study supports that founder CEOs controlled firms have lower management scores to other forms of enterprises. Unsurprisingly, the research also shows management quality and the economic outcome has a significant and positive correlation. In their paper, Bandiera et al. (2018) analyzed the number of working hours difference between family CEOs and professional CEOs (1,114 CEOs from manufacturing firms across six countries: Brazil, France, Germany, India, the United Kingdom), and they contended firms run by family CEOs are on average less productive than the those managed by professional CEOs.

Section 2.2. Reasons why family CEOs have worse management quality and outcome

Then, why do family firms with family CEOs have worse management quality? Early researches provided several reasons.

The first one is perception. CEOs lack awareness of their poor performance. The managers may be overconfident and overestimate his or her capability on running the company. In this case, they are satisfied with their current leading style and management practice and are not willing to adopt better management practices. Bennett et al. (2016) confirmed this hypothesis. By leveraging the self-reported measure collected from World Management Survey, their study suggested that the founder CEOs tend to have higher self-score in management scores than other types of CEOs. Additionally, their research also points out that “the lower managerial scores of founder CEO firms are associated with managers’ systematic lack of awareness of the weakness of their firms’ management quality” (p.173).

The second explanation is the nonpecuniary benefit. The study of Bennett et al. (2016) also find that even the family CEOs realize their poor performance, they are reluctant to apply formalized managerial practice because they enjoy the private benefit of controlling the firms such as the discretion on human resources. The study by Hurst & Pugsley (2011) finds that the nonpecuniary benefit is the most important reason to establish a business for many entrepreneurs. Applying the standardized managerial practice means less discretion on company’s operation, and it hurts family CEOs’ private benefits. Therefore, many family CEOs are not willing to adopt a more efficient managerial practice. Realizing private benefits usually implies sacrificing company’s resources. One typical example is hiring and rewarding persons based on personal preference rather than the capability and performance of employees. The relation-oriented culture may strongly motivate the family CEOs to do so. If CEOs hire and reward persons based on family and friend affiliation rather than their performance, it will impact the morale in company, which finally impede the company’s growth.

The third reason is implicit commitment. Unlike other types of enterprises, the relationship between employee and employer of many family businesses is not pure labor relation. Some implicit relationships behind the surface, and the relationship between the two parties are complex. Besides just fulfilling what the labor contract states, the CEOs have to offer some implicit commitments to employees such as taking care of employee’s family members. Since the family firms have a closer relationship with their employees than other companies, it is necessary for them to take care of employees' families even if they do not work for this firm. The cost caused by implicit commitment could be one downside of implicit commitment lead to worse performance of family firms. Another form of implicit commitment is that family firms offer greater job security to employees (Bassanini et al. 2010). In this case, compare to other companies, it is not easy for a family firm to fire low ability workers to improve efficiency.

The fourth reason for management differences between the two models is that the succession to only offspring narrows down the CEO choices since outgoing family CEOs can only choose successors from their children. Without the successor choosing limitation, the firm could be passed to any capable manager from both outside and inside, and a larger talent pool means increasing the possibility of success. Some may argue that managerial talent can be easily transmitted within the family members; thus, handing down the business to the next generation has no problem with talent pool since the offspring of current managers are capable enough. However, research shows it is not that case. Bloom et. Al (2011) state “sons who become CEOs usually have poorer college results and are much younger than other CEOs”.

Section 2.3. Reasons for still Choosing Family CEOs

Even though many researchers have stated that having the ownership and controlling concentrated on the same person is inferior to the separation of ownership and management, still lots of current owners of family firms choose to hand down the business to next generation and appoint their children as the managers of the firm for three reasons stated below.

The first reason is culture. Different types of persons have different utility functions, and their preferences are not the same. Culture plays an important role in deciding preferences and utility functions. Bertrand and Schoar (2006) analyzed a sample of established size manufacturing companies across different countries from United Nations Industry Development Organization (UNIDO) database. Their analysis finds stronger family value has a significant correlation with high self-employment rate and smaller firm size. Therefore, the researchers contend that the outgoing family business controllers may prioritize the survival of the family firm for the next generation and in turn forgo growth opportunities. In this case, even the family managers knowing passing down the business to their children is not the best option regarding the firm's financial performance, they will still choose to do so since it benefits their personal interests. In this sense, family values in certain cultures create inefficiency in running a business due to the introduction of nonmonetary factors into the current family business owner’s utility function. Sometimes, the family members’ attitudes to the family business also force the owner to hand down the business to offspring. In some cultures, family members treat the family business as a legacy, and it is an asset that can only be controlled by family members. If the next generation insists that they want to manage and control the family business, the current owner usually has no choice but to agree on them if he or she does not want to incur the dispute within the family.

The second reason leads to the concentration of ownership and management is having limited access to professional managers market. The thin talent pool causes hiring outside managers not attractive for family business since it has fewer chances to find a capable professional manager. Finding, screening, and recruiting a qualified CEO is not only costly but also time-consuming.

Compare with the complex recruiting process with unknowing risk, appointing the family member whose ability and traits are known by outgoing family CEOs to be the CEO is more efficient and saving time and money. Thus, the outside CEO has fewer comparative advantages than the family CEO when the talent pool is thin and the labor market is not developed. On the other hand, managing a family business may not be attractive for some capable managers. The pecuniary reward does not fully satisfy these ambitious managers if they pursue working in an enterprise that they can totally control. In both cases, lacking access to those capable outside managers could lead to family business be handed down to the next generation.

The third reason is environmental or institutional constraints such as the legal system and trust among society. According to Bertrand and Schoar (2006), “if formal institutions regarding investor protection, contract enforcement or property rights protection are weak or nonexistent, strong family ties may provide a second-best solution for the development of economic activity” (p.92). (notice that the data analysis only offers moderate support for this idea in this study). In an inefficient labor market with a weak legal system, fraud and betrayal happen more frequently, a dysfunctional legal system cannot protect the interest of firms and the investors (owner). In this situation, trust within family works as a substitute for weak legal protection to protect family business owner from devious outside managers. Thus, appointing a family member as the CEO becomes the optimal choice under the inadequate legal protection setting since it is the best way to protect the family business from moral hazard happened between the family and outside manager.

Although knowing that family CEOs is not the optimal option for the family business, the current owners still have to appoint them as the leader in firms for the reasons mentioned above. So far, this chapter analyzed two different types of CEOs in family business succession, but it is mainly based on the case worldwide. As a country with a unique economy system, China’s case might differ from other regions.

3. Family Business in China

This chapter first provides some development history regarding family business in China in section 3.1. Then, section 3.2 describes a unique phenomenon in Chinese family business compared with family business described in early literature, the better performance of family business with family CEOs, and five reasons that caused it. Section 3.3 and 3.4 analyze the question of what is the best solution to Chinese family business's succession process with considering the involvement of corporate governance in the process.

Section 3.1. Development of Chinese family business

Chinese private economy started in the late 1970s when China's leader decided to implement economic reform. Then, the Chinese economy system transformed from state ownership and central planning to market-oriented during that time. The development of private economy spawned many private enterprises, and most of them are family businesses. In the early stage of economic reform, most private enterprises are very small. The financial system in China was far from perfect, and starting funds of enterprises are mainly provided by private persons rather than banking or other financial institutions. Since the labor market was also not efficient and the size of businesses is not large, the founder has no opportunity and necessary to find partners (co-founders), so the owner of firms usually was also the managers during that period. Some owners may hire other family members such as siblings to help them manage the company, but most of these family members have no share or a small portion of share in the company and only manage part of business, the founders were still the CEOs. All these characteristics, concentrated ownership, founder CEOs and family members servicing in the company showed the embryo of Chinese family business.

Section 3.2. Better performance of family CEOs in China

Although family business in China shows the same basic characteristics with it in other countries, it has different performance compare with its counterparts. The literatures mentioned early contends that family businesses with separation of ownership and management are more efficient than those having family CEOs, but none of these researches analyze China's case specifically. Some Chinese researchers who study on the performance of Chinese family business find a different result that family CEOs in China actually outperform non-family CEOs. For example, by analyzing data provided by China Stock Market & Accounting Research and the Wind Financial Database over the period from 2003 to 2011, a study by Xu et al. (2015) shows that "the second generation's involvement in the decision process is beneficial to firm performance. Specifically, operating return on total assets (OROA) and operating return on sales (OROS) for firms with the second generation as the CEO/chairman (director) are 3.1% (3.2%) and 6.9% (6.7%) higher" (p.244). Forbes (2012) also finds that Chinese listed family business outperforms other listed companies in China (including private listed non-family companies) in terms of profitability and growth rate. Chinese family business with family CEOs may have similar problems as its counterpart in other regions such as lacking awareness of poor performance, implicit commitment and limited CEO choices. However, other unique contextual factors around them may bring about better performance of Chinese family CEOs, and these four factors are shown below.

The first one is the size. Considering the short history of the family business in modern China, in contrast to the family business in other regions, many Chinese family businesses are in their early stages. For example, by analyzing the nationwide business statistical data such as the number of registered private enterprises and employees, Wan (1998) concludes the majority of family businesses in China are still in their early stages. The size is small, and the organization structure is simple. Family members control both ownership and management benefits on the quick decision on significant events, and it saves time for the decision-making process and the cost. Compare with the big and mature company, quick decision making and swift reaction to market change are the advantages for small businesses. Introducing outside CEOs in family business may hurt the benefits of small business. Therefore, the existence of a large percentage of early-stage business in China could be one explanation of why concentrating on ownership and management outperform other companies in terms of their profitability and growth rate.

The second factor that makes Chinese family business different from family business in other regions is the one-child policy. In the same year of launching economy reform, the Chinese government also implemented the one-child policy, which makes the family business succession process in China is unique. Unlike other regions' family firms whose potential successors could be more than one child, if the outgoing CEOs of Chinese family businesses decide to hand down the firm to next generation, they have only one choice. The unique one-child policy causes less infighting in the succession process. Sibling fights for family assets in wealthy family frequently happens in the world. It is obvious that internal fight in the family business has a severe impact on firm's daily operation. Even if the dispute and bloodletting are finally settled, it usually ends with the partition of family assets, which impedes business growth. Compared with the multiple-child family, the advantage of the one-child policy in succession process is to bring less infighting within the firm; therefore, resulting in less internal friction and more resources for growth. However, some people may argue that less offspring also means more limited successor choices compare with family business in other regions. One explanation for this argument could be that the impact of narrowing choices of the successor is far less than it of family infighting. It might because the one-child family pays more attention to the education of the child since he or she has plays a more important role in the family compare with the child with siblings. If parents put more effort into cultivating the child, especially their talent in management, the possibility of one-child mature into a capable family business manager will increase. Additionally, the adverse consequence of appointing an incapable successor in business is gradually showing in the future (as long as the successor is not extremely bad at management. If the successor is, the founder is more likely hiring outside managers). On the other hand, the effect of infight is instant. Family businesses with infighting have a dramatic drop in financial performance or even bankruptcy after the succession.

The third reason is access to capable professional managers. The talent pool in the market is also a consideration when it comes to deciding CEOs type in Chinese family firms. Although higher education in China has developed for more than 30 years, it is still not enough compared with developed countries. The quality of outside managers is still questionable. The mechanism of talent market also needs to be improved. According to Xing & Wang (2014), the professional managers market in China lacks a complete and unified market system and a neutral agency that assesses professional managers' ability. The market also has no governance institution to monitoring and discipline the devious managers. For example, the devious managers who hurt his or her last employer do not receive instant punishment, and then the new employer may not know what he or she did before without the existence of governance for the talent market. Therefore, the Chinese talent market, especially for senior managers are still in a mess. Lacking information and transparency of the market leads to difficulty for the family business to find suitable outside managers. On the other hand, for some historical reasons, many family businesses were involved in some dirty activities such as fraud and cheating on taxes, which caused the bad image of private enterprises among the public (Jing, 2014). The bad reputation of family business in China makes it is unattractive for capable professional managers. Finally, reverse selection happens in the talent market. Competent and brilliant professional managers choose to either work for other firms or establish their own business, and family businesses only have the option to hire those with low capability. It finally causes the family business with family CEOs to outperform those with outsides CEOs since family CEOs do not have such problems.

The fourth reason is the political connection. It also works as a factor that makes Chinese family businesses outperform other enterprises. The research by Xu et al. (2015) reveals that “a founder's political connectedness is a critical factor in deciding to appoint a second-generation member as the CEO or chairman or a director in the family firm” (p.258). In the context where the extent of corruption is great, and the volume of relationship-oriented transaction is large, the connection with local government is essential for business. According to data provided by Transparency International, China’s corruption perceptions index ranks 80th in the world, it is higher than other major economies, and it potentially leads to having family CEOs in business meaningful. A good relationship with local officers provides many advantages. For example, the firms whose controlling person has close relations with officers are easier to get favorable policies and get advantages on government biding. In a country with powerful government such as China, the local government can even control the local financial industry, including bank and private equity. Firms that are close to the government are easier to get bank loans with low-interest rate and various equity investments to support the company. Unlike in developed countries where companies have to be big enough to capture government officers' attention, companies do not need to be big enough to access senior offices to get support from financial institutions in China. Therefore, the threshold of access to political resources is low in this country. Even the small companies are possible to build connections with local officers, and the return is ample. Because political connection in China is a personal relationship built by the founders or the current family controllers of business, the founder's personal relationship is easier to transmit to other family members compare with outsiders, and it gives the reason to the controller of the family business to appoint family members as the next CEO.

Section 3.3. Is the family CEO the best solution to Chinese family business?

Although the research reveals that family CEOs outperform outside CEOs in China, it does not necessarily mean handing down the family business to family members is superior to hiring professional managers all the time. From the size dimension, based on the analysis of success factors of Chinese family CEOs mentioned above, having family CEOs in China is the right choice only for those traditional family businesses which are small. Compare with large family firms, the small family businesses are vulnerable to political impact and tunneling activities, and their resources to access talent pool is limited. Having family CEOs can protect them from these problems. But the big companies do not have such issues; hence, they should not adopt family CEOs. From the development phase dimension, the social context is dynamic; it is possible that the context suitable for the dynastic family business no longer exists. For example, China is reconsidering its one-child policy, and more infighting may happen within the family business in the future. Therefore, the superiority of family CEOs only works in certain context, and it is not fair to say Family CEOs is always the best solution to family businesses. The ultimate goal is still separating ownership and management. The detailed three explanations are shown below.

Firstly, as explained early, because many Chinese family businesses are in their early stages, they usually focus on niche markets. Therefore, the resources required to operate the firms in the small market are limited. Family members provide most of the production factors of firms such as labor and management intelligence. Professional managers are unnecessary in this stage, so it is possible for one family to run a company. Additionally, the Chinese family value also improves firms' efficiency when it is run by one family when the firm is small. Based on Xing & Wang (2014), when the firm is under the family's control, implicit rules that are easily recognized by family members are established based on traditional Chinese family values. Because of the inherent connection, everyone within the family firms can easily understand other's working styles and habits without much communication cost. It finally lowers the friction in their working as well as the cost of management. Along with the firm growing bigger, for ambitious family firms, focusing on one niche market is no more an option. Entering a new market requires more sophisticated resources and knowledge to manage the firm, the resources and capability owned by current family managers is no longer fit company's needs. The number of capable family members to run such a complex business is also limited, then looking for help from outside is essential. Hiring professional managers is a crucial step to do. The outside managers usually are trained by college, so they have a well-developed management system in mind. Additionally, they also have the necessary experience to run the business and offer the essential factors not owned by the current family management team. Despite other institutional factors, hiring professional managers still benefits family firms when their businesses grow into complex.

Secondly, an inefficient talent market is another reason why outgoing family CEOs do not want to choose professional managers mentioned early. The untransparent talent market leads to adverse selection, so the possibility of finding a suitable manager from the talent market is low, and it increases the risk for family businesses that are going to hire outside managers. Fighting with these devious managers is a tough task for smaller family firms. When the small firms hire these professional managers, they place big hope on these outsiders, they usually make the wish that the professional managers could bring them into a new phase. Therefore, many outside CEOs are in a strong position facing firms. Plus, when the disputes happen between professional managers and the firm, a well-trained manager knows how to use the legal weapon to protect his or her interest, no matter whether the interest is legitimate. Hence, hiring outside CEOs is a high-risk and high-cost thing for small firms.

However, it is not that case for big companies. When big firms hire outside managers, slight growth is good enough, and they do not expect a breakout. In this case, firms in a stronger position. Compare with smaller family firms, large family businesses have more resources to protect their interest from professional manager's betray. The organization structure of big firms is well-developed, the strict internal control and strong legal department can efficiently prevent outside CEOs' tunneling activities. Additionally, a global family company has more access to capable professional managers. Their talent market is not limited in China, and attracting talented people from developed talent market is not difficult for them.

Thirdly, in the last section, the political connection is mentioned as one explanation of why appointing family CEOs makes businesses have better performance than hiring outside CEOs. As stated earlier, political connections work best when corruption is high and relation-oriented transactions play an essential role in the market. Along with the social and economic development in China, it is possible that the percentage of relation-oriented transactions will also decrease in the future and corruption problems will be largely mitigated. The data from Transparency International (2019) shows that China has been making an effort to solve the corruption problem. Its corruption perception score has continuously increased from 36 points in 2014 to 41points in 2019 (higher score means high transparency and less corruption). On the other hand, either because of the size growing or the characteristics of industry (for some technology industry, having global business relations are unavoidable), some family businesses may enter the global market and have business overseas where the political connection cannot be easily built as in China. In this sense, the importance of political connection decreases. Additionally, having a modern corporate governance structure (which is separation of ownership and management) have significant meaning for these global companies. A good governance structure could attract investors from oversea. It also gives company's potential partners such as suppliers and customers the confidence to do business with these companies. Oversea investors, supplier and customers are crucial for Chinese firms which do business globally. For these ambitious companies, a matured modern corporate governance structure is the key to survive in global competition.

Based on the analysis above, in China, even though appointing second-generation CEOs shows better company financial performance than appointing outsiders, it is not the best solution all the time. Combining the analysis from both development phase dimension and size dimension, ae time. At the current stage, family CEOs is suitable for small business in China. Still, for big companies with many resources and complicated business models, it is better to have professional CEOs. Along with the economic and social development, the business environment and talent market will be complete. In such a context, separation of ownership and management is easier and less costly to achieve.

Section 3.4. Importance of Corporate Governance in Family Business Succession

Separation of ownership and management alone does not make sure family business with professional managers outperform its counterpart. Without developed corporate governance, simply separate ownership and management will cause agency problems, which is defined as managers sacrifice the owner’s interest to earn personal economic gain. Corporate governance is hence designed to solve this problem.

Just after the economic reform, the corporate governance of Chinese family business was also simple. According to Huang (2005), because the professionalism of production factors at that time was low, transaction cost caused by opportunism inside the firm was also small; thus, a complicated and efficient corporate governance structure did not help much, let alone the cost of building such structure was high. Later, along with the continuing economic reform, the Chinese government liberalize the financial sector, which prospers the financial industry. Establishing a company with outsides resources (especially money) becomes possible, and the organization structure of enterprises in the market also changed from dominated by sole proprietorship enterprise to limited liability company. On the other hand, after more than ten years of restoration of higher education, some people were trained by college, and become capable professional managers. The development of the labor market provides enterprises the option to bring outside managers in (even though the market is still unmatured, it is better than no existing). Some family businesses started to set institutions such as shareholders meeting, board and board of supervisors. However, the majority of positions in these institutions are still occupied by family members, companies still controlled by one person and lack of enough monitoring. For example, research by Li (2003) states that among the 50 sample companies, more than 88% of senior managers in these companies are relatives of the owners (as cited by Huang, 2005, p.11). Although corporate governance in Chinese family business has been developed, it is still far from mature governance structure in other developed economies.

A functional governance structure usually consists of three parts, managerial incentive, a good board of directors and monitoring mechanism. Among these three parts, the managerial incentive is used as an instrument to align the interest of the owner and managers. By doing so, to make sure managers' effort also benefit the shareholder, so that the tunneling activities of managers could be minimized. Typical incentive includes monetary incentive and implicit incentive. As the name implies, monetary incentive refers to using company performance-related compensation packages to align the interest of both managers and shareholders. Implicit incentive refers to punishment such as the threat of being fired. As the entity of making critical decisions and in charge of the company's overall operation, a well-designed board is crucial to building functional corporate governance. The board's quality could be evaluated through the background of board directors and the structure of board. To minimize agency problems, a well-designed board should include several critical committees such as audit and risk management committee and remuneration committees to reduce the chance of tunneling activities. In addition to the internal mechanism, outside monitoring is also necessary. Shareholder monitoring is one part of the monitoring system. By introducing other institutional investors such as insurance companies and private equity, the family business owner could share the burden of supervising outsides managers' daily operations since other investors have the same interest as the controlling family. These institutional investors are experienced in monitoring the company they invested in. With help from professionals, the family could protect its interest better.

Even though building such a functional governance structure is very costly, but it helps those big and global Chinese family businesses improve efficiency when choosing to use outside managers rather than handing down business to the next generation. By leveraging the functional corporate governance, Chinese family businesses with professional CEOs could achieve a respectable performance improvement with minimizing the agency problems and tunneling activities. As a successful Chinese family business that succeeds to a professional CEO, Midea has dramatically improved its management efficiency and performance after the succession. Midea's success consists with the hypothesis that the separation of ownership and management is still the optimal choice for big Chinese family businesses. The next chapter will analyze Midea's case and try to find out how and why the professional CEO works in this family business.

4. Midea Case Study

Midea is a typical Chinese family business with one principal founder who established the company and held the majority share of the company. When coming to succession, unlike most other family businesses in China, Midea's founder decided to pass down the management of the firm to a professional manager with his family still owning the firm. After the professional manager's succession, Midea experienced stable and high growth in terms of both the stock market and financial performance. The success of Midea’s professional CEO succession model makes it meaningful to analyze how and why outside successor could help the family business to achieve prosperity.

The rest of this chapter will analyze Midea’s case, starting with section 4.1and 4.2 introducing some basic information of Midea such as its history, management change and background of founder family’s second generation. By display the equity market return and financial data, Section 4.3 demonstrates the change of Midea’s stock market performance and financial performance before and after the succession. Section 4.4 introduces Midea's corporate governance structure and how it supports Midea’s professional CEO succession model. The chapter ends with section 4.5 which concludes the case.

Section 4.1. Background of Midea

Midea Holding company is a Chinese private-owned group, and it is a traditional family business with majority shares are held by one family. The family is now doing business in many different industries, and control these businesses through the entity called Midea Holding. Among these businesses, the appliance business, Midea Group, is the earliest, biggest and most important subsidiary. Considering the history and importance of Midea Group, this case study mainly analyzes this company rather than all businesses of the family. The history and background information of Midea in this section is obtained from multi-resources, including business journals, Midea’s official website and its annual reports, and the figure is constructed based on them by the author.

4.1.1 History and Development

In 1968, With 5,000 CNY, He Xiangjian established a workshop for the production of plastic products in Foshan, Guangdong. Later, the small company entered the appliance industry by producing air fan in 1980. One year later, the company renamed Midea. In 1993, Midea proceeded its initial public offering of shares (IPO) on Shenzhen stock exchange and became a listed company. With help from the capital market, Midea greatly expanded its business over the following years of IPO. Midea Group finally became the largest manufacturer of appliances and robots in the world after acquiring a German robotic company, KUKA (Bloomberg, 2017). By checking the annual report of Midea, in 2019, Midea's total revenue reached 40.5 billion USD, and its net profit attributable to shareholders of the company was 3.5 billion USD. Midea's current market cap is 412.14 billion CNY (equivalent to 58.3 billion USD, as of June 24th, 2020). With the brilliant financial performance, Midea group ranked 312nd in Fortune Global 500 2020. Despite its dominating position in the domestic market in the white goods industry, Midea is also a global company. Midea opened its first oversea factory in Ho Chi Minh City, Vietnam, in 2007. It marks the beginning of Midea's global expansion. Later on, Midea formed several joint ventures with the famous American air-conditioner manufactures, Carrier Corporation, in many countries. Besides setting oversea production facilities and forming joint ventures. Midea also implements its globalization strategy through acquisition. Two famous acquisition cases happened in 2016. The first one was the acquisition of Toshiba's home appliance business in 2016, and Midea acquired KUKA later in the same year. Because of the successful globalization strategy, as of the end of 2019, Midea had over 30,000 oversea point-of-sales, and oversea sales account for over 40% of the total revenue of Midea Group (Midea Group Co., Ltd, 2020). Midea' size and global business model make it a good example to understand how a prominent Chinese family business with a professional CEO succeeds under functional governance.

4.1.2 Ownership and Management Change

By checking the public business registration information, the family owner, He Xiangjian controls Midea Group through his 0.65% shares in the company as well as 94.55% share of the parental company of Midea Group, Midea Holding Company (his daughter-in-law owns the rest 5.45% share of Midea Holding). Midea Holding owns 31.73% stakes of Midea Group. Considering the second-largest shareholder of Midea group, Chinese Securities Finance company only holds 2.84% shares, He's family has absolute control over this company. The ownership and control relations between the controller and Midea Group are shown in figure 1.

In August 2005, Midea Electric announced that Fang Hongbo succeed He Xiangjian's CEO

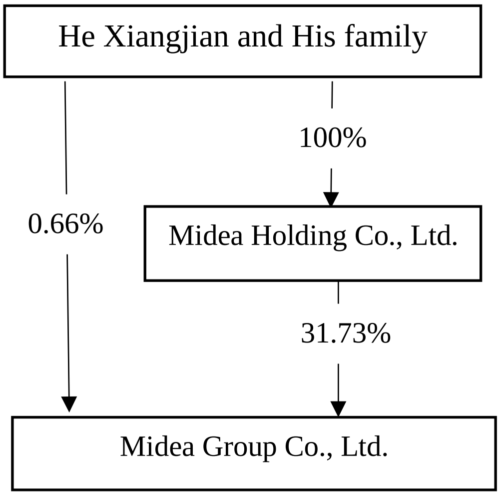

Figure 1 Ownership of He's Family

position in the company (at that time, Midea Electric was the primary subsidiary of Midea Group, and it was also the entity of listed company). In 2009, He Xiangjian also handed over the chairman position of Midea Electric to Fang. Finally, along with the decision of re-listing for the entire Midea Group in August 2012, the board of Midea Group announced that the de facto controller, He, has decided to resign from the position of chairman in the company as well as the position of a board director. The chairman and CEO of the Midea Electric, Fang Hongbo, was then named the new chairman of Midea Group. At this point, the succession process of Midea group completed, and Fang became the both CEO and chairman of Midea group. Unlike other Chinese family businesses that pass down business to the next generation of family members, Fang is not a member of the controlling family. He joined Midea in 1992 when he was 25 years old and finally grew into a capable professional manager in Midea. The succession of Fang marks the separation of ownership and management of this massive family business.

4.1.3 The second generation and succession

The succession process in Midea was not as simple as it on paper. In the late 90s last century, Midea experienced a significant drop in sales. The founder, He Xiangjian, realized the capability of family members in Midea is not good enough to lead Midea into the next phases. Bringing in outside talent was necessary. Then, in 1997, Midea first introduced professional managers. The reform of Midea's management team saves Midea's slumping business. However, the success of the outside management team led He to be in a dilemma. He had struggled with the choices of the successor for many years since that time. Appointing Fang as the CEO was not the only choice for He. The son of him, He jianfeng, is also a capable entrepreneur. Jianfeng established his own business in 1994, started as an original equipment manufacturer (OEM) of Media. Hereafter, Jianfeng achieved massive success in his career and became a controller of several listed companies. When Mr. He supported his son to start business in the appliance industry, he did have the idea to train his son as the successor of the family business. However, along with the business of Jianfeng had been expanded, he gradually lost interest in managing the family business. Instead of working in the traditional manufacturing industry, he chooses to pursue his investment business career. Therefore, lacking interest became one of the reasons why Mr. He hands down the business to the outside manager. Even though Midea's management was not passed down to the next generation, with the help of functional corporate governance, Midea still has made huge progress over the past dozen years or so. Midea's case provides a good example of how the separation ownership and management in a family business could help the companies go further under a functional corporate governance structure.

Section 4.2. Post-Succession Financial Performance

This section will analyze the impact of Midea's succession plan through both stock market performance and financial performance. The reaction in stock market shows Chinese public attitude toward the way of family business succession in Midea. The financial performance of Midea directly demonstrates how this family business performs under outsiders' control. All the data in this section are retrieved from Wind Financial Database, a leading financial information and analytic tools provider in China. Wind provides diverse data including equity market data and company's financial numbers. All tables in this section are constructed based on data collected by author.

4.2.1 Stock Market Performance

This part will compare Midea's stock return with it of Midea's competitors in white good sectors around the critical dates such as the day when Fang became the CEO of the company.

(1). The stock returns around the date when Fang was appointed as the CEO of Midea electric. Table 1 shows stock return, excess return, the accumulative excess return of Midea around August 2nd 2005. (The return of the white-good sector is used as the expected return)

Date	Stock return	Expected Return	Excess Return	Accumulative Excess Return
7/26/2005	2.34%	1.58%	0.76%	0.76%
7/27/2005	7.90%	2.30%	5.60%	6.36%
7/28/2005	-0.77%	0.18%	-0.95%	5.41%
7/29/2005	0.19%	-0.04%	0.23%	5.65%
8/1/2005	0.78%	1.59%	-0.81%	4.83%
8/2/2005	0.38%	1.13%	-0.75%	4.08%
8/3/2005	2.11%	0.78%	1.33%	5.41%
8/4/2005	-1.31%	-0.46%	-0.85%	4.56%
8/5/2005	2.09%	2.41%	-0.32%	4.24%
8/8/2005	2.98%	0.78%	2.20%	6.44%
8/9/2005	0.36%	1.89%	-1.53%	4.91%

Table 1 Stock Return around the day of Fang's CEO Appointment in Midea Electric

In broad terms, the public has a neutral attitude toward the Fang's appointment as the CEO of Midea electric. The accumulated excess return does not change much after the announcement date. The result shows the public considers the outside CEO will not have massive impact on the operation of the company. It might because the founder, Mr. He, still held the chairman position, so the public thinks it is not a complete succession.

(2). Table 2 shows the stock return around the date when Fang was appointed as the chairman of Midea Electric.

Unlike 2005, Fang's appointment as the chairman prompts the big jump in accumulative excess return after the announcement date. It shows the public has confidence in Midea's future performance. Might because of the past performance, investors this time believe Fang as an outside CEO will lead Midea to the next phase. It also demonstrates the Chinese public has confidence in the separation of management and ownership. If the company is monitored under a functional corporate governance structure, they believe a capable outside manager could improve company's performance.

Date	Stock Return	Expected Return	Excess Return	Accumulative Excess Return
8/20/2009	6.84%	3.64%	3.20%	3.20%
8/21/2009	4.20%	2.82%	1.38%	4.58%
8/24/2009	1.52%	1.64%	-0.12%	4.47%
8/25/2009	0.20%	-0.67%	0.87%	5.33%
8/26/2009	3.57%	3.70%	-0.13%	5.20%
8/27/2009	6.02%	0.04%	5.98%	11.18%
8/28/2009	-3.78%	-2.94%	-0.85%	10.33%
8/31/2009	-6.45%	-6.13%	-0.32%	10.01%
9/1/2009	-1.51%	-0.07%	-1.44%	8.56%
9/2/2009	4.20%	1.50%	2.71%	11.27%
9/3/2009	3.20%	13.35%	-10.15%	1.13%

Table 2 Stock Return around the Day of Fang's Chairman Appointment in Midea Electric

(3) Fang's appointment as chairman was one part of the re-listing and reform plan for Midea Group in 2012. After the announcement of the reform plan and appointment of Fang's chairman position, Midea' stock was suspended about half a year. Table 3 shows the accumulative excess return

of Midea before and after the announcement. For the day afterward of Midea's resumption of trading, the accumulative excess return of Midea jumped to 40% five days later, compared with the -2.52% accumulative excess return before the suspension of stock, the market gives very positive attitude toward Midea's reform plan and Fang's appointment. One thing that needs to be noticed is that Fang's appointment was only a part of the reform plan. However, although the stock market reaction is a response to the whole reform plan, Fang's appointment was one of the most critical parts. It is reasonable to speculate that the public favors the succession of Fang based on the massive jump of accumulative excess return.

Date	Stock Return	Expected Return	Excess Return	Accumulative Excess Return
8/17/2012	-1.06%	0.05%	-1.12%	0.68%
8/20/2012	-0.65%	0.07%	-0.72%	-0.04%
8/21/2012	0.54%	1.13%	-0.59%	-0.63%
8/22/2012	-0.54%	0.19%	-0.73%	-1.35%
8/23/2012	0.33%	1.49%	-1.16%	-2.52%
8/24/2012	-0.86%	-2.14%	1.27%	-1.24%
4/1/2013	10.02%	0.83%	9.19%	9.19%
4/2/2013	10.00%	-1.15%	11.15%	20.34%
4/3/2013	9.99%	-0.88%	10.87%	31.21%
4/8/2013	9.98%	0.54%	9.45%	40.65%
4/9/2013	0.60%	1.05%	-0.45%	40.20%

Table 3 Stock Return around the Day of Fang's Chairman Appointment in Midea Group

Therefore, during the whole succession process, the attitude of public had changed. From neutral and indifference to positive, the public now has the confidence that Midea as a family business will be greater under professional managers' leading.

4.2.2 Financial Performance

The section will analyze the change in performance around the 2012 when Fang officially became the chairman of the company. The analysis is based on the profitability, growth capacity, capital structure, and operating capability.

(1). Profitability. Based on four indicators, net income over revenue, operating income over revenue, gross margin and ROE, Table 4 shows the profitability change of Midea from the year 2007 to 2017. Before Fang totally had control over Midea in 2012, the net income over revenue and operating income over revenue fluctuated around 5%. After the takeover of Fang, both net income and operating income over revenue dramatically increased to 6.84% and 7.69% respectively in 2013. In 2016, the two indicators increased to 9.92% and 10.91%, respectively. The change of another measurement for profitability, gross margin, also states the performance improvement. Before 2013, the gross margin of Midea was around 19%, after 2013, the data jumped to 27.31% in 2016 and fluctuated around 25% because of the successful cost control (Midea, 2017). Before the succession, the ROE of Midea was unstable and experienced a significant drop from 2011 to 2013. After 2013 when Fang became the chairman, the ROE gradually recovered, and it maintained around 26%.

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Net Income/Revenue (%)	5.46	4.15	4.84	5.86	4.96	5.98	6.84	8.18	9.78	9.92	7.69
Operating Income/Revenue (%)	5.69	4.40	5.22	5.03	5.57	6.82	7.69	9.45	10.70	10.91	8.94
Gross Margin (%)	19.55	18.88	22.58	18.16	19.12	22.56	23.28	25.41	25.84	27.31	25.03
ROE (%)	47.16	32.26	24.93	38.86	28.87	24.29	22.55	29.04	28.66	26.62	25.63

Table 4 Profitability Indicators of Midea

(2). Growth capacity. Figure 2 and 3 shows the change in revenue and net income from 2007 to 2017, respectively. The revenue bar shows that even though it has some fluctuation, the revenue after succession still has an upward trend. Compare with the 114% increase from 2007 to 2012. After Fang became the chairman, the revenue in 2017 jumped to 241 billion CNY which is 136% of revenue in 2012. Besides, the revenue experienced a big drop before the succession. After 2012, the growth recovered. The net income graph shows a more straightforward result. Compared with the income before the succession, the increase in net income after 2012 is steadier and more obvious.

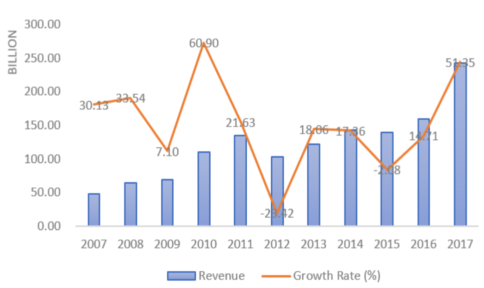

Figure 2 Revenue and Growth Rate of Midea

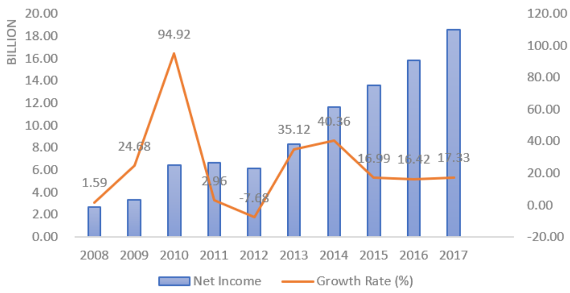

Figure 3 Net Income and Growth Rate of Midea

(3). Capital structure. The two-year average debt-to-asset ratio provides a more explicit way to read the decreasing trend of this indicator. Both the debt-to-asset ratio and current ratio indicate the company's liabilities have been dramatically decreased since Fang became the chairman. The increase of debt to asset ratio in 2017 is because Midea raises the long-term debt for acquiring KUKA company rather than for its daily operation.

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Debt to asset ratio (%)	68.75	68.94	68.15	69.98	67.42	62.20	59.69	61.98	56.51	59.57	66.58
Two-year average of Debt to asset ratio	68.84		69.07		64.81		60.84		58.04		\
Current Ratio	0.99	0.90	1.08	1.15	1.14	1.09	1.15	1.18	1.30	1.35	1.43

Table 5 Capital Structure Indicators of Midea

(4). Operating capability. The indicator, net operating cycle, is used to measure the operating efficiency; specifically, it calculates how long the one dollar put in the production and sales process can convert into cash received. Less net operating cycle indicates a strong capability of converting investment into sales and gained cash. The net operating cycle is calculated by days inventory outstanding + days Sales Outstanding – days payable outstanding. Table 6 shows a dramatic drop in net operating cycle after 2012. Along with the constant days sales to outstanding and days payable outstanding, the decrease in net operating cycle can be attributed to the decline of days of inventory outstanding, so Midea can convert its inventory to sales in a shorter period of time. It shows that after Fang took over the company, the efficiency of production and selling process was improved significantly.

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Days Inventory Outstanding (days)	73.14	57.96	60.33	62.41	61.58	67.27	55.36	51.47	44.66	40.60	44.96
Days Sales Outstanding (days)	15.98	17.80	28.82	23.43	23.49	34.98	26.47	21.97	25.66	26.97	23.17
Days Payable Outstanding (days)	65.46	52.30	73.89	63.01	58.63	75.83	64.54	64.13	65.90	66.64	60.35
Net Operating Cycle (days)	23.66	23.46	15.27	22.83	26.44	26.42	17.29	9.32	4.41	0.92	7.78

Table 6 Operating Capability Indicator of Midea

The financial analysis indicates, in the post-He era, Midea had achieved great success in terms of financial performance. The consistent rising stock price also created huge wealth for its shareholder. After the resumption of trading on April 1st, 2013, Midea's stock has achieved a 550% return as of June 27th, 2020. Therefore, Midea has been regarded as a typical "white horse" company (stable earing and healthy growth prospect) in the Chinese stock market.

Section 4.3. Corporate Governance of Midea

Usually, the external CEO will cause severe agency problems since the inconsistency of interest of two sides. However, Midea's strong performance proves that the separation of management and ownership does not necessarily cause considerable agency problems. If a functional corporate governance structure is in place, the outside CEO will have the same interest as the company's owner. A capable professional manager could bring the company into the next phase. Next, the section will explore the corporate governance structure inside Midea, to find out how the governance mechanism minimizes the agency problem and unifies the interest of owner and agent. The corporate governance structure of Midea will be analyzed by three dimensions, incentive structures, the board of directors and monitoring.

4.3.1 Incentive structures

The incentive structures are the instruments which are used to align interest from both parties, and it can be divided into explicit and implicit incentives. Explicit incentive includes any monetary reward to motivate managers such as bonus and stock option. Midea implements its explicit incentive mainly through a combination of stock option, restricted stock and straight stock. Employees can gain from stock through its price increase and dividends. In most cases, both price's rising and dividends are supported by strong financial performance and stable and sustainable growth. Therefore, unlike bonus-based compensation plans which encourage managers to privilege short-term over long-term profit, the stock-based compensation package applied by Midea motivates managers to take a long-term perspective. It is one reason why Midea could keep a high rate of growth for a long time. By checking the 2019 annual report, through several employee stock ownership plans, Fang became the third biggest stake owner in Midea Group with holding 1.96% shares in total. In 2019, Fang's fixed salary was only 9.63 million RMB, but his gain from stock dividends was 219.2 million RMB. The profit he earned from dividends is about 23 times his fixed salary, which means most of his remuneration directly relates to the company's performance. Holding a large amount of stock assures that Fang's interest is aligned with the family owner's in the long term; hence, minimize the agency problem within Midea.

4.3.2 Board of Directors

As the entity that protects the interest of shareholders and handles the critical decision in firm's daily operation, the quality of board is crucial to ensure functional corporate governance in place. An effective board should include both executive directors and independent directors. To ensure the effectiveness of the board, the Chinese Securities Regulatory Commission (CSRC) requires the board members of the listed company to include at least one-third independent directors. Midea's board has far exceeded the requirement. It consists of 7 directors and has an equal number of dependent directors and independent directors. Among these seven directors, 3 of them are executive directors, 3 of them are independent directors, and 1non-executive director. It is worth mentioning that the only non-executive director in Midea is the son of Midea's founder, and the other six directors have no relation with the founder’s family. Therefore, the composition of Midea's board guarantees the management team is under appropriate supervising. The family member as one of the board members assures the agent will not hurt the benefits of the family. Besides, Midea also has an effective board structure. Like other successful companies, Midea set four committees under its board, including Strategy Committee, the Auditing Committee, the Nomination Committee and the Remuneration and Appraisal Committee. These committees are designed to offer suggestions and advices to the board; therefore, to ensure fairness in the daily procedure and improve the efficiency of decision-making process.

4.3.3 Monitoring

The monitoring mechanism consists of internal and external monitoring. The Auditing Committee is the entity that mainly implements the internal monitoring in Midea. External monitoring is performed by several external parties such as external auditors, shareholders and financial gatekeepers. The external auditor helps the company minimize financial manipulation; thus, protect shareholder’s interest. Midea hires a professional and experienced international external auditor, PwC, to ensure the fairness of its financial report. Other shareholders except for the family also play an important role in the monitoring system. Because the other stockholders have the same goal as the family, they share the responsibility of monitoring. The institutional shareholders such as asset management company and investment bank, they have the professionality and experience of supervising management team. The background of Midea’s shareholders are diversified, including both domestic and foreign institutional investors. Among the top ten shareholders, four of them are institutional investors. China Securities Finance Corporation holds 2.84% shares as the 2nd biggest shareholder in Midea, and Central Huijin Asset Management Company as the 5th biggest shareholders hold a 1.29% stake. Two foreign institutional investors also have huge amount stake in Midea. Canada Pension Plan Investment Board and Merrill Lynch hold 1.73% and 0.84% stake, respectively, and they ranked as 4th and 7th biggest shareholders in Midea Group. These institutional investors bring their experience of corporate governance into Midea, and form an effective monitoring mechanism. Solely depends on one family is hard to supervise the whole management team. By leveraging the knowledge and experience brought by these investors, monitoring the management is much easier and more efficient. Besides the external auditors and shareholders, the financial gatekeepers such as stock market analyst and rating agency also support the shareholder in monitoring the management team. The information provided by these gatekeepers is valuable; they provide fair evaluations about how the management team performed. As a typical “white horse” stock in the Chinese market, Midea is very popular among analysts. Numbers of analysts write reports on it, and they provide rich information about Midea’s operation. By checking these third parties’ opinions frequently, the controlling family could find any agency problem within the company in time.

Long-term value-oriented incentive plan, well-structured board and effective monitoring together formed a functional corporate governance structure. Midea's incentive system aligned the interest of the controlling family and professional manager to mitigate agency problems. A well-structured board structure ensures the implementation of internal governance is independent and impartial. Regarding external monitoring, the existence of several institutional investors makes sure the management team is receiving appropriate supervising. The financial gatekeepers provide rich information about the company to help the controlling family understand the professional manager’s performance. Overall, the functional governance structure of Midea minimizes the possibility of agency problems happened in the company. By applying the governance analyzed above. The controlling family could enjoy the benefits brought by the capable professional manager and also protect its interest at the same time.

Section 4.4. Case Study Conclusion

Because handing down the business to professional managers, Midea achieved huge success regarding its stock market and financial performance. The strong performance in the secondary market indicates the public’s favor to professional CEOs and Midea’s separation of ownership and management. Regarding the financial performance, after the succession, Midea’s profitability keeps going up, the growth capacity remains high, the capital structure was optimized, and the operating became more efficient. Its corporate governance plays an important role in the growth of Midea. With functional corporate governance in place, the interest of professional managers is aligned by performance-based ownership stock incentive plan, and agency problems are minimized. An effective board makes sure the fairness and independence of the decision-making process in senior manager level. The son of outgoing leader, He Jianfeng, takes the position of director also ensures the management team works for the family's interest. The diversified shareholders and financial gatekeepers share the monitoring responsibility of Midea's controlling family and use their knowledge and experience to help the family supervise the management team more efficiently. Overall, Midea's case proves that the family business with outsides CEO can bring a good result if under the supervision of appropriate governance. It also provides a good example of how the family business could leverage the talent of professional managers without bearing much risk of agency problem.

Despite Midea's success, one thing that needs to be noticed is that not all family businesses in China are suitable for Midea's solution in the current context. Building such a completed governance structure is very costly. For the small family business, access to talented managers and directors is limited. Even they successfully established the governance system, the complicated and conservative decision-making process will sacrifice their advantages as small businesses such as flexibility when facing market change.

5. Conclusion

The world's mainstream opinion regarding family business is that hiring a professional CEO is a better choice for company's operation and performance. Many researchers believe lacking awareness of poor management quality, implicit commitment in family business and narrowing down the CEO choices are the primary causes that lead to the poor performance of dynastic family business. However, the researches by Chinese scholars who specifically study Chinese family business shows China's case is a unique one. Compare with family businesses with outside CEOs, the dynastic family firms in China have better performance. It can be attributed to the smaller size of Chinese family business, less infighting caused by one-child policy, the importance of political connection in China and undeveloped Chinese labor market

Although the study shows the advantage of family CEOs in China, it is not the best solution to the family business. The benefits of family CEOs only exist in certain contexts. (1) It works best in smaller and traditional firms instead of a big global family business. When the company's size is small, concentration of ownership and management ensure a flexible reaction to the market change. (2) Undeveloped talent market limited family firms' access to capable professional managers, and it also increases the cost and risk of hiring the outside CEO. (3) Family CEOs also perform better in certain social contexts such as high corruption. Handing down business to family members ensures the succession of political connection. The political connection plays an important role when corruption is high and relation-oriented transactions happen frequently. Therefore, combing the consideration of both development phase dimension and size dimension, except the small family business, professional CEOs is still the optimal choices because of the higher management efficiency.

Simply separate ownership and management is not the goal. Without an appropriate governance structure, it will cause severe agency problems and hurt the family's interest. It is essential to have governance in place. Midea's case provides a good example of how a global family business led by a professional CEO could achieve huge success under the supervise of functional corporate governance.

The outperformance of family CEOs in Chinese family firms is a temporary result caused by certain contexts. The family business succession is a complicated topic that one solution does not fit all different types of family businesses. Therefore, from both size dimension and development phase dimension, the final statements include three situations: (1) the small family firms have no necessary to separate ownership and management at the current stage in China because of the advantages mentioned above; hence complete corporate governance is not essential for them; (2) for big Chinese family business especially for those have business over the world, they are less impacted by political factor and have a vast amount resources to access capable professional managers, so it is better for them to have professional CEOs because of efficiency improvement; (3) along with the social and economic development, if the problems of corruption and unmatured talent market in China are alleviated in the future, hiring outside CEO become less risky and costly. The separation of ownership is then more natural and more necessary to achieve even for some small Chinese family businesses.

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