ISCTE Business School
Instituto Universitário de Lisboa

Dual Governance of Chinese Family Businesses

——Case Study of Bin Valley Group

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Thesis submitted as partial requirement for the conferral of the degree of

Doctor of Management

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Dual Governance Model of Chinese Family Businesses-Case Study of Bin Valley Group

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Abstract

This thesis first reviews relevant theories on governance of family businesses and investigates the development of Chinese family businesses on the whole. It adopts the research method of single-case study and Bin Valley Group, a family business, is the case of this thesis. It systematically analyzes the conflicts between family system and corporate system, relational governance, contractual governance, dual governance model of Bin Valley Group during different phases. After all these analyses, it proposes that contractual governance and relational governance should be integrated differently during different phases and further concludes that pan-familism is the best for dual governance model. Also, it puts forward the corresponding research limitaions and prospects.

Key words: Family Business, Contractual Governance, Relational Governance,

Dual Governance Model

JEL: M10; D21

Resumo

Esta tese investiga as teorias principais sobre governança de empresas familiares e aplica essas teorias ao desenvolvimento das empresas familiares na China. Nesta tese adotamos o método de estudo de caso único. O Grupo Bin Valley, o objeto de estudo desta tese, é analisado sobre o prisma das teorias da governança contratual e da governança relacional ao longo das fases da sua vida. Ao longo do desenvolvimento do Grupo Bin Valley assistimos a um conflito entre o sistema familiar e o sistema empresarial, assim como ao conflito entre a governança contratual e a governança relacional. Esta tese propõe que a governança contratual e a governança relacional devem ser adotadas de acordo com a etapa de desenvolvimento das empresas familiares e que a governança dualista exige o pan-familismo.

Palavra-chave: Empresas Familiares, Governança Contratual, Governança Relacional, Modelo de Governança dualista

JEL: M10; D21

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List of Acronyms

CCCPC	Central Committee of the Communist Party of China
SNA	Social Network Analysis
R&D	Research and Development
IPR	Intellectual Property Right
PKU	Peking University
PRC	People's Republic of China
GDP	Gross Domestic Product
NCCPC	National Congress of the Communist Party of China
WTO	World Trade Organization
NPC	National People's Congress
CPPCC	Chinese People's Political Consultative Conference
RMB	Renminbi

Chapter 1: Introduction

Family businesses are an important component of China's economy, and need to tackle a crucial issue of heated discussion: how these types of businesses should optimize their governance structure. This chapter mainly introduces the research background, issues, purpose and value, and key contributions of this thesis.

1.1 Research Background

1.1.1 The Emergence and Contribution of Research on Family Businesses in the Global Economy

Historically, family businesses are the earliest form of corporate organization, and emerged during the early stages of industrialization in various countries. They have brought a profound impact on the social and economic development of many different regions and countries, such as the top ten family consortiums in the USA (e.g. DuPont, Rothschild, Morgan, Rockefeller and Ford), the de Wendel Family in France, the Haniel Family (the pioneer of industrialization in Germany), and the Mitsui, Mitsubishi, Sumitomo and Yasuda families in Japan before World War II.

Family capitalism gradually gave way to managerial capitalism in the USA, as the Managerial Revolution emerged between 1840 and 1910 (Chandler, 1987). Many people believed that family businesses took a dominant role only in developing countries, or only existed at the early stage of capitalism. They concluded that with the development and perfection of the institutional environment, such as the external capital market, professional manager market, and product market, the role of the family business would naturally decline until the organizational form itself disappears (Jenner, 1992).

However, the people's predictions turned out to be wrong. In terms of the globalization of the world economy, large numbers of family businesses still survive and continue to develop in a range of different circumstances: from emerging developing countries to developed countries; from world-famous multinational corporations to obscure "hidden champions" in some industries; and from street booths comprised of only a few family members to big firms made up of numerous employees.

Family businesses play a significant role in economic development across the world. According to Gersick (1998), even the most conservative estimates show that 65%~80% of enterprises in the world are owned or run by a family, and 40% of the Fortune 500 corporations are family businesses. Poza (2010) argues that family businesses are crucial for the economic development in the USA and other free economies. Roughly 80%~95% of the enterprises in the USA and Latin America are controlled and owned by family, and over 80% of the companies in Europe and Asia are family businesses. According to the Family Firm Institute (2011), family businesses have created about 70%~90% of the global annual GDP, 40-50% of the job opportunities in Europe and two-thirds of the GDP in India.

According to Family Enterprise USA (2011), the number of family businesses in the USA has reached 5,500,000, contributes to 57% of GDP (about $8.3 trillion) and provides 63% of the job opportunities in the country. Family Business Magazine (2007) shows that, the most well-known companies in the USA derive from family businesses, topping at 54.5%. The corresponding proportions were 76% in the UK, 75% in Australia, 71% in Spain, and even over 90% in Italy and Sweden. Currently, some of the world's most successful enterprises derive from family business, such as LG Electronics in South Korea, BMW in Germany, Carrefour and PSA Peugeot Citroen in France, and Wal-Mart and Ford in the USA.

1.1.2 Development of Research on Family Businesses

1.1.2.1 The Rise of Research on Family Businesses

Family businesses have been brought to the attention of Western academia since the 1950s, however, until the 1980s Western scholars only conducted some research in this area. Since the Family Business Review (which focuses on family businesses) started to be published in 1988, research on family businesses has begun to increase.

A review of the relevant literature finds that research into family businesses in Western academia concentrates on the following aspects:

(1) The family business system: Gersick (1998) put forward the Three Circle Model, which regards family businesses as a three circle system, comprised of family, business and ownership, which are independent of but intertwined with each other. Carlock and Ward (2001) investigated the relationship between family members and family businesses more comprehensively from the perspective of the life cycle.

(2) The governance structure of family businesses: Neubauer (1998) held the view that family businesses face a more complicated governance structure than non-family businesses. Berghe and Cachon (2001) argued that the governance structure of family businesses should be studied at five levels.

(3) The management and trust issue of family businesses: Williamson (1993) proposed that trust plays a positive role in the development of enterprise, but on the other hand it may become an inertia which limits the scope of transactions and the development of the organization. Fukuyama (1995) argued that trust is divided into two types. One is a low degree of trust, which is built upon kinship ties, such as in China, Korea and Italy. The other is a high degree of trust, which is beyond kinship ties, and can be seen in large firms in Germany and Japan.

(4) The life cycle of family businesses: Gersick et al. (1997) put forward the Three Dimensional Developmental Model, which indicates the spatial relationship between the life cycles of family members and family businesses, and the ownership of family businesses. Based on this proposition, Carlock and Ward (2001) established a model that looks into the influence of the life cycle on family businesses.

(5) The succession within family businesses: Smith (1991: 1) examined the immediate and long-term impacts on financial performance of 124 management successions within Canadian family controlled firms. He found that, "*when family successors are appointed, stock prices decline by 3.20% during the 3-day (-1 to +1) event window, whereas there is no significant decrease, when either non-family insiders or outsiders are appointed*." Chua, Chrisman and Sharma (1999) defined family business by behavior, and used structural equation models to test whether the components of family involvement in the business (ownership, management, governance and existence of successors) can be predictors to a

family's intention. They developed a behavioral governance model to measure the intentions of family.

Profound research into family businesses appeared in China later than in countries in Europe, America and other developed regions. Since the 3rd Plenary Session of the 11th CCCPC in 1978, the reform and opening-up policy has been implemented gradually, and the private economy has begun to flourish. The research on Chinese family businesses has become increasingly important, and is turning into a vital research field (Yang & Li, 2009).

1.1.2.2 Controversial Issues of Research on Family Businesses

Around the world, research on family businesses has two heatedly discussed issues: Governance and succession. However, in China modern family businesses have only existed for a relatively short amount of time, and succession is not the most prominent issue. Rather, the focus is always on governance.

Governance is one of the most important issues in the research on Chinese family businesses, and has crucial theoretical and practical significance. This is due to the relatively short existence of most Chinese family businesses and these businesses are currently managed by the first generation from the family, or are about to be handed over from the first generation to the second generation.

1.1.3 Background of Chinese Family Businesses

1.1.3.1 Contribution of Chinese Family Businesses to China's Economy

Since the reform and opening-up policy, businesses in China have been growing, injecting fresh vigor into China's economy. China's private economy has grown from almost nothing to something of considerable significance. According to the Research Center of All-China Federation of Industry and Commerce (2010), private enterprises have become the biggest corporate group, constituting over 85% of all the enterprises in number and contributing more than 50% to GDP.

Private enterprises in China are the main driving force behind economic growth and most of these private enterprises are family businesses. The Chinese Family Business Report (2011) examined 4,614 enterprises in China, which included 3,286 family businesses (after excluding enterprises that did not disclose information about shareholder structure). Family businesses account for 85.4% of the effective sample. Therefore, since China's reform and opening-up, the rapid development and success of private enterprises has relied mostly on families (Chen, 2003), and family businesses are the main driving force of private enterprise in China.

Since the reform and opening-up policy, the private economy, mainly dominated by families, has been the most dynamic and fluctuating contributor to economic development. It has effectively allowed the employment of millions of Chinese (Zhang, 2009). By the end of 2012, households of private enterprises in China had reached 10,857,200 in number, and provided job opportunities for 112,961,000 people.

According to the National Bureau of Statistics (2013), the private economy accounted for 79% of the national economy. By reviewing relevant literature, it is evident that there are two main views on the governance of family businesses: one is that family businesses are a traditional corporate system and should evolve into a modern corporate system, responding to the requirements the of market economy (Jenner, 1992); and the other is that family businesses should continue to exist as they are and not have to shift to a modern corporate system (Berger, 1988). This thesis argues that family businesses have different characteristics at different times, and several different management methods should be applied to family businesses, rather than a single, one-size-fits-all method. Nor should modern corporate systems be advocated without proper consideration of applicability and appropriateness to family businesses.

1.1.3.2 The Focal Issue of Chinese Family Businesses: the Governance Model and Economic Efficiency

Gersick (1997) held the view that the life cycle of family businesses is divided into start-up, expansion/formalization and maturity phases. During the start-up phase, a family business begins as a family unit, and is jointly run by entrepreneurs and other family members. They use a family’s accumulated capital as the main capital, and at this stage ownership and control highly overlap. Based on kinship ties and marriage, the family business becomes a community of mutual interests. The principal-agent problem does not exist at this stage, and there are no corporate governance issues or problems in management.

When family businesses go into the expansion/formalization phase, the ownership and control of the business begins to separate to a certain degree with the addition of external human resources. Family members still retain ownership of the business, but the form of ownership begins to diversify and the principal-agent problem begins to appear at this stage. Arguments and conflicts between owners and professional managers also begin to arise frequently.

After continued development, the family business steps into the maturity phase, where the business becomes increasingly open and socialized. Along with the separation between ownership and control, the principal-agent problem gradually becomes more serious. As a result, the family's control and influence over the business continuously declines and family members transition into becoming ordinary shareholders. The family business eventually evolves into an enterprise that has lost its original familial characteristics. The governance of the family business may now become a more general corporate governance issue.

The expansion/formalization phase is the most special and representative of the life cycle of family businesses, and the corporate governance of a family business is an important issue during expansion/formalization. As a number of family businesses in China have reached the expansion/formalization phase it is vital to discuss at present: how to deal with the problems happening during the expansion/formalization phase; how to build a family business management model that suits the Chinese context; and how to achieve higher economic efficiency.

1.1.4 Corporate Background

1.1.4.1 Evolution of Bin Valley Group

Bin Valley Group is a diversified and complex corporate group, comprising of 11 subsidiaries. It has six major business segments, namely engineering, technology, investment, trade, finance and culture. In 2013, its revenues topped €75,350,000, with profits of €11,920,000 and 257 employees.

The first company of Bin Valley Group was Sichuan Yuandian Installation Engineering

Co., Ltd., which was founded in 2003. Later, 11 companies were gradually established as Bin Valley Group's scope of business became more diverse. As the concurrent Chairman of the Board and CEO, the founder of Bin Valley Group, Bin Yonggang, serves as the legal representative for most of these 11 subsidiaries, and his trusted managerial staff serve as the legal representatives for the remainders. Bin Yonggang and his wife own all of these companies.

Bin Yonggang has more than 10 years' experience in the electrical engineering industry, and is qualified as a First-Class Constructor and Senior Engineer. He is also involves himself in educational and social activities, as the former chairman of the 13th MBA Federation in Southwest Jiaotong University. He has received 2010 China MBA Top Ten Startup Stars and 2011 China MBA Top 10 Elites awards, and was hired as an extracurricular MBA mentor at Southwestern University of Finance and Economics, MBA enterprise mentor in Southwest Jiaotong University, and a committee member in the Consultative Committee of China MBA Union.

Currently, he leads Bin Valley Group as it enters into the culture industry, is the president of the Sichuan Committee of World Health Culture Assembly, and the Honorary President of the Sichuan Commercial Photography Association. Bin Yonggang advocates achieving humanity, harmony, win-win outcomes for customers and employees, and pursuing green/sustainable development, science and technology to serve the country.

1.1.4.2 The Practice of Corporate Governance in Bin Valley Group

Bin Valley Group is a typical example of a family business and the founder, Bin Yonggang, began his business by founding an engineering team with a few fellow villagers in 2002. The team began to expand its business in 2003, and officially established itself as a company at this time (the birth of this family business). After ten years of development, this company grew into a relatively large family business.

In its first eight years, Bin Valley Group adopted relational governance model, which meant that the business relied more on the family members' mutual trust and affection to overcome difficulties and gain bravery, loyalty and unity. At this stage, they overlooked any immediate interests and the performance of Bin Valley Group grew rapidly.

However, as Bin Valley Group continued to thrive, the existing capabilities and qualities of the family members could not keep up with the growth and development of the business. The inherent nature of being able to share sorrow but not happiness and wealth led to internal discords, and gave rise to personal privilege. This hindered the improvement of Bin Valley Group's managerial efficiency and business, and some family members even left the company.

Bin Yonggang has never stopped studying and brought broadened visions and new concepts to Bin Valley Group. He has introduced a large number of professional managers into the company, transforming his family business and gradually implementing contractual governance. At this stage, Bin Valley Group's leader has started to prioritize employees' capabilities and created values. He has studied and decided Bin Valley Group's developmental strategy, and established a series of rules and regulations, which include performance evaluation methods. He has decomposed goals and clarified responsibilities to the management team, and has set up a Discipline Inspection and Supervision Department to supervise managers and ordinary employees.

Such contractual mechanisms constrain and regulate the operational and managerial behavior of all employees, including family members. These mechanisms also clarify the management relationships and processes, shape the corporate culture of advocating excellent performance, and improve managerial efficiency to boost collectivization and diversification.

However, another issue has arisen: it is not easy to receive and maintain the loyalty of professional managers. The team of professional managers is not stable and the uneven salary distribution often leads to arguments. The gap between professional managers and family members is relatively wide.

As Bin Yonggang learns and socializes more, he recruits his trustworthy schoolmates and friends into the team of professional managers. Bin Valley Group has set up its governance structure with inspiration from chambers of commerce, unions, clubs and other social organizations, and has gradually evolved into a pan-family business. It now deliberates on how to establish a dual governance model to combine relational governance with contractual governance.

1.2 Research Questions

During early stages, Family businesses have incomparable advantages over other corporate forms of business. For startup phase, family businesses are based on kinship ties, which drastically reduce transaction costs. These transaction costs are bound to arise if contractual governance is implemented, and the governance efficiency during family business startup is therefore higher, when contrasted against other corporate forms. However, as Bin Valley Group went into the expansion/formalization phase, it expanded in proportion. It was necessary for Bin Valley Group to absorb external materials, capital and human resources, and as a result, the efficiency of the relational governance model has decreased continuously.

It has been over 30 years since the reform and opening-up policy was carried out in China, and the private economy in China has since achieved rapid development. Family businesses, as the main driving force of the private economy in China, have also quickly grown. When family businesses grow bigger in scale and scope, the traditional relational governance model can no longer satisfy the requirements for further development, which indicates it is time for family businesses to shift their governance model.

Bin Valley Group, founded in 2003 and headquartered in Chengdu City, has become a diversified corporation over its 10 years of development. As a family business, Bin Valley Group`s development can be regarded as an interaction between its family and corporate systems. During its development, its different systems have displayed inconsistent goals and conflicting resource distributions, which have forced Bin Valley Group to confront the issue of corporate governance and address the resulting unstable economic efficiency.

This thesis studies the following three aspects: (1) What was the evolution of Bin Valley Group? What is the strategic goal the founder has set for Bin Valley Group? What resources does this goal require? (2) How and why do the family system and corporate system show inconsistent goals and conflicting resource distributions? How do these conflicts affect Bin Valley Group's efficiency? (3) How does Bin Valley Group choose an effective governance model to integrate the dual needs of the family’s trust and the non-family professional managers’ capability, to maximize the interests of the family business?

1.3 Research Purpose

This thesis begins with the developmental process behind family businesses and the evolution of their governance structure, based on the theories of family business governance. It systematically makes a generalized analysis on contractual and relational governances for family businesses at different stages.

By analyzing the status quo of Chinese family businesses and their main issues in terms of governance structure, this thesis introduces the concept of relational governance. Then it constructs a dual governance model, which combines contractual governance with relational governance. It proposes that contractual governance and relational governance should be integrated flexibly at different developmental stages of a Chinese family business, in order to explore specific measures to optimize the resulting governance structure.

Based on the case study of Bin Valley Group, this thesis aims to explore an economically rationalized governance model for the effective development of family businesses (especially Chinese family businesses), by conducting theoretical and practical analyses on the dual governance model that integrates relational governance with contractual governance.

1.4 Research Value and Contribution

This thesis selects Chinese family businesses as the research focus, with a family business during the expansion/formalization phase, Bin Valley, as a case study. It goes deep into the family to discuss the theoretical connotations, mechanisms of action and the changing processes of the dual governance model (contractual and relational governance) in Chinese family businesses. Its main theoretical significance is embodied in the following two aspects:

Firstly, it expands and improves the research into Chinese family business governance, and builds a theoretical framework for the dual governance model of relational and contractual governance. In this thesis, the start-up, expansion/formalization and maturity phases of Bin Valley Group are reviewed and analyzed in detail. It deeply analyzes the internal governance structure model of family businesses, by sorting through relevant information on family businesses' development. From the relationships between owners, family members and professional managers, this thesis analyzes the theoretical connotations, mechanisms of action and the changing process of the dual governance model in Chinese family businesses by applying contract theory and agency theory. On this basis, it works to establish the theoretical framework for the dual governance model of relational and contractual governance.

Secondly, this thesis presents an innovative research perspective that combines relational governance with contractual governance, and discusses the choice of governance model at different stages of family businesses. It emphasizes how family businesses form, and utilizes the case study of Bin Valley Group to identify the correlations between kinship ties, ownership, control and managerial power. This lays the foundation from which this thesis can analyze how the internal power distribution within family influences a family business.

In addition, this thesis has certain practical significance, mainly demonstrated by its contribution to Bin Valley Group and relevance to Chinese family businesses: (1) this thesis explores an effective dual governance model with economic efficiency to reconcile the conflicts between family and the family business of Bin Valley Group; (2) under the social ethics and behavioral regulations of a Chinese family, this thesis provides a sustainable and economically-efficient governance model in a Chinese specific context for Chinese family businesses.

It also raises concerns and presents discussion on an appropriate governance model for Chinese family businesses.

1.5 Research Structure

Through studying the developmental process of an existing family business, this thesis analyzes the balance and strategy between contractual and relational governance, to realize the healthy, sustainable development of family and a family business. It is divided into five chapters: Introduction, Literature Review, Research Method and Design, Field Work: the Case Study of Bin Valley Group, and Discussion. The structure and logic of the approach used in this research is shown in Figure 1-1.

Chapter 1: Introduction. This chapter mainly introduces the academic and real-world background of this work, which includes the: research object, research issue, research meaning, and research value and contribution, which paves the way for the following chapters.

Chapter 2: Literature Review. This chapter mainly reviews relevant research at home and abroad to build up its theoretical framework, which includes the definition of a family business, the status quo of research into family businesses, contract theory and principal-agent theory under the circumstances of asymmetric information.

Chapter3: Research method and design. This chapter mainly presents the selection of research methods, data collection methods and collection process.

Chapter 4: Field work: the case study of Bin Valley Group. This chapter introduces and analyzes the rise and decline of Chinese family businesses after New China was founded, in detail and developmental stages. It then introduces the main developing pathway of Chinese family businesses, and derives the dual governance model to provide a governance model to support their development. On this basis, this chapter studies the governance structure of family businesses at different stages and the feasibility of the dual governance model (relational and contractual governance), using the case study of a typical Chinese family business: Bin Valley Group.

Chapter 5: Discussion. This chapter talks about the conclusion, recommendation, limitation and future research of this thesis.

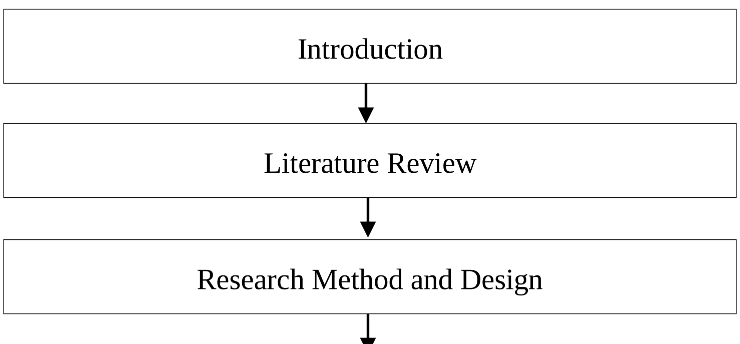

Figure 1-1 Research structure

Source: Sorted out by author

Chapter 2: Literature Review

This chapter mainly identifies and reviews the definition of a family business, relevant research, agency theory, and contract theory. In addition, it presents a commentary on relevant theories.

2.1 Definition of a Family Businesses

2.1.1 Available Definitions

There are a multitude of definitions for a family business, however, there is no single, authoritative, unanimous, commonly-accepted and precise definition. Although foreign and domestic scholars define a family business from different perspectives, most of them define it from the angle of ownership and control.

From the relevant literature, more than 20 definitions of family business can be identified, and some of the commonly-accepted definitions can be reviewed chronologically.

Chandler (1987) pointed out that the founder and his family members own most of the shareholder rights of a family business, and they maintain a close interpersonal relationship with professional managers. Additionally, they reserve the main decision-making power, especially in terms of finance, resource distribution and recruitment of top management.

Leach et al. (1990) argued that when over 50% of the voting power is dominated by a family, and/or a family group, they may control the entire company, and/or a significant proportion of the top managerial staff are family members.

Upton et al. (1993) asserted that being family-owned and family-controlled has a certain significant effect on the decision-making within a family business, which embodies the characteristics of family business.

Carsrud et al. (1994) thought that members of a "kinship ties organization" control the ownership and decision-making of family business.

Sun (1995) proposed that a family business is such an enterprise that its control power is directly or indirectly possessed by one or several closely-related families, or part of or all of its ownership is dominated by one or several closely-related families. Family members who directly manipulate the control power serve as top and middle managerial staff, and this family or several families may control over half of the ownership. Indirect control means to employ professional managers to manage the family business. In this case, owners, are able to control the family business indirectly via professional managers.

Litz (1997) argued that for family business, its ownership and control power are both dominated by a family, and family members seek to continue to exist or increase their involvement in the family business.

Pan (1998) believed that when a family or several closely-related families have all of or part of the ownership, and directly or indirectly dominate the control power, such enterprises are family businesses.

Chen (1998) pointed out that family economic organization is an informal organization which is formed out of informal system. A family business derives from family, and it has certain economic functions with similar structure and operative modes to the family itself.

Ye (1999) defined family business from the perspective of shareholding and control power. A family business should be identified by the critical shareholding ratio and the differences in stakeholder structure of the individual company. Also, the level of control of the family should be taken into account.

Chua et al. (1999: 25) asserted that, “the essence of a family business consists of a vision developed by a dominant coalition controlled by one or a few families and the intention of that dominant condition to continue shaping and pursuing the vision in such a way that it is potentially sustainable across generations of the family.”

Wang (2001) pointed out that a family business is an economic organization based on family affection and kinship ties. It actively pursues family interests, by using its control power in the form of enterprise.

Yu et al. (2003) argued that family business is an economic organization. Marriage and kinship ties are its bonds, and its operation and accumulation of capital are built upon family.

Chu (2004) preferred to define a family business from the angle of shareholding and control power. In this sense, a family business is regarded as a continuum. From 100% ownership and 100% control power to the critical point of control power, this area belongs to the family business. Once beyond this critical point, the family business will become a public company.

Ibrahim and Ellis (2004) defined a family business as such when at least 51% of the ownership is dominated by a family. Moreover, at least two family members are involved in the management or operation of this enterprise, and the transfer of leadership to the next generation of family members can be anticipated.

Ye (2004) pointed out that marriage and kinship ties are a family business' bonds. Its source and accumulation of capital are based on family background, and leadership can be in succession within the family.

Feltham and Barnett (2005) proposed that the relationship between a family business and family creates a special type of corporate culture and philosophy, which is particular to family businesses

It is universally accepted that family businesses are a type of enterprise, and are governed and owned by a core family. Generally, the family must have absolute and relative advantage in terms of the ownership. Meanwhile, family and family members should get involved in the management and operation to a certain degree. After collecting and reviewing the definitions of a family business by the research groups mentioned above, some key defining elements were found (as shown in Table 2-1), which are ownership, governance and management, succession, kinship ties, prospects, and philosophy and culture.

Table 2-1 Key elements to define family businesses

Scholar	Ownership	Governance and Management	Succession	Kinship Ties	Prospects	Philosophy and Culture
Chandler (1987)	√	√				
Litz (1997)	√	√				
Leach (1990)	√	√				
Carsrud (1994)	√	√		√		
Chua (1999)	√	√	√		√	
Ibrahim and Ellis (2004)	√	√	√			
Sun (1995)	√	√				
Ye (1999)	√	√				
Wang (2002)	√			√		
Yu (2003)	√	√		√		
Chu (2004)	√	√				
Ye (2004)	√	√	√	√		
Feltham and Barnett (2005)	√	√				√

Source: Sorted out by author

It is evident that a considerable number of groups have studied the definition of a family business, but their definitions have different emphases and characteristics. However, almost all of these definitions have a focus on ownership and control power.

2.1.2 Definition of a Family Business for this Thesis

After integrating the definitions of a family business by foreign and domestic scholars, this thesis treats the definition of a family business as follows: family business is an enterprise built upon kinship ties and marriage; at least 51% of the ownership is possessed by a family; at least two family members are involved in the management and operation of this enterprise; and its ownership and control power can be in succession within the family.

2.2 The Status Quo of Research on Family Businesses

The earliest concern of academia on family businesses arose in the USA, and since the 1960's, Western countries' studies on family businesses have been intensifying. After 1996 family businesses have become th focus of much research in Western countries, and even globally, where these studies include the following: the definition of a family business, and the governance structure, conflict management, status and function of female family members, financing preference, succession, life cycle and public listing of family businesses.

(1) The definition of a family business. This has been discussed in previous sections (2.1.1 and 2.1.2).

(2) Generational succession. Churchill and Hatten (1997) saw generational succession as an indicator to define a family business. Anderson and Barnes (1976) argued that the lack of succession planning is an important reason for the failure of a family business' succession. Lansberg (1988) argued that family members inevitably have an ambivalent attitude towards the transition of succession, which prevents the main policy makers from planning constructively for the founder’s exit.

(3) Conflict management. Jehn and Mannix (2001) thought that conflicts within a family business are caused by the difference, incompatibility, and irrational desires or wishes between family members and the family business. Through empirical studies, Shah and Jehn (1993) found that relationship conflicts reduce personal and organizational performance, and affect the possibility of future cooperation. Janis (1982) proposed that suitable task conflicts allow a family business to benefit from different perspectives, while conflicts in processes decrease performance and morale.

Scholars have studied the positive and negative results of conflicts and their internal causes. Cosier and Harvey (1998) proposed that task and process conflicts can boost a family business' innovation, and Litz and Kleysen (2001) provided proof for this view when they studied generational succession and innovation. Sorenson (1999) put forward five strategies to deal with a family business’ conflicts: competition, accommodation, collaboration, compromise, and avoidance.

(4) Governance structure of a family business. Neubauer and Lank (1998) comprehensively analyzed the governance structure of a family business from the angles of corporate governance, the classical governance model, the family system, the board of directors, key elements of management, control and governance practice. Tagiuri and Davis (1982) developed the Three Circle Model (ownership, family and business) based on the fact that the participants in the governance structure of a family business have multiple roles. Mustakallio (2002) proposed some characteristics about the governance structure of a family business and developed a model that combines relational governance with contractual governance. Based on this model, he further proposed a series of issues on the relationship between governance structure and decision-making. Neubauer and Lank’s (1998) studies on governance structure demonstrated that a family business faces a more complicated governance structure of business than a non-family business. Leach et al. (1998) indicated that the growth of family business lies in whether the family can integrate with owners, boards of directors and managers, and whether the family business can optimize its governance structure. Cadbury (2000) argued that the link between a family and the family business is what distinguishes a family business from others, and this link is a source of strength. Carlock and Ward (2001) introduced the concept of the family council into the governance structure of family businesses, and this marked the initiation of the concept into the research field.

2.3 Research on Family Businesses in China

Since China launched the reform and opening-up policy in 1978, an external environmentsupporting the development of family businesses has gradually formed, and there is an increasing number of entrepreneurs and entrepreneurial families involved in this tide of economic development. Zhou (1994) found that family, as an old organizational form, continues to display its vitality in the development of socialist agriculture in China. Li (1998) also pointed out that it is hard to grasp China's economy, especially the development of corporate organization, without profound a understanding of the family system. Therefore, family businesses is a meaningful and important topic to China’s development.

2.3.1 The Social Ethics of Chinese Family Culture and its Influence on Commercial Activities

Family is very important to Chinese, and the hereditary monarchy, which is also an early type of family culture, once appeared in ancient China. Chinese family culture affects Chinese people’s ethical regulation, social ethics and commercial culture, and these behaviorisms have fitted seamlessly into Chinese family businesses.

Redding (1993) argued that Chinese family businesses are in essence, a cultural product, which implements paternalistic leadership, and family members are strongly committed to operate and manage the family business. Wang (1995) pointed out that the concept of family is fundamental to Chinese culture, and the core of Chinese people’s behavior. There is an obvious distinction between family members and non-family members, where family is a complete unit for property right, and also the ultimate emotional destination.

Family culture embodies the characteristics of Chinese traditional culture, and for thousands of years, family culture has had a great influence on the management, operation and life cycle of family businesses (Chu, 2000). Throughout Chinese history, Confucianism has been prevalent, which has family culture at its core. It is the cultural foundation on which Chinese family businesses prosper (Han & Deng, 2004). Family culture demonstrates the characteristics of Chinese traditional culture, and it pursues love and affection within family. It emphasizes peace and harmony, and good fortune will come when that peace and harmony is realized.

In Chinese culture, respecting the elderly and loving the youth is the most outstanding feature. It is very common for a traditional Chinese family to completely surrender to the elderly. Sons and daughters are unwilling to refute the elderly to avoid being condemned as disrespectful and disobedient. Because of this family relationship, Chinese family businesses are commonly guided by a family system.

Owners manage and run the entire family business with a certain degree of arbitrariness, just like parents and family leaders. Meanwhile, the kinship ties within family business tend to cause chaos and disorder, for example some family members may actually be incompetent but act beyond their power (Fu & Li, 2011).

The corporate culture of Chinese family businesses mostly reflects Chinese traditional family culture. Family culture has been popularized at every social level, even beyond family, and has been the guiding framework and behavioral principles for the Chinese people, shaping the formation of property rights and family business organizations. Family culture emphasizes ideologies of cohesiveness and helping each other, which equips Chinese family businesses with a strong, center-oriented focus. Family members are led to trust each other and possess the same values, and the transaction costs within the family business decrease.

Since ancient times, family culture has been considered as the core of interpersonal relationships in Chinese traditional society. Family culture is inherently popular, and not only does it provide family members with a guiding set of rules and regulations, but it also fits into every corner of their economic and social lives (Chu, 2003).

In China, the rules and regulations of family culture include behavioral roles, the relationships between family members, the ethical values of family, the framework of the family system, and the mental recognition of family. It also continuously extends to other interpersonal relationships and organizations beyond family (Yang, 1998).

Pan-familism embodies itself in two specific aspects. Firstly, the scope of a family continuously extends, and this goes beyond kinship ties. It can extend to the social interpersonal relationships between neighbors, people with similar religious beliefs, co-workers, schoolmates and the media (Peng, 2001). Secondly, pan-familism’s functions and influences gradually extend beyond family, and the inclination towards pan-familism is a prominent feature of Chinese culture. This is a significant feature that distinguishes Chinese family businesses from foreign family businesses (Chu, 2003).

2.3.2 The Contradictory Argument: are Family Businesses an Obstacle or Engine of Economic Development

There have been many studies on how family businesses will continue to evolve as the economy develops, and on how they are influenced by external political and economic factors. Until recently, family businesses have been considered as a comparatively passive organizational form, but after reviewing relevant studies on family business' effect upon economic development, we can find that scholars' attitude towards family businesses has changed substantially. Family businesses used to be considered as an obstacle for economic development, but currently many believe it to be an engine supporting economic development instead. In this section, we discuss these opposing views.

Before we examine the impact of Chinese family businesses on economic development, we need to understand that a Chinese family's lifestyle is essentially different from the West. Whyte (1996) pointed out that Chinese traditional culture is based on family, and stresses on the interests of family. A Chinese family tends to be a united family, where sons may live together with their parents, after having children, and every son may inherit family property. Family is deemed as a cross-generational unit that includes ancestors and offspring. Family is not only established by marriage, and family relationships are arranged paternally (the father passes on to the son), and marriage is strictly controlled. Even for a couple, their parents may only meet for the very first time at the wedding itself. Additionally, some families share their properties and honor their common ancestors. Therefore, we can tell that a Chinese family puts family responsibility above everything else, and family loyalty is the most crucial component of the Chinese people's lifestyle.

Chinese family businesses can be an obstacle to economic development. Weber (1915) first proposed when the Industrial Revolution first began in the West, why Japan could cope with the challenge of the West while China failed in the same period after 1968. Theories of modernization mushroomed in the 1960s, and during this period, there was a large amount of discussion attempting to explain why the organizational model of Chinese family businesses was harmful to economic development. The point was that family and modern corporations are incompatible, just like oil and water.

Weber (1915) held the view that the reason why China's economy did not grow was that family prevented economic growth, which inspired us to consider the fetters of the sib (burdens of family bonds). Modernization theorists often see this point as a drawback of family businesses, and not just limited to Chinese family businesses. Kerr (1960) argued that family provides food and protection to its members, but does not care about individual contributions. Thus, working family members are expected to benefit the entire family, and no matter if some family members are poor or lazy – they will still receive the family's care.

Family does not encourage personal savings because family loyalty and responsibility, the most important aspects, discourage family members from investing, saving and working only for themselves. Jenner (1994), who specializes in Chinese history, held the idea that the Chinese family system aims to ensure that children will first consider parents and seniors' interests when they invest in the future. This pressure has made Chinese culture more reserved, but simultaneously, it limits the individuals' creativity and independence.

Whyte (1996) identified the main factors of family businesses as obstacles. First, nepotism is a key factor to render a family business inefficient. A family business cannot appoint, reward, punish or fire family members according to their capability and performance because it is the family's responsibility to take care of every family member. Hence, a family business could recruit incapable family members, and talented and ambitious youths in the family may be discouraged from getting better jobs elsewhere. Moreover, family separates the external untrustworthy world from the internal reliable family members.

Second, family businesses may be unwilling to recruit non-family members despite these non-family members being better qualified. Even if these non-family members are recruited, they may feel they are inferior to family members, as family members may seize non-family members' opportunities to get promoted. As a result, non-family members' mobility is reduced, and once they have other better opportunities, they may leave without hesitation.

Third, Chinese people tend to avoid doing business with those who have no social connections with them. The main issue for Chinese economic life is that they rely too much on social connections that take a lot of time and effort to cultivate and maintain. This provides an opportunity for corruption to flourish.

Fourth, a high degree of family loyalty conflicts with the modern entrepreneurial and risk-taking spirit. Obeying family authority is incompatible with modern entrepreneurial spirits, and in fact, the lack of enterprising spirit and innovation is one of the main research issues on China's economy in the nineteenth century.

Fifth, limited corporate scale is an issue. Family businesses tend to maintain a small scale, and a lack of sufficient capital makes it hard for them to compete with modern non-family businesses, which are rich in capital and have advanced technologies. Also, family businesses tend to aim to maximize profits, rather than their corporate reputation or product popularity.

Family businesses may also engage in illegal commercial activities. Chinese family businesses find it hard to be cross-generational because they cannot cope with family arguments in future. As a consequence, family members are doomed to share and split assets of family businesses, and such drawbacks will put a family business into a dilemma when a non-family business comes into the same market to compete.

However, more scholars are holding the view that Chinese family businesses serve as an engine for economic development and it is natural for family businesses to occur. Whyte (1996) held the view that family businesses can boost corporate productivity to clearly define residual control over private property rights. Compared with modern corporate systems, family business' structure of property rights is simple and easy to manage. It adapts to external changes swiftly, and this structure of property rights suits most private enterprises during the startup phase. Moreover, a family business is an organization based on kinship ties, and in the startup phase, most businesses apply the family system because capital, technology, management and information are all insufficient.

Family members' reliance on family and their ethical responsibilities can generate a huge family cohesive force. When a family business is in its toughest moments, family members' help and support can come into play. In addition, the family culture can fit into the corporate culture and unify employees, which may motivate the entire family business to remain positive. Also, a family business has a wide social network, where different family businesses rely on each other and form financing and commercial networks. These networks may help to solve the lack of funding and information to a large extent, and can also help a family business save transaction costs. Such social networks and family systems are similar at a social and cultural level, and with these networks growing stronger, family businesses will gain wider room for development.

Therefore, Chen (1998) proposed that a family business is not necessarily inefficient, and under some specific circumstances, it will show more efficiency and competence than its market and bureaucratic counterpart. Zhou (1994) argued that family, as an old organizational form, will continue to display its relevance and contribute to social development.

2.3.3 Characteristics of Chinese Family Businesses

2.3.3.1 The Organizational Characteristics of Weak Organizations and Strong Linkages

The efficacy of a Chinese family businesses' strategy basically relies on the family's social network. Although the family business may be small in scale and limited in capability, or its scale is big but unstable, the network economy led by Chinese family businesses is extensive and resourceful. Research on Chinese family businesses mainly comes from cultural sociology studies, and a typical example is Redding's research. Redding (1995) conducted a series of research on overseas Chinese family businesses, and found that Chinese family businesses are characterized by paternalistic leadership. He also discussed the network and social capital of family businesses, and noted that Chinese social culture is social-connection oriented: its characteristics are strong linkages and weak organizations. He believed that Chinese society and history mainly exercises its influence on Chinese people in three aspects: paternalistic leadership, personalism, and the sense of insecurity.

Paternalistic leadership and the relevant family ethics are the main principles that support the structure of Chinese society, and the whole society exudes this type of leadership (Hamilton, 1986). Paternalistic leadership gives rise to a stable hierarchy, but it also limits some family members' rights.

Personalism: Fukuyama (1995) considered Chinese society as having a low degree of trust in order to explain why family businesses are popular in Chinese society. The lack of trust combined with a poorly-developed legal framework that is unable to regulate transactions, results in people finding it hard to build reliable relationships with each other and gives rise to personalism. Mutual trust becomes an important mechanism for transactions, and interpersonal relationships are crucial for the society and economy.

Sense of insecurity: people generate a sense of insecurity when they live in a society that lacks mutual trust. To survive, families need to compete with each other, while the government is unable to cope with people’s demands beyond basic needs, which worsens peoples’ sense of insecurity. It also comes from the decline of totalitarianism, low efficiency of production and population pressure (Elvis, 1973). The Chinese people have had to form such values where they have to rely on their own talents and efforts in order to survive, instead of expecting help from the government. These values are formed by the Chinese people’s personal experiences.

Weber (1915) explained the origin of familism from the perspective of Chinese Confucianism. The Confucianist concept of "self-cultivation, family harmony, country management and world peace" puts family above the nation and the world, and in this context, Chinese family businesses have the organizational characteristics of weak organizations and strong linkages. For the long-term development of a family, family members have to control family business more tightly. They have to protect assets and avoid risks, need to make key decisions within the family, and limit non-family members’ skills such as management, technology and marketing (Redding, 1991). As such, a robust legal framework has been supplanted by personalized trust restrictions (Landa, 1981).

2.3.3.2 Differential Mode of Association, Altruism and Nepotism

(1) Differential mode of association

Fei (1947) put forward the concept of, “differential mode of association,” to describe the interpersonal relationships built upon kinship ties. These interpersonal relationships are similar to the ripples on water, and scatter outward from the center. The distance from the center shows the closeness and alienation in kinship ties. He believed that the Chinese people’s differential mode of association distinguishes family members from non-family members, and people have different attitudes towards people in different positions.

He analyzed Chinese traditional society by SNA, and distinguished between Chinese traditional and modern societies more precisely, by proposing the concepts of differential mode of association and organizational mode of association. His proposal of differential mode of association is widely accepted by academics of sociology, and he has presented an analogy to distinguish between differential mode of association and organizational mode of association.

Western society sees individuals as units and interpersonal relationships are like bundles of matchsticks. The accumulation of matchsticks creates bundles of matchsticks and that is how an organization forms – each individual is in parallel and this is the organizational mode of association. In contrast, native Chinese society regards family groups as units, and interpersonal relationships are like a web formed by kinship ties. Everyone is not parallel and that is a differential mode of association. In this mode, everyone sees themselves as a center to form webs, and each circle of webbing spreads outwards from the center. The more distant from the center, the less significant that circle is.

What are the criteria to determine closeness and alienation? Fei does not answer this issue directly, but he mentions that when you push yourself outward, you form your social network. The network basically consists of family members, and kinship ties technically refer to the relationships created by birth. He argues that intimate kinship ties limit some social activities, and cause conflicts and competition. Furthermore, he points out that commerce can never go on smoothly in a society of kinship ties, because this type of society is supported by social connections. For transactions, social connections should give way to commercial interests, and people should be governed rationally.

Traditional Chinese society is closed and self-sufficient, and people tend to stay in a place permanently. This type of society does not welcome people from elsewhere and government control is relatively weak here. Therefore, family patriarchs can exercise their power with less restriction, and this differentiates traditional Chinese society from modern Western society – by the family system. It is a paternal society, and a Chinese family is a continuous community, which is centered on the relationship between father and son, as well as mother-in-law and daughter-in-law. People in traditional a Chinese society tend to avoid movement and they prefer to live in their hometown permanently, which means that people's land resources tend to remain stable.

The concept of differential mode of association is crucial for us in order to understand and analyze Chinese traditional society. After reviewing the concept of differential mode of association, we may conclude that in traditional Chinese society, people base their closeness and intimacy with others on paternal kinship ties, and this is the root of differential mode of association. Moreover, kinship ties are incompatible with commercial activities, which are based on rationality, and therefore contradictory. Thus, a society of kinship ties limits commercial activities, and rationality is a characteristic of a modern society.

Zheng (1995) argued that paternalistic leadership is best characterized by the rule of man. A leader does not see his inferiors as equals, and instead, classifies his staff into insiders and outsiders. This is determined by three criteria: relationship – what relationships exist between the leader and his staff, such as family members, fellow townsman or schoolmate; loyalty – how obedient are the staff to the leader? Are workers willing to sacrifice their own interests? talent - how competent and mobilized are the staff to conduct their tasks? Loyalty is paramount, talent less so, and relationship is the least important. Based on these three criteria, we can classify staff into eight types, which once assigned, are difficult to change. Paternalistic leaders take a kind attitude towards the insiders, but behave oppositely to the outsiders.

(2) Altruism

Altruism refers to the practice of caring about others' welfare and putting others' well-being above one's own, and is considered a virtue in many cultures. Since the 1970's, economics has gained a breakthrough in the assumption of human nature, and altruism has received extensive attention. Altruism has played an equally important role in market transactions as individualism.

Where does altruism come from? There are at least three sources, and first, it may be gained by birth. We may call this innate altruism, and Wilson (1975) argued that altruism is gained by genetics and is a human instinct. Second, altruism is produced by the common belief of a community, such as religions or political parties, and people with such altruism do not expect rewards. We may call it acquired altruism. A third source is to see altruism as a way of mutual benefitting, and it is actually a liberal type of self-interest. We may call it instrumental altruism. For example, social exchange theory believes altruism is an instrumental behavior to expect social recognition and rewards, and equity theory considers that altruism is generated when benefits outweigh costs.

Altruism can be inherited from within a family, or is more probably created by their common family belief. In an extended family, altruism may also be instrumental. Without any doubt, family is the best example of altruism and according to the Rotten Kid Theorem of Becker (1974), even though family members may be selfish, they are willing to help each other when their incentives are properly aligned. Becker (1981) further illustrated that altruism is commonly more efficient in a family, but is less so in the market environment.

Altruism within a family brings competitive advantages to that family's governance, and these advantages can be embodied as incentives. Farh and Cheng (2000) held the view that altruism allows every employed family member to be the owners of family business. Everyone acts on the belief that they have residual claim to corporate assets, so it inspires family members to pursue maximum profits for the family business. Based on principle-agent theory, this belief will cause family members to coordinate their own interests, and thefore reduce the transaction costs of concluding, supervising and implementing contracts.

Moreover, altruism strengthens the cohesive force of family businesses. Ying (2001) pointed out that it is relatively easy to adopt a family corporate structure, because it does not require many rules and institutions. Instead, it relies more on family members' mutual trust and recognition. This type of intimacy is built upon kinship ties and brings family members together. Such a powerful cohesive force also means that family members are loyal to family business and the family itself, therefore, it can efficiently prevent the negative impact of a manager's betrayal. Also, a family's informal contracts, formed by altruism, constitute different types of incentive and supervisory mechanisms.

Eshel et al. (1998) proposed that altruism boosts communication and cooperation, and reduces asymmetric information between family members, facilitating the implementation of informal contracts. The organizational structure of a family business tends to be simple, due to the mutual trust between family members. Due to sufficient and smooth communication, family businesses can avoid asymmetric information and prevent family members from shirking their responsibilities. This will help improve the quality of decision-making and business efficiency.

Nonetheless, altruism does not lead to a perfect agency, whose individuals do not care at all about personal interests and instead only for others' well-being. Altruism can trigger principal-agent problems in two aspects. The self-interest motive causes agents to not keep their goal consistent with organizational principles. Morck et al. (1988) referred to this as self-servicing, and managers of family members may escape penalties through their advantageous positions.

Leibenstein (1983) found that managers of family members may pursue short-term interests instead of long-term goals of a family business. They may try to avoid risks, and tend to invest in those projects that can improve their own image, rather than help the family business profit overall. They may also pursue maximum sales, regardless of profits, to fulfill their own desire. Mejia (2001) proposed that it is less likely for mangers of family members to get fired, compared with managers of non-family members.

Altruism itself may cause principal-agent problems, of which there are two circumstances: ①it may cause hold-up problems – Buchanan (1975) put forward the Samaritan's dilemma, where if a teacher increases the score of a complaining student, it is something easy to do in the short term, but in the long term the student's complaints may increase; ②it may not deliver good results due to limited rationality. For instance, parents' excessive love may spoil children, and they can blindly endure their child's misconduct. Altruism is actually a double-edged sword, and the principal-agent problem also exists within family when family members serve as both agents and principals.

(3) Nepotism

Two biologists from the University of Helsinki studied the behavior of ants and found that kinship ties come into play when ants hatch. They deduced that nepotism is a common social act, and current nepotism has gone beyond the boundary of kinship ties. Superiors, inferiors, friends and co-workers can all be possibly affected by nepotism, and this puts a family business in jeopardy.

Many managers of private enterprises are afraid to deal with an employee's misconduct because they are worried that the employee had been introduced into their enterprise by a powerful figure. They are concerned that they may annoy this powerful figure if they cannot handle it well, and as a consequence, fairness becomes an issue. When an enterprise is to recruit employees, some managerial staff may introduce their friends, family and fellow townsmen because they hope that they can gain favors when and if they need them. However, when an enterprise encounters difficulties, people will avoid taking responsibility for these problems.

Zheng (1995) argued that the issue of nepotism is mainly due to top managerial staff themselves, by not setting an example for their employees to follow, and when dealing with inferiors, not acting impartially. Moreover, the management of the enterprise may leave much to be desired by abusing their power, and not clarifying responsibilities. This is mainly the fault of top managerial staff, who adopt a doubtful attitude towards their employees and do not dare to decentralize their power. They always fear that their employees are incapable of handling things well on their own and this is contrary to our understanding of equity. However, for a family business, succession within family members has been commonly accepted.

Through the review of relevant research, we can find that family businesses may encounter some problems in the context of family culture and family involvement. Based on differential mode of association, altruism of family business may bring some advantages and disadvantages, but the resultant nepotism will affect a family business' sustainable and healthy development. A family business therefore, has to reflect on their corporate governance and interpersonal relationships. If a family business handles relational governance well, it can develop quickly, but if relational governance is overused, the family may face some difficulties.

2.3.4 Governance of Chinese Family Businesses

2.3.4.1 Familism vs. Professionalism

Li (1998) argued that the essence of Chinese economic organization is familism. Chinese economic familism is obvious in three aspects: nepotism, paternalistic leadership and family ownership. Nepotism has been discussed in the previous section, and paternalistic leadership can be understood as when kinship ties within a family business are converted into the ideal relationship between superiors and inferiors. Family ownership means that family should own and control corporate assets.

As a family business grows stronger, it is inevitable that professional managers will eventually be required to maintain the running of the business. Weber (1921) thought that the authority of professional managers is based on legal-rational authority, i.e. professional qualifications and rationality. Chandler (1987) proposed that professional managers are those who regard managing enterprises as their careers and have already been running enterprises of considerable sizes. He refers to this as “managerial capitalism”. Drucker (1971) argued that mangers are the most precious resources within an enterprise, and such resources depreciate the fastest and always require supplements. Max, Web and Chandler agree that professional managers should be non-family members and have no ownership over corporate assets, but Dyer (1989) argued that the criteria for non-family members are too strict. Family members can also be professionalized through training and upskilling, in order to boost the professionalization of a family business.

Zhao (2005) pointed out that professional managers should have professional knowledge and skills, professional ethics, and ethical regulation. They should gain income by running and managing modern enterprises with their professional knowledge and skills. Although China has discussed and attempted to bolster the professional manager market, most Chinese family businesses in transition have trouble cooperating with professional managers. Academics have not reached a consensus on the correlation between the development of a family business and the growth of professional managers (Chu & Wang, 2006).

Therefore, combined with the status quo of professional managers in Chinese family businesses, this thesis defines professional managers as those who are responsible for running and managing enterprises, and possess control power over corporate assets. Also, they are professionalized experts in running and managing enterprises. After being recruited in the professional manager market, they receive financial rewards through a salary or shareholder rights.

2.3.4.2 Contractual Governance vs. Relational Governance

Contractual governance is to govern a transaction with a formal contract. It includes all the formal systems governing transactions, such as the board of directors, the board of supervisors, the incentive scheme for employees and other relevant contracts. In market transactions, as the risks get higher, contracts become more important (Wu, 2007). Scholars commonly propose that the family system is an effective governance model during the startup phase. It can swiftly gather family capital and relational resource, and skillfully adapts to the changing external environment. However, as family businesses grow in scale, it will become necessary to introduce professional managers and set up standard contractual governance, so that the family can free itself from corporate management and engage more in motivating and supervising managers.

Cadbury (2000) proposed that when a family business goes beyond the point where the founder or a family partnership can manage the business effectively, it becomes necessary to set up a standardized corporate governance structure. This is a shift from relational governance to contractual governance, and certain drawbacks become apparent. In contractual governance, the moral hazard and adverse selections (caused by principal-agent problem) due to asymmetric information can be very serious.

The concept of relational governance comes from MacNeil's relational contract theory (1999). This theory analyzes different ways to conclude an agreement based on the characteristics of interpersonal transactions in social interactions. He believed that different ways to conclude an agreement matched different types of transactions, and finally summarize a principle of contract law. Most Chinese small and medium-sized enterprises are family businesses, and when choosing their governance model, they mainly implement a relational governance model. Under some constraints, this governance model is a rational choice for Chinese small-and-medium-sized or startup companies, because the scale of capital of these companies is small, and their businesses and managements are relatively simple. They will therefore have advantages if they implement relational governance.

The natural trust between family members tends to form loyal and trustworthy relationships, which simplifies the supervisory and incentive mechanisms. As a result, the transaction cost can be saved, and the organizational structure of the family business is relatively stable. A family leader's authority and differential mode of association push the family business to adjust and regulate itself, and the value of family management is deeply rooted in the family's culture. Since family itself is a unit, the family business will find it easy to cultivate teamwork spirit, which will benefit the business. Therefore, it is fully rational for Chinese small-and-medium-sized companies to implement a relational governance model, and this model should not be abandoned arbitrarily.

2.4 Agency Theory

Berle and Means (2005) mentioned that when businesses grow, the number of shareholders will also increase. Directors' shareholdings will become smaller, and owners may not have control power while managers may not have ownership. This generates a separation of ownership from control, and is accompanied by the principal-agent problem, which is caused by asymmetric information between the agent and principal. Chu (2002) noted that, asymmetric information exists in any social economic system, and the only difference lies in the extent of asymmetry and the way it exists.

Information asymmetry refers to the situation where a party knows better or more information than the other in a transaction. For example, professional managers know their capabilities and diligence very well, while shareholders may know little about them. Agents have their own information about their qualities, capabilities and behavior, but such information is unpredictable to principals. This hidden information is called ex ante information asymmetry. Additionally, agents have hidden actions because principals find it hard to predict their efforts, and the way agents fulfill the contract is uncertain. Agents may act in their own best interests, and since agents and principals are both pursuers of their own maximum utilities, they have different preferences and reasons for conflict. Owners normally target maximum profits for the shareholders, and that is how the principal-agent problem arises (Jensen & Meckling, 1976; Fama & Jensen, 1983).

Agency theory is the most important development within the last 20 years of contract theory. Jenson and Meckling (1976) defined the principal-agent relationship as a contractual relationship. Bound by a contract, principals employ agents to fulfill some services on behalf of them and hand over some decision-making power to the agents. Simply put, the principal-agent problem is the problem of agents not acting in the best interests of principals.

How does the problem of principal-agent arise? It is caused by information asymmetry, and was a core concept in information economics in the 1970s. Information economics explain asymmetric information as asymmetric distributions of information between corresponding economic parties. In contract theory, asymmetric information refers to the situation where one party knows more or better information than the other, and it is the information that the other party cannot confirm. The reason for this is that the cost involved is too high, which makes it economically unviable or irrational to confirm. Uncertainty, asymmetric information and transaction costs are the fundamental reasons for agency costs.

When there is asymmetric information, principals cannot predict the behavior of agents. Principals can only observe relevant variables, and these variables are decided by the action of agents and other external random factors. Principals, therefore, cannot use a contract to restrict agents, but an incentive compatibility constraint is useful. Principals need to design an incentive mechanism to motivate agents to act in the principals' best interests.

Agency costs, noted by Jenson and Meckling (1976), refer to the losses of interest to principals. Due to the information asymmetry and different pursuit of interests, it is uncertain whether agents will act in the best interests of the principals. This regards the profit levels realized by an optimal contract in the context of sufficient information being available as the criteria. More precisely, if we calculate the difference between the profits from perfect information and from asymmetric information, we end up with the agency costs. It is impossible to completely eradicate asymmetric information, and it is therefore also impossible to completely eliminate agency costs. We can only try to reduce agency costs.

The principal-agent problem can be categorized into two types, i.e. moral hazard and adverse selection, which originated from insurance. Moral hazard refers to opportunism after a contract, and is where agents cheat after signing a contract because it is impossible to observe and confirm some of their behavior. Adverse selection is opportunism before a contract, and is where agents have information about their worker costs or their valuation of a service, before signing a contract.

In terms of economics, a moral hazard can be defined in this way: when a person puts the interests of someone else at risk, in order to maximize his or her own utilities. Smith (1776: 86) realized the existence of moral hazard, but he did not name it. He noted that, "the interests of agents are never perfectly aligned with those of their principals, creating a persistent challenge to ethical standards." There are two reasons for the generation of a moral hazard: firstly, even though both parties know the information in a contract, they cannot ensure what happens after signing the contract; and secondly, there are costs involved in the negotiation, conclusion and fulfillment of the contract, which in reality, is impossible to avoid. These costs are an important reason for the occurrence of moral hazards.

Moral hazard refers to the costs brought by the hidden actions of agents to principals. Adverse selection refers to the market failure caused by information asymmetry, and may bring losses to principals, due to the agents' hidden actions. Akerlof (1970) analyzed adverse selection from the angle of modern economics, and in this sense, people apply the concept of adverse selection extensively to analyze different market transactions. These analyses emphasize information asymmetry, and highlight that under these conditions, the costs for principals to confirm whether agents act in the best interests of principals are very high. Sometimes, this may cause market inefficiency.

An easy way to tackle the principal-agent problem is to strengthen the supervisory mechanism and improve the incentive mechanism for agents. New institutional economics argues that modern corporations' efficiencies rest on whether they can design a set of effective supervisory and incentive mechanisms to regulate agents' behavior. These mechanisms should encourage agents to disclose their personal information and work harder. It is important to design incentive-compatibility, which is a mechanism that motivates agents to act in the best interests of principals while maximizing their own utilities.

Incentive-compatibility within the framework of agency theory is a cutting-edge research issue of modern corporate governance. Principals and agents have different pursuits of interests and asymmetric information, and the costs to supervise and regulate agents are high. Thus, unless principals can efficiently restrict agents, the decisions that agents make are not always optimal, and agents may not act in the best interests of principals. This thesis is going to address how to design an incentive mechanism to allow agents to achieve the best outcome for themselves by acting in the best interests of principals, without strict supervision.

2.5 Contract Theory

A contract is commonly known as an agreement, deal or protocol, and Article 1101 of the Napoleonic Code states that, “a contract is an agreement by which one or several persons bind themselves, towards one or several others, to transfer, to do or not to do something.” According to this explanation, an agreement refers to a bilateral consensus, and both parties are bound by the contract.

The concept of a contract in modern economics is more extensive than in law. It not only includes legal contracts but also some acquiescent contracts. In terms of the concept of a contract in modern economics, all market transactions (including long-term and short-term, and explicit and implicit ones) are considered contractual relationships and viewed as components of economic analysis. Modern enterprise is a community of shared interests, and members of this community are bound together by implicit or explicit contracts (law, agreement, promise, culture, or habitual customs). These members are owners of different parties and they seek to get their parties’ rewards.

The concepts of neoclassical, classical and modern contracts are all different. Classical contract theory is greatly influenced by the social contract theory created by Hobbes, Locke, Rousseau and Montesquieu. It is guided by Locke's thoughts on inviolate freedom under law and dominated by the theory of perfect competition. Classical contract theory has main three characteristics: (1) the contract is the course of action chosen by the free will of different parties in transactions and the contract they sign cannot be interfered with by any external force; (2) the contract is discrete; (3) the contract is instantaneous. Classical contract theory is in agreement with the formation, development and maturation of classical economics, and it is not without its shortcomings.

There are several components to neoclassical contract theory. (1) The abstract quality of the contract. In essence, this type of contract eliminates the moral factors of the classical contract and is a market product. This is in agreement with Darwin's theory of evolution, and after the different parties involved in the transaction explore and constantly adjust, they will conclude with a contract. (2) The completeness of the contract, where a neoclassical contract is concluded in an orderly situation, without external interference. (3) The uncertainty of the contract. As noted by McNeil (1999), a long-term neoclassical contract has two common characteristics: it allows room for some unforeseeable circumstances, and is relatively flexible.

Modern contract theory was produced by modern mainstream economics, and it builds a series of models, formulas and types, using a set of key concepts, scopes and analytical methods. Modern contract theory divides a contract into complete and incomplete contracts and analyzes how reality is different from the assumption of a complete contract. Economics has gained significant advancements, and in terms of a complete contract, both parties can foresee potential incidents and willingly obey the terms of contract. When arguments on the terms of a contract arise, a third party, such as a court of law, can impose compulsory execution. It is ideal to assume that a contract is complete, which means that all potential events and circumstances have been accounted for.

Incomplete contract theory was developed by Grossman and Hart (1986) and Hart and Moore (1990). An incomplete contract exists when due to one's limited rationality, external uncertainty, or information asymmetry, both parties cannot observe and foresee everything. As a consequence, the contract terms are incomplete, and it is necessary to design different mechanisms to deal with such incompleteness and some of the resultant issues. On the assumption of an incomplete contract, this theory aims to optimize the distribution of property rights or residual control, and this framework is the most important tool to analyze how the distribution of control influences the incentive mechanism and information in terms of corporate governance structure.

There are two reasons for the occurrence of an incomplete contract. Due to limited rationality, it is completely impossible for the contract to anticipate all possible events and the contract terms may not state how to deal with these events. Also, there are transaction costs, which for a long-term contract, can involve the following items: the cost of dealing with unforeseeable events; the cost of making decisions and reaching an agreement; the cost of making up a contract; and the cost of fulfilling contract.

Incentive contract is an important field of modern contract theory. An incentive contract is a mechanism through which principals induce agents to act in their best interests. In a competitive environment, an employer must try to encourage an employee to work at his best, which will reduce corporate costs, and to formulate an incentive contract means that employers need to pay a better salary to employees with higher efficiency. With an incentive contract, employers can recruit relatively competent employees.

Modern contract theory also discusses whether there is such thing as an optimal contract. If there is, then what is it? In terms of modern contract theory, an optimal contract can exist, but under some constraints, and is still a sub-optimal contract. This type of contract must satisfy the following conditions: agents and principals share risks together; principals are able to use all the possible information, and can construct a probability distribution by Bayesian statistics to design a contract; and finally, a reward structure should adapt to different information. Principals and agents should pay attention to uncertainties and try to avoid risks.

2.6 The Three Circle Model Family Business

Family businesses are fundamentally different from widely held public companies in corporate governance. This difference derives primarily from the discrete nature of their ownership, where family ownership concentrates on control and allows greater agency in governance. Family can play many roles across the business system, often facilitating and simplifying the decision-making process. This can both lower the costs of governance and generate unconventional, but strategically-advantageous decisions. In addition, the governance of family businesses often evolves, reflecting different developmental stages in the family business and family itself. The need to change governance structure over time is both an opportunity and a challenge for family businesses, and adopting different governance structures at different stages is one of the keys to maintain the performance of a family business (Ward, 2004).

The Three Circle Model is generally accepted as the standard model for family businesses and it includes the family, the business and ownership as the three main circle components (Gersick, 1998). Each circle has a governance structure and plan: the family council governs the family and prepares the family plan, while the management team prepares the succession plan and business development plan. The board of directors governs owners or shareholders, and takes charge of the strategic, sustainable development, contingency and succession plans. Too often, the circles are intertwined with each other.

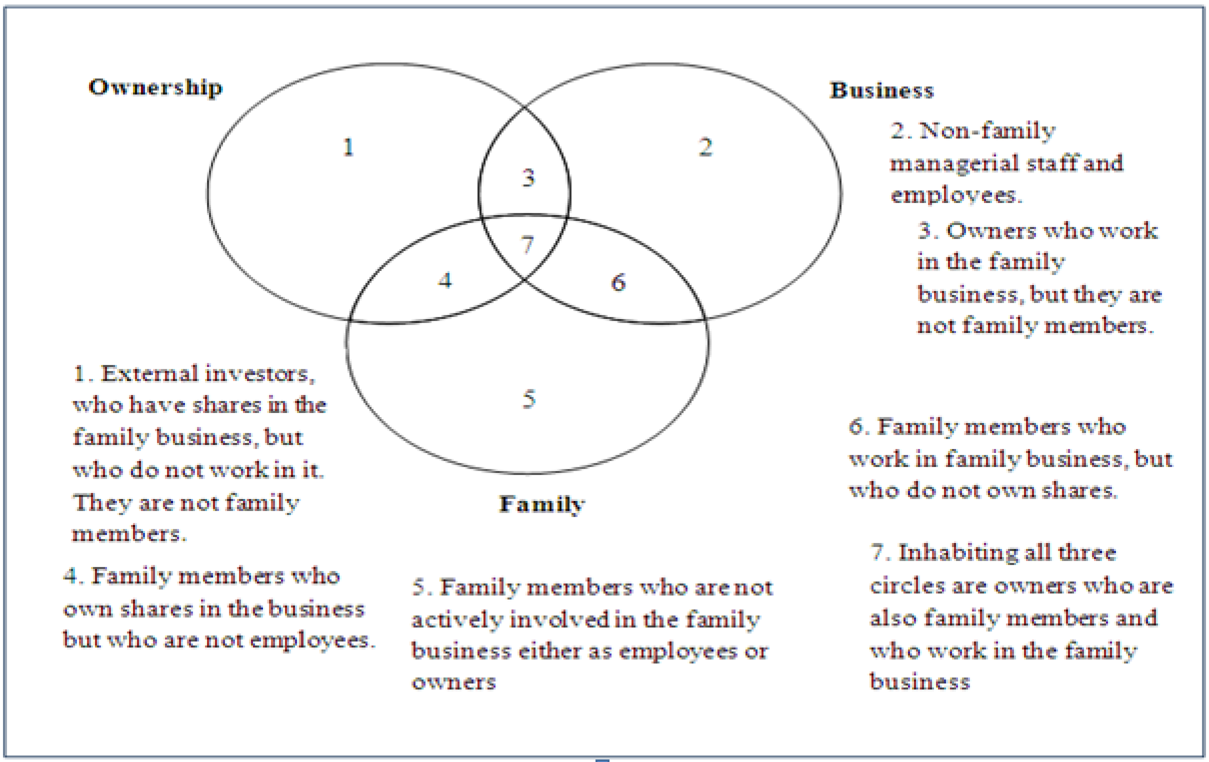

Figure 2-1 The three circle model of family business

Source: Adopted from R. Tagiuri and John A. Davis (1982), Bivalent Attributes of the Family Frim, Reprinted (1996) in the Classics section of Family Business Review, Volume IX, Number 2, Summer, 199–208.

In these three circles, there are seven identities, some of which can have successors in the future. People may change their positions within a business during their lifetimes, but membership of a family never changes, even as children become adults.

Different circles require different forms of governance, and this poses a challenge to family businesses. For the circle of family, the best governance model is a family council, which can govern all the family members, and aims to recognize and discuss how to deal with potential problems.

For the circle of business, the management team comes into play. Managers make up the management team, and include family members and non-family members. If managers of non-family members cannot participate in decision-making processes, they may leave the business and further reduce the quality of management. It is therefore important to plan for key managerial positions (Gersick, 1998).

For the circle of ownership, the governance model is the board of directors. The board of directors supervises corporate performance and provides the CEO with suggestions regarding dividends and reinvestment. Most importantly, the board of directors can unify shareholders and keep family members informed of corporate performance.

2.7 Familiness

Habbershon and Williams (1999) regarded familiness as the idiosyncratic resources and capabilities of a family business. Familiness mirrors the systematic relationships between families, family members and family businesses, and is generated by the interaction between family ownership, family involvement in management and the intention of generational succession (Chrisman et al., 2005). In essence, it shows the unique and diversified resources owned by a family business. We may refer to these resources as family resources, and they include leadership, culture, social network, capital, business governance, strategy and knowledge.

Table 2-2 Relevant research on familiness

Scholar	Perspective	Research result
Craig and Moores (2005)	Evolutionary theory	Familiness is the core essence of a family business and combines the concept of familiness with a strategic balanced scorecard.
Ensley and Pearson (2005)	Top management team and social capital theory	A family business' group dynamics refer to the interactions amongst the top management team. Familiness and the dynamics of the business group are in a positive correlation.
Hayton (2006)	Resource-based view of family business and systems theory	Familism determines whether human resources practices are successful or not within family or non-family business.
Lester and Canella (2006)	Social capital theory	Familism between organizations mirrors the extensive correlations that build and support family businesses.
Ram and Holliday (1993)	Sociology of the family	Familism represents a family's social relationships, and flexibility and constraints within the workplace mirror this.
Tokarczyk et al. (2007)	Resource-based view of family businesses	A qualitative study on how familiness helps to produce an effective market position, which results in a competitive advantage.

Source: Sorted out by author

The concept of familiness has been widely accepted, and is described as a unique set of resources for strategic advantage. This unique set of resources is handled by the family business, and arises out of the interactions between the family system as a whole, individual family members, and the business itself (Habbershon & Williams, 1999).

Chrisman et al. (2003) described familiness as the resources and capabilities about family involvement and interaction. Research on familiness is summarized in Table 2-2.

2.8 Dual Governance in Family Businesses

2.8.1 Contractual Governance

Contractual governance refers to the governing of a transaction through formal contracts.

For example, these are structures like board meetings and a board of supervisors, or other systems used to encourage colleagues and contracts to form links with corporations and stakeholders.

The risk is in the requirements for contractual governance in the market transactions. Owing to the investments in specific purposes and asymmetric information, professional managers probably make use of their operational and managerial power in pursuit of personal interests more than the businesses' overall interests. In order to lower the transactional risks between family businesses and professional managers, the family business will surely enforce contractual governance as the power to regulate the enterprise and professional managers.

The formal definition of contractual governance is to safeguard the exchange between a buyer and a seller as they conduct joint RD activities. The concept thus refers to the contracts (explicit, formal and written collaboration contracts) and IPRs used for managing buyer-supplier relationships. IPRs (patents, copyrights, trademarks and trade secrets) are viewed as a part of contractual governance, since their existence (potentially) provides protection against opportunism where innovations are concerned.

The importance of contracts is emphasized in the literature on the supply-chain and technology management in relation to the knowledge transfer between buyers and sellers. Successful supplier integration efforts cannot be entered into without a detailed agreement on project schedules, engineering capability, cost drivers, pricing and other business variables being included in the contract. Furthermore, non-disclosure and confidentiality clauses provide the ground rules for knowledge exchange. Contracting thus facilitates commitment and task allocation, which in turn, are relevant for successful conflict management.

While a certain amount of conflict may be beneficial for innovation, too much of it is likely to create problems. As Cullen and Hickman (1999) noted, classical contracts are drafted with the presumption that, “the parties are at arms’ length, rather than collaborating on the basis of close working relations”. Thus, the use of such contracts themselves may create conflicts by including terms that assume from the start that parties will not perform their obligations.

In a similar fashion, IPRs influence the balance between knowledge protection and sharing; if companies are confident about not losing their core knowledge (e.g. if they have strong patent protection) they are likely to be more willing to engage in collaboration and discussion. IPR protection of existing intellectual property is therefore a potential enabling factor for knowledge sharing. Furthermore, IPRs may make knowledge assets more manageable and transferable, for example, in terms of licensing or in managing the allocation of knowledge during the later phases of collaboration. Nevertheless, it is crucial for the parties involved in collaboration to agree on how knowledge is utilized, particularly if it is not or cannot be covered by IPRs. Without contracts (or adequate relational governance) the risk of abuse and opportunism increases, which may lead to collaboration failure and leave the knowledge-sharing firm at a disadvantage.

However, the problem is that the inherent uncertainty associated with the contracting situation makes ex ante contracting challenging. It is especially difficult to specify a complete contract in new product development projects. For instance, if one firm ends up with ownership of the innovation but still needs the complementary assets from its partners in order to commercialize the innovation, all parties will probably win. Conversely, if just one firm walks out with the exclusive rights and perhaps even takes the innovation to its partner's competitors, the situation drastically changes.

Indeed, the very prospect of such an outcome could notably weaken the effectiveness of the collaboration, and it is only the risk of losing in the endgame that may limit innovation. IPRs have undeniable protective benefits but are not necessarily effective in motivating collaborative RD. Moreover, no contract can account for every potential issue or contingency. Because property rights and other formal protection are costly and may not always be efficient, firms need to use an array of organizational arrangements to protect their valuable knowledge. Thus, given the limitations and rigidity of contractual governance, relational governance mechanisms are also needed.

Researchers commonly put forward that relational governance is usually a very efficient governance model in the startup phase. It can rapidly accumulate family resources and adapt to environmental uncertainties, however, when family resources can no longer satisfy the development of a family business, it becomes necessary to introduce professional managers and set up a standard contractual governance structure. Family members may free themselves from the busy management of the company, and engage in the motivating and supervising of managerial staff. Cadbury (2000) put forward that when a family business goes beyond the stage where the founders and partners can efficiently run the business, it becomes necessary to establish a standard governance model.

The board of directors is the main institution of contractual governance, and is regarded as the top internal control institution in contractual theory. It has two important functions, namely, supervision and consultancy. Although the board of directors may be small in scale and its control may be limited, more family businesses are beginning to establish a board of directors. In the Chinese context, it is rational to regard the board of directors as the main institution of contractual governance.

Nonetheless, the contractual governance model has certain drawbacks, and due to asymmetric information, the Principal-agent problem may bring about moral hazards and adverse selections.

2.8.2 Relational Governance

The concept of relational governance originates from the relational contract theory of American legislator, Macneil (1999). He believed that governance is made up of contractual governance and relational governance, and this theory analyzed different ways of concluding contracts and argued that different contracts can match different types of transactions.

A multitude of empirical research showed that relational governance links with trust (Zaheer & Venkatraman, 1995). Governance of family businesses also links with trust, and Li (2005) revealed how trust affects a family business' decision to hire professional managers. Entrepreneurs of Chinese family businesses even put forward that trust is an important way of governance.

Most Chinese small-and-medium-sized enterprises exist as family businesses, which implement relational governance. This is a rational selection under some constraints, and since small-and-medium-sized enterprises and startups are small in capital scale, their business and management are relatively simple. The natural trust between family members tends to give rise to loyalty and this simplifies the supervisory and incentive mechanisms, and this natural trust saves transaction costs. Also, a family patriarch's authority and differential mode of association from self-adaptability of a family business in terms of division of labor and cooperation, stabilizes the corporate organizational structure and organizational capability. Additionally, family management is deeply rooted in family culture, and as the family itself is a team, it is easy to cultivate a team spirit if we implement family management within a family business. Thus, it is very rational that most Chinese family businesses still implement relational governance.

Relational governance of Chinese family businesses is comprised of two factors: structural rules and relational rules. Structural rules are centralization, extraordinary knowledge and family involvement, and relational rules are trust, socialization and reliability. Trust, socialization and family involvement belong to the relational governance of managerial staff while reliability, centralization and extraordinary knowledge belong to the relational governance that family business owners apply to managerial staff (Li et al., 2005).

Relational governance is to govern transactions through relational norms. Relational norms refer to some social processes and regulations which exist because of the counterparts' relations in a transaction. Contracts can be explained as the exchange of relations among different people, relational governance is the enforcement of obligations, promises, and expectations through social processes that promote norms of flexibility, solidarity, and information exchange. Flexibility facilitates adaptation to unforeseeable events, which results in cooperation, and solidarity promotes a bilateral approach to problem solving, creating a commitment to joint action, which results in trust amongst the exchanging parties. Information exchange facilitates problem sharing and adaptation because parties are willing to share private information with one another, including short-term and long-term goals and plans. Every exchange has two features: contractual and relational. In fact, there is much study on relational contracts' governance that take assets' specificity put forward in Game Theory and relational norms into consideration. Relational contracts' governance consists of structure and process.

The relational structure dimension is represented as a vertical semi-integration while processes underlined in the relationship are presented as joint actions. Assets' specificity, uncertainty and mutual-beneficial investments, as well as trust, have all played important roles as engines affecting the structures and processes of a relational contracts' governance. In spite of experiential studies being insufficient at supporting these assumptions, it is innovative to have equal emphasis on all these factors and this has had profound influences on relational contracts' research. Joint actions' extents (including joint plans and resolutions) of strategically allied enterprises are affected by transactional forms, investments in the labor capital in the transactions, the businesses' network density, and the trust between organizations and people. These four factors have influence on the joint plans, while only personal trust and trust between organizations, together affect the extent of problems' joint resolutions.

Relational contracting has been used to describe mechanisms that utilize non-legal sanctions that result in decreased opportunism along with improved effectiveness. Indeed, under the label of the relational review, it is suggested that this governance mechanism has a value-adding function. They use the concept of relational governance to describe the non-contractual relational mechanisms (trust in its various forms and relational–cooperative–norms) that affect the exchange relationship between buyer and supplier. Trust and norms are multilevel concepts that apply to both the interpersonal and inter-organizational level of analysis. Commercialization success in a product and process improvement require strong relationships. In order to build such relationships, it is necessary to initiate both interpersonal and inter-organizational relational governance to produce value.

Trust and norms are clearly relevant in collaborative RD and are undoubtedly needed from the very beginning. Norms determine the appropriate behavioral guidelines fostering social obligation and control in the exchange relationship. Furthermore, buyers and suppliers have much to gain by working together toward shared goals in an environment of mutual trust and communication. Trust, in its simplest form, is the actor's willingness to be vulnerable, and is conceptualized here as the expectation of the other party's competence and goodwill. The relevant competence (technological knowledge, skills and know-how) is a necessary antecedent of trust and the collaborative endeavor to develop complementary technological knowledge. Signs of goodwill (moral responsibility and positive intentions) are also necessary for the trusting party to accept risk, and trust is generally considered to be a key mechanism enhancing collaborative communication, knowledge sharing, the implementation of other people's ideas and commitments, and successful conflict management. Collaborative communication strategies may also strengthen trust, particularly when the communication is not restricted by excessive doubts, and it is easier to discuss and achieve the collaboration goals. Trust and norms also protect the participants' knowledge assets because they decrease the probability of opportunistic behavior. Parties in a trusting relationship are also likely to take care of each other and monitor each other's rights.

However, excessive, generalized or naive trust may backfire and firms need to be prepared for situations when trust is broken. Someone who decides to trust someone else based on limited information about the future is always vulnerable to betrayal, and there is a clear distinction between being trusting and being naive.

2.8.3 Interaction between Contractual and Relational Governance

It appears that contractual and relational governance mechanisms should be combined to support successful outcomes from collaborative activities. This cannot be successfully done unless there is further research into the interplay of the two mechanisms during the different phases of the collaboration. Buyer-supplier RD into three distinct phases: exploration, development, and finalization.

The exploration phase is the period of time before there is actual RD activity. The value-creation potential is not yet clear, and the participants are discussing and exploring a problem that could be collaboratively solved. In the development phase, both buyer and supplier perceive the potential for value creation, and this provides the impetus for the collaborative development of solutions to a given problem. They engage in testing and small-scale piloting activities to verify the validity of a collaboration. The finalization phase is when the results of the collaboration start to show, and the commercial application and value capture opportunities are recognized (even though not necessarily exploited). These phases are an abstraction from reality, but believed that they help to identify where contractual and relational governance mechanisms are most needed, and the dynamics between them.

Dynamic relationships between governance mechanisms emerge in various ways, especially when the project phases (and the time horizon of the relationship in general) are taken into consideration. First, if trust and relational norms are present in a relationship the parties have less need to refer to IPRs and contracts. This may be beneficial in the exploration phase of a joint RD project, which is characterized by high level of uncertainty. Dealing with intellectual property issues is typically challenging at this point because the partners may not know their future goals. In such situations, relational governance may help to decrease the risks related to transaction costs, enable conflict resolution, and facilitate adaptation to change.

Relational capital existing between partners can also minimize the likelihood that a partner will engage in opportunistic behavior to absorb or steal knowledge that is core or proprietary to another partner. The previous relationship history between the partners is likely to promote relational governance – since continuous collaboration strengthens reciprocity and social ties. This might have positive effects in that previous experience with the same partner has been found to improve the performance of the current alliance.

It is likely that both types of governance are required in the development phase. A comprehensive contractual and IPR system appears to promote stability and predictability, and therefore enables safe knowledge sharing. This in turn, makes building trust in the relationships easier, but on the other hand, trust and norms help in dealing with situations not covered by contractual mechanisms.

The role of contractual governance is likely to be strongest in the finalization phase in which the value-enhancing potential becomes evident. Contracts and IPRs ensure the division of outcomes in terms of knowledge and benefits, and thus their role is likely to increase when there are outcomes to be divided. Neglecting this form of governance may be quite harmful: without clear rules, it is easy for the rights of the parties to be contravened, putting trust and the whole endeavor in jeopardy.

Contractual governance and relational governance can improve the governance effect of public family businesses, and these two governance models are not totally irrelevant. In day-to-day governance, due to the incompleteness of a contract, contractual governance cannot handle all the questions occurring in a transaction. Relational governance can supplement such incompleteness, and thus relational governance and contractual governance are complementary to each other. They can jointly shape the governance structure via the dual governance model.

The dual governance model of family businesses includes relational governance and contractual governance. In a general governance model, people pay more attention to the function of formal governance or contractual governance, and neglect relational governance. Family businesses think highly of contractual governance because the interpersonal relationships of family members influence the entire enterprise, and family businesses commonly carry out family management. Family management is in fact oriented by contractual governance, and even for some big family businesses, they may tend to pay more attention to relational governance.

Different family businesses may choose different governance models, and a family business may choose different governance models at different stages in its life cycle. In the startup phase, owners follow the preference order of family members, pan-family members, and non-family members to pass on their control, while in the meantime a relational governance model is applied.

Some enterprises have built up a formal governance model, but it does not always perform its role well. When family business enters into maturity/formalization, its capital scale and market scale reach an unprecedented height. At this point, it is very likely that relational governance does not fit in with the development of a family business, and it requires suitable changes to boost the internal governance structure. It becomes necessary to strengthen contractual governance or implement a contractual governance model, and generally, contractual governance becomes more important when a family business grows stronger.

Li et al. (2005) argued that due to the uniqueness of a family business, its governance model normally includes relational governance and contractual governance. The application of these two governances by family business is not necessarily even. Normally, one is used more than the other, and these two governance models may overlap and generate weak relational governance and weak contractual governance, weak relational governance and strong contractual governance, strong relational governance and strong contractual governance, and strong relational and strong contractual governance.

In family businesses, the choice of governance model is affected by multiple factors, such as environmental intervention, capital scale, leadership values and ownership structure. When there is more competition and more environmental uncertainties, family businesses may strengthen both governance models, but when a family business expands in scale, it requires contractual governance. A family business is more likely to choose a relational governance model because of family values. When family members own more shares, it is more likely that the family business will adopt a relational governance model, while a governance model directly affects the economic performance. Mustakallio et al. (2002) held the view that relational governance and contractual governance are mutually complementary and have an effect on corporate performance. Only with strong relational governance and strong contractual governance can family businesses perform the best in terms of economic performance. For the same reason, Ma et al. (2009) argue that family businesses should adopt the dual governance model.

2.9 Comments and Reference

After reviewing the above literature, we may conclude that the governance of family business mainly targets two types of people: one type is people with a “family background”, including family members and pan-family members; the other type is professional managers and employees, whose relationships with family businesses are based on contracts. With the characteristics of these two types of people, we identify two main governance models for family businesses: relational governance and contractual governance.

A family business has the organizational characteristics of weak organizations with strong linkages. Based on these organizational characteristics, familism and family culture, we can conclude that family businesses apply more relational governance to family members. In contrast, we can conclude that family businesses exercise more contractual governance to non-family members, based on contract theory and agency theory.

However, there is no definitive line between these two governance models. For example, family businesses can apply relational governance to professional managers on the basis of contractual governance, and likewise, family members need some contractual governance in addition to relational governance.

This is the key issue of this thesis, and by analyzing the main issues of the governance structure in Chinese family businesses from the perspective of modern contract theory, we introduce the concept of relational governance while preserving contractual governance to establish a dual governance model that combines relational governance with contractual governance. This thesis also proposes that contractual and relational governance should be integrated differently during different phases of a family business, and aims to explore concrete measures to optimize the governance structure of Chinese family businesses, by using the case study on Bin Valley Group.

Chapter 3: Research Methods and Design

The main research method is a case study, and methods for collecting data, including collection of first and second-hand data are introduced. First-hand data is collected through in-depth conversations and interviews with target enterprises, while second-hand data is collected by sourcing information from online resources, books and other open and accessible information. Data is collected on the target companies, industries and macro information.

3.1 Research Methods

3.1.1 Case Study

Research methods in the social sciences include case studies, experiments, investigations, documentation and analyses of files. Each method has its own pros and cons, and the selection of which method to use depends on three factors: the category of the research issue; the researcher's control over the objects; and whether the focus is on current issues rather than historical phenomena.

Generally, when "how" or "why" questions are raised, researchers can barely control the incidents or research focusses on modern phenomena, and we should therefore give priority to a case study. It is challenging to apply a case study in research on the social sciences, but in the 14 research methods defined by Galliers and Sutherland (1991), the case study is the most extensively used.

A case study generally conducts detailed research on an object, individual or organization, and based on analytical philosophy, researchers can integrate empirical or theoretical models within it. Researchers can conduct profound and comprehensive studies by collecting data and using appropriate research methods. As a strategy of research, a case study can be used for many occasions, which helps us to study some phenomena relevant to individuals, groups, organizations, politics and society.

The case study is a common research strategy, which is widely used in psychology, sociology (Gilgun, 1994), politics, social work and commerce (Ghauri & Gronhanug, 2002), and community planning (Yin, 2004). Case studies are also used in economics-related fields, where for example, a city or region may apply a case study to conduct relevant surveys on some industries or its economic structure. Under all these circumstances, a case study is necessary in order to understand complex social phenomena, and it allows investigators to preserve the comprehensive and meaningful characteristics of real-life incidents, such as the life cycles of individual, organizational and managerial processes, changes in surroundings, and the international relations and maturity of an industry.

The process of a case study is shown in Figure 3-1:

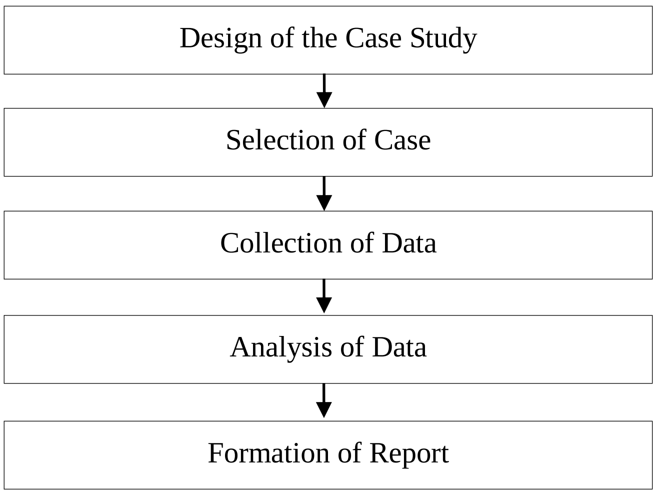

Figure 3-1 Process of case study

Source: Sorted out by author

There are four main indicators used to evaluate the design of a case study: effectiveness, internal validity, external validity and reliability. Through a case study, researchers can form systematic ideas, and by conducting profound research on the target, researchers can clearly learn about the cause-and-effect relationships of incidents.

The case study is a qualitative research method, which refers to the profound, detailed and long-term study on social phenomena by field experience, open conversation, participant observation, literature review and case study, within natural surroundings. Summarization is the main analytical method, and it collects first-hand information at a certain place. Researchers then try to understand participants' behaviors and perspectives on the target issue, when are then used to identify assumptions and develop theories. The conclusions they draw are then tested by falsification and other relevant test methods. The researchers themselves are the main research instruments and their backgrounds and relationships with research participants need to be taken into account. The process used in the research is an indispensable part of and contributor to the research conclusion, and it requires detailed accounting and reporting (Chen, 1996).

Specifically, qualitative research is a study on a selection of small-scale samples, and this research does not necessarily display statistical significance or sense. However, with researchers' experience, sensitivity and related technologies, researchers can efficiently observe research targets' behavior and motives, as well as their potential influences.

Qualitative research is a mechanism that provides an angle to study the internal law of something, according to its nature and contradictory movement, and it is built upon universally-acknowledged theorems, which are a set of deductive logical tools and a large amount of historical data. Qualitative research is based on theories and experiences, and aims to identify the main characteristics of the phenomena under scrutiny, while temporarily leaving out any quantitative differences.

Qualitative research is classified into two different levels: (1) pure qualitative research, which is completely without or lacking in quantitative analysis, and tends to lead to conclusive and argumentative results; and (2) qualitative research built upon quantitative analysis. In actuality, qualitative and quantitative research often work together, and before quantitative research, researchers often need to decide the nature of their research through qualitative research. In quantitative research, researchers use qualitative research to decide where qualitative change occurs and why this qualitative change happens.

3.1.2 Selection of a Single Case

A family business is usually a closed system, and outsiders find it hard to obtain the real information inside it. It needs to protect its own family interests, and it is therefore better to begin with a specific typical family business. In this thesis, we adopt a qualitative case study to understand the dual governance model of Chinese family businesses by analyzing the development of Bin Valley Group. The goal of this thesis is to design a well-formulated case study, collect and showcase objectively-analyzed data, and conduct how and why exploratory research on the governance model of Bin Valley Group.

This thesis adopts the research method of a single case and selects a small-and-medium-sized family business (Bin Valley Group) as the study object. We analyze its developmental path to an individually-owned enterprise, from the various stages of a home business, pure family business, and pan-family business. Its organizational structure, family relations, and the connection between performance and salary are analyzed to identify its characteristics and rules of family management, and summarize the governance model that fits this kind of family business, which can serve as a reference for other Chinese family businesses.

Bin Valley Group is a typical family business, and based on the definition of a family business presented in Chapter 2, Bin Valley Group is founded upon the kinship ties of the founder Mr. Bin and his marriage to Xie Yan. The ownership of this enterprise is completely in the hands of this couple, and thirty-nine family members are involved in the operation and management of the business, including Mr. Bin and Xie Yan. Currently, Bin Valley Group is still a family business run by the first generation, but Mr. Bin and Xie Yan are mentally ready to hand over ownership and control within the family.

3.2 Research Design: Data Collection

There are many sources of data for case study, such as documents, archival records, interviews, direct observations, participant observations and physical artifacts. Each source has its own pros and cons, and the methods most appropriate to generate data for this case study were selected as first-hand data and second-hand data.

3.2.1 First-hand Data

This thesis collects first-hand data through questionnaires, in-depth interviews and observations.

(1) In-depth interviews

One of the most important sources of information in a case study is in-depth interviews, which are easy to use to trigger participants' curiosity. An interview is a guiding conversation, and not a structured consultation. In other words, during in-depth interviews of case studies, the interviewer seeks to maintain consistency across interviews, but is likely to allow some flexibility, rather than staying completely rigid (Rubin, 1995).

For this thesis, the interviewees of the case study include the top managerial staff of Bin Valley Group (principals), medium and top managerial staff and, a portion of the family members (this also includes people who have left Bin Valley Group). The interview content varies according to different the interviewees, but is mainly centered on the corporate developmental strategy, the relationship between family members and professional managers, the knowledge of the corporate structure, the need for an incentive mechanism, and the control of information.

The questions were unstructured and interviews were conducted by Bin Valley Group's internal research group, which is comprised of the Director of Planning Department, Director of Human Resources, Manager of Human Resources and Administration, and Secretary of President. The Director of Planning Department coordinates and organizes the whole of internal research, designs questionnaires together with the Manager of Human Resources and Administration, and conducts the in-depth interviews. Apart from designing questionnaires, the Manager of Human Resources and Administration is mainly responsible for handing out, organizing, filing, collecting and statistically analyzing the questionnaires. The Secretary of President takes charge in collecting second-hand data and assists the Director of Planning Department in the in-depth interviews, which last from May to August, 2014. The profile of the interviews is shown in Table 3-1.

Table 3-1 Interviews about Governance of Family Businesses in Bin Valley Group

Interviewee	Position	Relationship with the owner	Date of Interview / Duration of Interview	Content
Mr. Bin	Chief Director (Owner/Founder)	Owner himself	1. Jun 6, 2014 / 3.5 hours	1. Company's strategic developmental momentum, choice of governance structure, attitude towards the team of professional managers and family members, and how to improve the governance structure.
			2. Aug 26, 2014 / 3 hours	2. Family history, personal efforts of success, reflection on strategy and internal governance problem.
Xie Yan	Director	Family member (Owner's wife)	Aug 1, 2014 / 2.5 hours	Company's strategic developmental momentum, choice of governance structure, the weighting between the rights of decision-making and control, attitude towards the team of professional managers and family members and how to improve governance structure.
Bin Gang	Former Standing Deputy Executive Manager of Engineering Business Segment	Family member (Owner's brother)	Aug 10, 2014 / 1 hour	Company's history, company's strategic developmental momentum, attitude towards the team of professional managers and family members, comments on the company's managerial system and advice to the owner.
Jiang Houliang	General Manager of Technology Business Segment	Family member (Owner's uncle)	Jun 10, 2014 / 1 hours	Company's prospects, orientation of Technology Business Segment, owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.
Kang Shizhong	CFO	Non family member	May 17, 2014 / 2 hours	Company's prospects, restrictive factors of strategic development, managerial efficiency, the functional orientation of the Finance Department, and attitude towards

				the team of professional managers, and the relationship with family members.
Tang Kai	Assistant of President	Pan-famil y member (Schoolm ate)	May 25, 2014 / 2 hours	Company's prospects, restrictive factors of strategic development, managerial efficiency, functional orientation of the President Office, owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.
Liu Bin	Manager of Human Resources and Administration	Non-famil y member	June 5, 2014 / 2 hours	Company's prospects, restrictive factors of strategic development, managerial efficiency, advice for the Department of Human Resources and Administration , owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.
Li Xiaohong	General Manager of Engineering Business Segment	Non-famil y member	Jun 15, 2014 / 2.5 hours	Company's prospects, orientation of the Engineering Business Segment, owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.
Li Yaping	Deputy Manager of Engineering Business Segment	Non-famil y member	Jun 20, 2014 / 2 hours	Company's prospects, orientation of the Engineering Business Segment, owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.
Tang Xiaoyun	Manager of Marketing Department of Engineering Business Segment	Non-famil y member	Jun 20, 2014 / 2 hours	Company's prospects, orientation of the Engineering Business Segment, owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.
Yao Chengyun	Deputy Manager of Commerce and Trade Business Segment	Non-famil y member	Jun 24, 2014 / 1.5 hours	Company's prospects, orientation of the Commerce and Trade Business Segment, owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.

Yang Zhen	Deputy Manager of Culture and Tourism Business Segment	Non-family member	Jun 30, 2014 / 1.5 hours	Company's prospects, orientation of the Culture and Tourism Business Segment, owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.
Huang Li	Manager of Procurement Department of Culture and Tourism Business Segment	Family member (Wife of owner's brother-in-law)	Jun 30, 2014 / 1.5 hours	Company's prospects, orientation of Culture and Tourism Business Segment, owners' trust and authorization, and attitude towards the team of professional managers and relationship with family members.
Xiao Weimin	Former General Manager of Engineering Business Segment	Non-family member	Aug 10, 2014 / 1.5 hours	Company's prospects, orientation of Culture and Tourism Business Segment, attitude towards the team of professional managers and relationship with family members, comments on company's managerial system and advice to the owners.

Source: Sorted out by author

(2) Questionnaire

When designing the questionnaires about the governance of Bin Valley Group, we drew on the questionnaire template of Alliance PKU Management Consultants Ltd. At the same time, we took into account the status quo of Bin Valley Group, and designed variations of the questionnaires based on the different types of staff, namely: managerial staff of family members, managerial staff of non-family members, ordinary staff of family members and non-family members.

Since March of 2014, we have handed out 232 questionnaires to the above four types of staff and had 227 responses returned, 225 of which were valid. Table 3-2 shows the distribution of the questionnaires against the different types of staff.

Table 3-2 Distribution of questionnaires to the different types of staff

Receivers of questionnaires	Pieces	Proportion	Number of questions
Family members:	39	16.8%	
Managerial staff	16	41%	13
Ordinary Staff	23	59%	13
Non-family members:	193	83.2%	
Managerial staff	25	13%	13
Ordinary Staff	168	87%	13
Total	232	100	

Source: Sorted out by author

3.2.2 Second-hand Data

In contrast from first-hand data, second-hand data refers to information selected out of the relevant literature and interpreted by research groups in relation to their own interests. Second-hand data generally includes data collected by other researchers, and investigations conducted by research institutions and governmental organizations. In management research, the use of second-hand data is common.

Second-hand data tend to accompany massive amounts of examples and information, which are suited for long-term data analysis. Additionally, second-hand data is relatively objective and strongly persuasive (Chen, 2008). The second-hand data of this thesis come from external open sources of information, and second-hand data from certain enterprises. External open information sources include data on macroeconomics, family businesses and the private economy, and are mainly from the China Statistical Yearbook (from 2011 to 2014) and China Association of Industry and Commerce (from 2011 to 2014). The internal information of Bin Valley Group mainly comes from two important functional departments. Revenues, profits, assets and liabilities data were collected from the Finance Department, information about staff, salary and positions was obtained from the Human Resources Department. Specifically, this information originates from Bin Valley Group's financial statements, bulletins and meeting minutes (from 2011 to 2014).

3.3 Research Design: Processing the Data

After collection of the data, the research group organizes and interprets the data, which includes filtering, coding, categorization and selection.

3.3.1 Processing the Data from Interviews

In order to extract the research themes from the massive amounts of qualitative data and conduct research analyses, records of the interviews are sorted through and the content is coded into related entries. Later, we continuously modify and add information to these items until, finally, we have a relatively complete database.

When we code the data, we work in pairs and extract the data through discussions. Specifically, a researcher conducts an initial coding based on the interview and matches the content of the interview with relevant concepts of this research. Then, another researcher adjusts the entries upon reviewing the efforts of the previous researcher. The researchers discuss and re-code the data until they are both satisfied and reach a consensus, and the entries can then be inserted into the database.

When the coding is finished, the data is filtered and particular entries are selected from which relevant information is extracted for this research. The data must be definitive and relevant to the research, and as before, this process is also done with pairs of researchers.

3.3.2 Processing the Data of the Questionnaires

Through descriptive analyses of the data, we find inherent patterns and choose further analytical methods. This thesis conducts statistical analyses on the relevant questions, which mainly include frequency, central tendencies, dispersions and distributions, and presents relevant statistical graphs and tables. Through descriptive analyses, we attempt to account for the answers provided by the different staff at Bin Valley Group.

This thesis also applies ratio analysis of financial statements to compare relevant data, analyzes how staff evaluate Bin Valley Group's corporate governance (Please turn to the Annexes for the questionnaires).

3.4 Research Design: Data Analysis

Chapter 2 reviews relevant theories on family business governance, in which some scholars regard family system as an engine for the development of family businesses, whereas others hold the view that family system is an obstacle for family businesses to prosper. This section addresses whether family system hinders or boosts Bin Valley Group's development.

After processing the data of interviews, we eliminate less important content and form the following entries:

Table 3-3 Entries of interviews

Opinions on Bin Valley Group's Prospects
Opinions on the Relationship between Family Members and Non-Family Members
Opinions on Bin Valley Group's Founder
Opinions on Bin Valley Group's Management

Source: Sorted out by author

In accordance with these entries, we get the following findings from the corresponding questions and responses in the questionnaires: 423 employees think that Bin Valley has a great future ahead, with the proportion of 60%; 505 employees maintain that the relationship between family members and non-family members is harmonious on the whole, accounting for 71%; 390 employees have great comments on the founder, with the proportion of 55%; 590 employees identify with Bin Valley Group's management, which constitutes a proportion of 83%.

In addition, Bin Valley Group's corporate performance shows an upward trend from 2013 to 2015 (please refer to Table 4-6).

Therefore, Bin Valley Group's family system is an engine for its development rather than an obstacle. Note that the interviews and questionnaires may not truthfully reveal respondents' thoughts and this data analysis may possibly be distorted.

Chapter 4: Field Work: Case Study of Bin Valley Group

This chapter charts the evolution of Chinese family businesses and elaborate on how domestic scholars regard the governance structure of a Chinese family business. After that, it analyzes Bin Valley Group in various aspects, ranging from governance structure to corporate performance

4.1 Historical Review of Chinese Family Businesses

Chinese family businesses disappeared for a period of time due to external factors, but Chu (2000) thought that since the family business system appeared in China, familism and pan-familism have existed in a different or latent form. They have never completely disappeared in China, even in a planned economy, and have exercised significant influence on political and economic activities.

Chinese family businesses sprouted and developed after the Second Opium War, however, due to the policy of that time, family businesses developed very slowly. In the 1980's, China shifted from a planned economy to a market economy, and new family businesses in China gradually appeared. Family businesses were reborn in the form of an "underground economy".

Scholars have classified the development of Chinese family businesses in their own ways. Yu (2007) thought that Chinese family businesses have been through these following stages after the reform and opening-up policy: 1981-1987 was the initial stage; 1987-199 was the growth stage; and after the 1992 Deng Xiaoping's Southern Tour was the speed-up stage. Ma (2009) classified it in this way: before 1949 in the Ming and Qing Dynasties, was the birth and growth; 1949-1978 was the disappearance of the private economy in China; from 1978 to 1987 the development of private economy was allowed and family businesses were reborn; from 1988 to 1992 the private economy's development was encouraged and family businesses developed tenuously; and after 1992 family businesses developed stably.

After drawing on these scholars' views, four remarkable events in China can be identified: 1949 was the foundation of the People's Republic of China; at the 3rd Plenary Session of the 11th CCCPC in 1978, the private economy was revived, which symbolized the beginning of the reform and opening-up policy; after Deng Xiaoping's Southern Tour Speech, the non-public economy's position and function were clarified and the private economy began to develop stably; and at the 16th Party Conference it was proposed that "it is necessary to encourage, support and guide the development of the non-public sectors of economy." The private economy in China presented many opportunities from its rapid development, and according to these four notable events, we can classify the development of Chinese family businesses into these five stages in time: (1) before 1949; (2) 1949-1978; (3) 1978-1992; (4) 1992-2002; and (5) after 2002.

4.1.1 Before 1949

In ancient Chinese society, the family system played a very significant role. It was a necessary factor for the feudal regime, and for the political and economic climate. In a self-sufficient social system, handicraft techniques, and the best production methods of a certain craft, were first invented by an individual family. Family handicraft began to dominate and form its own brand in the Ming and Qing Dynasties, such as the He Family's cloth in Goulan Lane, the Chen Family's jewelry in Qianmen Bridge, the Dang Family's shoes in Dongjiang Barn, the Song Family's boots in Dazhalan, and the Diao Family's pills in Diwangmiao Street. Family businesses were bound to appear as a corporate form in pre-modern China.

For pre-modern Chinese family businesses, the most famous businessmen were Shanxi and Huizhou merchants in the Ming and Qing Dynasties. They built merchant halls using their families' power, and these halls gradually evolved into the enterprises run by government or jointly by government and merchants at the end of the Qing Dynasty. Regardless of ownership structure, they were all family-owned and became family businesses. These family businesses were special in terms of their organizational structure, information, culture and ethics. Family advocates altruism, which reduces costs and improves efficiency (Pan, 2009).

Shanxi and Huizhou merchants were the most powerful merchant groups in the Ming and Qing Dynasties, and even now, they are still very powerful and have already adopted a hereditary management culture. Shanxi merchants originated from the initial stage of the Ming Dynasty, when in the middle of the fourteenth century, armies stationed in the north were at war and they needed a large amount of food and salt. Shanxi merchants capitalized on this chance to profit from transporting salt because they happened to be close by. In the early years of the Daoguang Reign, Shanxi merchants established the Shanxi Draft Bank, which played a leading role in the field of finance, and also opened China’s first bank overseas.

Shanxi merchants declined with the Qing Dynasty. In the fifth year of the Hongzhi Reign of the Ming Dynasty (1492), the government adjusted its policy on salt and Shanxi merchants built up their commercial monopoly using their family power. Their family and townsmen were all engaged in the same market, and so they expanded their commercial capital and stood firmly in the salt business in Huainan and Huaibei. They also built the Huizhou Merchant Hall to help Huizhou merchants. When the government implemented reforms on the law of salt in the twelfth year of the Daoguang Reign of the Qing Dynasty (1832), they could no longer monopolize the salt industry, and this marked the beginning of the decline of the Huzhou Merchants. Shanxi and Huizhou merchants boosted social, economic and cultural developments, and laid a foundation for the evolution of pre-modern Chinese family businesses.

In the late Qing Dynasty, there were types of government-run enterprises to support the military industry. These enterprises were the product of a Westernization Movement, and were affiliated with and owned by the government. Their efficiency was very low, and two other forms of corporation types were merchant-run-and-government-supervised enterprises and merchant-and-government-jointly-run enterprises. They appeared in the late Westernization Movement, and were set up to absorb non-government capital. Nonetheless, they did not break away from the control of the bureaucracy, and later, these enterprises gradually became a means for rent-seeking.

Pan (2009) argued that ownership of merchant-run-and-government-supervised enterprises nominally belonged to family, but government officials were stationed in the factories and these officials directly controlled the decision-making power and business operations. The supervisory power was extended to control because officials could provide various privileges and benefits for merchants. Merchant-run-and-government-supervised enterprises were therefore actually funded by merchants but run by the government, and this was an early form of bureaucratic capital.

However, merchant-run-and-government-supervised enterprises were full of conflict and corruption, with efficiency due to the intervention of government officials. In the late Qing Dynasty, the government began to privatize government-run enterprises, which created a good environment for people to invest and engage in industry. Private enterprises gained massive momentum and began to lead capitalistic industrialization in China. Merchants first invested in light industries, such as cotton, flour, cigarettes and matchsticks, because they required less investment and took effect sooner. However, China's national economy struggled, due to the pressure of the internal feudal regime, bureaucratic capital, and external imperialism. Bureaucratic capital marked the continuation of merchant-run-and-government-supervised enterprise and merchant-and-government-jointly-run enterprise. In the Anti-Japanese War and the Liberation War, bureaucratic capital mainly referred to the private capital and private economic activities of the Nationalist Party. The top four Chinese families were the Jiang Family (Jiang Jieshi), the Song Family (Song Ziwen), the Kong Family (Kong Xiangxi) and the Chen Family (Chen Guofu and Chen Lifu). These top four bureaucratic families tried to control the national economy by using suppression, exclusions and mergers, and Chinese family businesses struggled to develop.

The period from the First Opium War to the foundation of PRC (1949), was rife with internal and external conflicts in and around the Chinese nation, and it was all about the survival of the country. There were two reasons why different types of family businesses to appeared in such a chaotic era. Thousands of years of family handicraft readily provided production methods and skillful smiths, and Western cannons forced the door to China open, which changed the traditional mindset of self-sufficiency. Colonists invested and built up factories in China and sold industrial commodities in large amounts at a lower price. This helped form the market economy system of free exchange, and simultaneously, corporate organizations began to appear in China.

The small-scale peasant economy and household handicraft workshops found it hard to survive, and they gradually formed product and labor markets. Moreover, when the country was in times of internal chaos and external invasions, those government officials, who had promising futures ahead, decided to run businesses and save the country by developing industries. The feudal bureaucracy noticed that it could protect the feudal regime and increase revenues by encouraging people to run businesses.

In such a complex era, family businesses struggled to survive, but still managed to grow stronger. For example, the Rong Family showed up during this period of time, but unfortunately, due to continuous external invasions, internal conflicts, social order, and the financial and monetary systems being in chaos, their family business' development was severely crippled. As a result, the family business continued to struggle in a semi-colonial and semi-feudal society.

4.1.2 1949-1978

Before 1949, China had two types of private economic organizations. They belonged to the bureaucratic bourgeoisie and the national bourgeoisie, respectively. After the foundation of the PRC, theories of a "comprehensive economic base" were proposed in order to stabilize social and economic development, and Chinese family businesses (represented by the national industry and commerce) and rising state-owned companies were able to exist peacefully for several years.

However, this peaceful time did not last long. China learned of the economic model of the Soviet Union that mechanically implemented a planned economy, and it adopted the ideas of state ownership, collective ownership and rural people's communes. People could not own private property and needed to share the fruits of their labor. From 1953 to 1956, the Chinese government conducted socialist reform on agriculture, handicraft, and capitalistic industry and commerce.

Capitalistic industry and commerce was the most important among these three major reforms. Specifically, there were two steps: the first was to shift from capitalism to national capitalism; and the second was to shift from national capitalism to socialism. By the end of 1956, China had basically finished reforming its private sector, and this marked China's entrance into the initial exploratory stage of socialism. Later, China experienced the Great Leap Forward Movement, the Movement of the People's Commune, and the Cultural Revolution. Over ten years, the Cultural Revolution almost brought the national economy of China to the edge. In 1948, before the foundation of the PRC, China's GDP ranked 40th in the world, however, following this, China's GDP ranked second to last in the world, with only 2/3 of India's GDP.

At this stage, public ownership of means of production reached an unprecedented height, but it limited the development of social productivity. Family businesses faced the problem of rationality and survival, and the private economy and private enterprises struggled again. Gradually, Chinese family businesses vanished or went into "dormancy".

4.1.3 1978-1992

After the 3rd Plenary Session of the 11th CCCPC in 1978, China decided to focus on economic construction, implement the reform and opening-up policy, allow the existence of various economic forms, and set up a route for mutual development. Family businesses were accepted and welcomed, and provided with awesome opportunities for development, which allowed them to gradually become the most active corporate form in China.

The 3rd Plenary Session of the 11th CCCPC in 1978 pointed out that the mission for the Chinese Communist Party in the new era was to build China into a powerful, modern, socialist country, which marked the start of the reform and opening-up policy. Officially, there were no private enterprises and 140,000 sole proprietorships existed at that time.

In 1982, the 12th NCCPC recognized the benefits of the supplementary role the private economy provided to the socialist public economy, and the private economy gradually gained the government's recognition and legal support. Private enterprise became more extensive in operation than sole proprietorships, and began to become more apparent while developing rapidly – spreading across the country. When the government acknowledged the legal status of the private economy, private enterprises and sole proprietorships gained further recognition and growth. By the end of 1982, there were 2,610,000 sole proprietorships with 3,200,000 employees, and in 1986, rich and powerful family businesses had increased to 400,000 family businesses with over 8 employees.

In October, 1987, the legitimacy of the private economy was recognized in the report of the 13th NCCPC, which stated that a basic policy of the Party is to encourage, protect, guide, supervise and manage the private economy. In 1988, the number of private enterprises reached 90,581, with 1,640,000 employees and ¥8.4 billion of registered capital in total. Most sole proprietorships in industry and commerce were run by a family, and family businesses played an irreplaceable role in the market, solving unemployment issues and enhancing market awareness at this time.

The rousing of family economic activities also pushed China into the initial stage of the market economy, however, growth of the market was not mature and the market system needed to be improved. Essentially, the market was in a disorder, and farmers lacked the appropriate knowledge and experience. Some leaders of provincial governments wanted to get rich quickly and were eager for success and instant benefits, so they overlooked the importance of management and paid attention to quantity instead of quality. As a result, most enterprises were not proficient in management and technology development.

Through constant reform and market regulation, family businesses that possessed advanced manufacture equipment and had rich experience in manufacturing survived, but still faced the issues of funding, sourcing raw materials and debt chains. Meanwhile, with the political turmoil in 1989, Chinese family businesses encountered difficulties and setbacks, and reached a point of stagnancy.

From 1979 to 1992, the majority of family businesses in China were start-ups. Production within family workshops was normally small in scale, and at this time, private enterprises often formed and developed into the form of a sole proprietorship. Most family businesses seemed to wear a “red hat” for protection, and its purpose appeared to be to avoid the risk of social conflict. For one thing, a family business’ growth required certain “soil”, and for another, a family business’ right of property was not clearly defined and they could make good use of social capital.

At this time, the most typical managerial model was family management and corporations did not exist. Business owners were mostly unemployed educated youths who just went back to the cities, peddlers, farmers, unemployed people, and those who quit their jobs in state-owned companies and tried to run a business themselves. Most of them were not highly educated, but their minds were agile, and they had critical decision-making abilities, strong entrepreneurial senses, and uniquely courageous enterprising spirits. They used their own advantages in technology, information and gut feeling to start running family businesses.

From 1978 to 1992, family businesses' efforts at this time laid a solid foundation for their future, even though the environment was not mature, and this stage was an important phase for the development of family businesses.

4.1.4 1992-2002

With further development of the market economy and the promotion of the household responsibility system, means of production, such as labor and land resources, gradually entered the market and could move freely without limitations. With this increase in scale and quantity, family businesses experienced a period of gradual development.

After Deng Xiaoping's South Tour Speech in the spring of 1992, the non-public economy gained consolidation in its status and function. The 14th NCCPC determined the important position of the private economy and removed the ideological chaos around the non-public economy, which cleared obstacles obstructing the development of the non-public economy. By the end of 1992, sole proprietorships in industry and commerce had reached 1533.9 in number, and there were 24,677,000 employees in this field. For registered private enterprises, the number was 139,600, and employees in the businesses topped 2,318,000 in number, increases of 28.8% and 26% from 1991 respectively. In 1993, relevant policies were issued to protect the legal revenues of private entrepreneurs, and this elevated the status of private enterprises and boosted the development of family businesses. From 1993 to 1995, the non-public economy in China gained rapid development, with an average yearly increase of 66%, and the lowest and highest of which were 51% and 82% respectively.

At this stage, the government adjusted and optimized its policies, and Chinese family businesses benefited substantially. The 15th NCCPC in 1997 pointed out that the non-private economy is an important component, and in 1999, the relevant acts were approved to recognize the important function and position of the private economy. The family economy in China was on a new track of rapid development, and in 1998, private enterprises reach over 1,200,000 in number (Chen & Ying, 2003). Corporation Law, Partnership Enterprise Law and Sole Proprietorship Enterprise Law were approved, and China's legislation began to focus on investment rather than ownership. The private economy gained equal footing with the public economy by law, and in 2000, China stopped levied income tax on sole proprietorships and partnerships to avoid double taxation on family businesses and encourage the development of such businesses.

In 2001, Chinese family businesses were able to go public directly, thanks to the government, and the Hong Kong stock market opened its door to allow the Mainland's private businesses to enter the capital market. This expanded the financing sources of private enterprises, but while Chinese family businesses increased in number, they also faced more stringent supervision.

When China entered the WTO on Dec. 11, 2001, family businesses were forced to invest more in technology management and innovation to improve the qualities of their commodities and services. Family businesses also faced unprecedented challenges in terms of intellectual property, and it had been an urgent issue for many enterprises to build up their core competitiveness. The 16th NCCPC in 2002 clearly proposed that, "it is necessary to encourage, support and guide the development of the non-public sector." This series of external reforms and optimizations cleared the obstacles for the rapid development of family businesses and consolidated the confidence of entrepreneurs. In the middle of the 1960's, China converted a batch of state-owned, and township and village enterprises into private enterprises, and some of them became family businesses. Lenient and stable policies allowed many enterprises to get rid of their "red hats" and clarify property rights, and at this stage, entrepreneurs were mostly government officials and professional technicians. They were the main driving force to start businesses, and these private business owners were highly educated and qualified. They had accumulated social capital, due to their previous jobs, and had managerial experience and technological capability, which gave them more advantages in their procurement and sales networks.

After they improved their economic status, they began to pursue political status. Some entrepreneurs joined the NPC, CPPCC, or Chamber of Commerce and Industry, while others joined and supported causes for helping the poor and other charitable activities. They were eager for political security, but since 1996, some family businesses blindly expanded their businesses and pursued diversification. As a result, they encountered obstacles, and companies such as Apollo, Flying Dragon, Sanzhu and Giant all became shooting stars.

At this stage, through the approval of Township and Village Enterprise Law, Sole Proprietor Enterprise Law and the reform of the taxation system, taxation discrimination against private enterprise had disappeared. The external environment and internal institution of family businesses gained great improvements, and window shops and small workshops continuously continuously into manufacturing, outgoing and technological enterprises. Medium-sized enterprises existed prevalently, and large enterprises and groups arose, such as Xiwang Group, Zhengtai Group and Delixi Group. These powerful family businesses began to form immense corporate groups to grab market share, and became diversified because they wanted to reduce risk and gain more profit. Family businesses started to pay attention to qualities and brands, and they all gradually began to focus on brand construction and advertisements. Technological innovation had become a new way for family businesses to gain market shares, and family businesses continuously invested in innovation, research and development, which became an important facet of their development.

This stage could be regarded as the immature stage of family businesses, and there existed a market with large demand. Sellers did not worry about sales in times of shortage in the economy, but consumers were not mature enough and business owners were beneficiaries from the market environment. Human resource management was very casual and a paternalistic style was very common in family management.

4.1.5 2002-2012

In 2002, The 16th NPC proposed that, "it is necessary to encourage, support and guide the development of the non-public sector." Later, the government introduced a series of policies to support the development of private business. In 2003, the 3th Session of the 16th NPC decided to perfect the socialist market economy system, put forward the decision to lower the bar for market entry into the private economy, and allowed non-public capital to enter the field of infrastructure and utilities. The private economy should enjoy equal treatment with other types of enterprise in investment, financing, taxation, use of land and foreign trade. In 2004, the NPC revised the Constitution and ruled that the legal private properties of citizens are inviolable, which further boosted the private enterprises' confidence in investment. In 2005, the State Council issued their decisions to encourage, support and guide the economic development and exploration of the non-public sector, which lowered the bar of market entry for the non-public economy and further optimized the environment for the private economy. In October of the same year, a new Corporate Law was issued, and it not only lowered the threshold to establish a company, but also provided a better corporate structure. It strengthened the control on the chairman of the boards of directors, and these measures further protected the interests of small-and-medium shareholders. In the long term, it would benefit the development of Chinese family businesses.

With the constant reforms and optimizations of the external environment, Chinese family businesses had opportunity for rapid development. In 2002, the Institute of Sociology, Chinese Academy of Social Sciences, Chinese Sociological Association, and All-China Federation of Industry and Commerce jointly conducted a survey in 21 cities and autonomous regions. They selected 1,947 small-and-medium-sized enterprises in 250 cities and found that 80% of the enterprises were family or pan-family businesses.

The booming private economy is a sign of the rapid development of family businesses, and based on the data of the 6th Annual Report of Private Enterprises (2004), registered private businesses reached 3,651,000 in number, with ￥4,7936 trillion of registered capital, 50,170,000 employees and ￥23.05 trillion of output. Thus, as the reform and opening-up policy went further, the development of Chinese family businesses was on fire. At the same time, the rapid development of family businesses brought more job opportunities to the society and injected new vigor into social and economic development, which played an important role in the development of China’s economy.

During this phase, some owners of family businesses had already accumulated substantial managerial experience and dominated corporate ownership. They successfully transformed technology and knowledge into commercial profits, and attracted more college students, elites of overseas elite schools, and talent from industry and commerce into startup and management teams. Together, they continuously made an effort to tackle the the challenges they faced.

The external environment of Chinese family businesses improved and family businesses have had opportunities for rapid development. Family business met some bottlenecks and they needed to continuously improve themselves in management and regulations, but for the most part, they always worked hard, and adapted and developed themselves to gradually became a significant component of the national economy.

4.1.6 After 2013

In 2013, the 3rd Plenary Session of the 18th CCCPC studied several major questions to deepen the reform comprehensively, and put forward that, “mixed economy is an important means of our basic economic system,” and emphasized that we should encourage the development of mixed-ownership non-public enterprises. In 2014, the Government Work Report, censored and approved by the Standing Committee of the NPC put forward that we should accelerate the development of a mixed economy, and state-owned and private enterprises should integrate their advantages and complement their disadvantages. This would be the main driver of the new-round reform on state-owned businesses, to topple the monopoly of state-owned businesses in some fields, give private businesses more chances to join the reform of diversifying the shareholder structure of state-owned businesses, and create new opportunities for the development of the private economy.

In 2014, the 4th Plenary Session of the 18th CCCPC censored and approved The Chinese Communist Party Central Committee's Decisions on Several Important Issues on

Comprehensively Boosting Governance of the Nation By-Law. It put forward that we should comprehensively boost governance of the nation by law, and this is necessary in order to improve the nation's governance system and governance ability. A mixed economy stresses the rule of law and contract, and mixed ownership enterprises should govern themselves by law and establish a modern corporate structure.

At this time, Chinese family businesses face new issues and challenges in terms of shareholder structure. To improve the nation's legal system will not only promote the fusion of private and state-owned businesses and break the boundary of identities, but also regulate the corporate governance of mixed-ownership enterprises and push family businesses to go public.

4.2 The Developmental Path for Chinese Family Businesses

Domestic scholars draw their own conclusions on the developmental path for Chinese family businesses from different clues. Zhu (2004) pointed out that family businesses normally evolve along the route of an individual business. A home business, family business (in a narrow sense), pan-family business, and family business-to-be, are all based on the idea that ownership of family businesses passes on from founders to family members to immediate family to pan-family members (friends and other social members) and finally to non-family members. Wang Guoguang set his eyes on the developmental phases and organizational forms of family businesses. He put forward the evolving route of a pure family business, beginning with a rule-of-man business, to a rule-of-law business, and finally to a modern family business. On the developmental path of a family business, domestic scholars basically agree that family businesses evolve on the route of a home business, beginning with the familization of the enterprise, to the corporatization of family, and then to a widely held public company. They reached a consensus on the final result of the evolution: a widely held public company is the ideal choice for the sustainable development of a single family business.

Hu and Pang (1998) thought that the evolution of family businesses superficially was the separation of ownership from control. On the other hand, Lai (1999) argued that the evolution of family business refers to the constant separation between labor, capital and management. Some scholars argue that the evolution of family businesses is a redistribution of the right of property, especially the actual control power (Wang et al., 2001). Chu (2003) held the view that the evolution of family businesses is in essence the constant fusion between family and social capitals.

This thesis defines the evolving path of family business as follows: it first goes from a home business to a family business, and with the increase of corporate scale, it evolves from a family business into pan-family business. Finally, it becomes a widely held public company.

4.2.1 Home Businesses

In China, family is a fortress, and since ancient times, family and country are indivisible. The “family standard” is thought to be one of the characteristics of Chinese Society, and to lower their costs, most private enterprises begin as family businesses in their initial stages. A family handicraft workshop is a small business that operates at home, and family members live at the workplace. There are not many employees at this type of enterprise, and the workforce is normally comprised of family members and a few external workers. Production, processing, operation and storage are all carried out in the same building, which combines the employer’s home, employees’ dormitories, workshop and warehouse all together. It is inevitable for the model of home businesses to occur, and financing, human labor and information are the limitations in the initial stage, however, family businesses can alleviate these problems to a great extent. Family businesses save on finance and human labor, maintain the fluidity of information and can act fast to make decision, which all benefits corporate development.

The most obvious characteristic of a family workshop is the family standard, where kinship ties are the criterion for appointment. It is a relatively conservative criterion, and since the family workshop decides positions and salary according kinship ties, it is impossible for it to motivate employees. At the same time, owners tend to take an attitude of disbelief and ignorance to non-family members, and these talented outsiders can only satisfy their ambitions by thinking of the greener grass on the other side. This substantially reduces their mobility, and as a result, it is impossible to construct a powerful team.

4.2.2 Family Businesses

A family business is a miniature society of production, consumption, education, insurance, living and emotion. The fundamental characteristics between family businesses and other organizations are its strong cohesion and trust, and the family's cause is very important to family members' mobility. Succession of kinship ties and the constant prosperity of the family are the long-term social goals that are focused on.

As home businesses develop, they will evolve into family businesses, where a family patriarch dominates the control power and family members are appointed to key positions. Outsiders are in less important positions, and shareholder rights are in the hands of family members. Power is highly centralized within a family business, and the family patriarch determines corporate culture.

Family businesses are unique in all types of corporate forms, because the ownership of family business rests in the hands of family members, but this does not necessarily mean that the family business is inefficient. Compared to other corporate structures, family businesses excel in some aspects, but such uniqueness also gives rise to the inherent limitations of family businesses.

In a family business, ownership and control are combined together, and family members engage in the management and operation of the business and distribute residual claims. Family members are motivated to run businesses well to avoid adverse selection and moral hazards, and since family members often communicate with each other, this substantially reduces asymmetric information and transaction costs. Due to kinship ties, family members may form a sense of responsibility to serve the family business well, and may not care whether their financial rewards are satisfactory.

There is a selective incentive mechanism within family, where family members must work hard for family. When a moral hazard and adverse selection occur, the family patriarch may fire a family member, but under pressure, family members tend to discipline themselves. Family members work hard for both the family business and the family itself, and with a reduction in asymmetric information and selective incentives, transaction costs are substantially reduced. Family members have shared values, ethical ideas and kinship ties, and owners can reduce the costs to supervise staff, which is the advantage of a family business.

On the other hand, family businesses still have their drawbacks, and may form various interest groups, which due to kinship ties, puts leaders of a family business into a dilemma. When family members violate corporate regulations, leaders of a family business may not necessarily penalize them.

Another drawback is human resources. A family business is generally allergic to outsiders and it is hard for non-family members to enjoy shareholder rights. Non-family members may find it hard to fit in, and without the talents of outsiders, a family business' development will be affected. Also, the decision-making process of family business can be arbitrary, and this arbitrary decision-making contributes to the success of a family business in the startup stage. It reflects the entrepreneurs' decisiveness, and with the growth of the business, the risks of each investment get higher. The losses may be hard to reverse and family businesses need to ensure a scientific and democratic process of decision-making.

4.2.3 Pan-Family Businesses

It is not enough to depict the values of the Chinese people using only the word "familism", and we must recognize that Chinese familism has a tendency to be popularized. Fan (1992), Yang (1998) and Liu (1996) studied pan-familism and argued that family strongly influences Chinese people's thinking and behavior, and in turn, family members subconsciously influence non-family members. Yang (1998) argued that Chinese people promote the organizational, interpersonal and behavioral characteristics of family: (1) Chinese people popularize the family's structure and operation to non-family groups or organizations; (2) Chinese people popularize a family's ethical relationships to non-family groups or organizations; and (3) Chinese people popularize the concept, attitude and behavior they learn within family to non-family groups or organizations. That is to say, in non-family groups or organizations, Chinese people will act in accordance with familism. Specifically, they see those who have kinship ties and geographical ties with them as "insiders", but non-family members as “outsiders”, and treat people based on particularism, instead of universalism, with different attitudes toward insiders and outsiders. Fei (1947) depicted pan-familism this way: in differential mode of association, everyone sees themselves as the centers of a web. Each circle spreads outward from the center, and the further from the center the circle is, the less significant it is.

Chinese family culture has already expanded and permeated into every corner of society. In this sense, pan-familism can embody the behavior of Chinese people better than familism, and it is hard to draw a satisfactory conclusion about the behavior of Chinese people simply by familism. That is often why Westerners cannot see through Chinese interpersonal relationships, and in essence, familism is a static and reserved concept. It can be used to describe almost every individual’s values within any society, but pan-familism is a dynamic and open concept, and is strongly excludable. When it comes to the distinctions between Chinese and Western cultures, pan-familism comes into play (Chu, 1998). Pan-familism is also the inherent secret of Chinese organizations, especially Chinese family businesses.

4.2.4 Widely Held Public Company

Generally, the growth of an enterprise is embodied by three aspects: the expansion of capital, the extension of organizational structure and the improvement of market profitability. For family businesses, the expansion of capital shows that family businesses need to absorb social capital. The extension of organizational structure indicates that family business need to recruit professional managers into business and integrate human resources. Improvement of market profitability means that family businesses need to build an extensive commercial network, ally with other enterprises and shape its core competency in corporate culture. Family businesses need to integrate social capital, and when a family business’ control and ownership are lower than a critical value, the family business develops into widely held public company.

The core of a family business’ development is how to integrate social capital, and when family business cannot integrate social capital, they will fail or decline. For Chinese family businesses, there are two main developmental paths: home business/family business to a pan-family business to a widely held public company or family possessing critical control. Note that not all the family businesses will become widely held public companies, and some of them fail in the middle or continue to be pan-family businesses.

4.3 The Evolution of Bin Valley Group

4.3.1 The Foundation and Founder of Bin Valley Goup

The internal research group of Bin Valley discovered how Mr. Bin strove to establish his company, by conducting an in-depth interview with him. Mr. Bin was born in 1976 in a small town in Ziyang City, Sichuan Proince, and is a typical Chinese entrepreneur who started from scratch. His parents were ordinary workers and he has two older brothers. During his childhood, he dreamed of becoming a scientist, and studied passionately and diligently, which distinguished him at school. However, after he graduated from junior high school in 1993, instead of attending senior high school, he chose to study in a vocational school in order to earn a living. After graduating from the vocational school in 1995, he worked in a local factory as a technician. Filled with the desire to obtain a university degree, he worked and pursued studies at a junior college simultaneously.

In 1998, he resigned from his the construction company in order to study at Chengdu Electronic Technology University to gain a bachelor’s degree, and continued gain other forms of employment at the same time. He has served as a project manager for Huaxi Group and Chengdu Road and Bridge Engineering Co., Ltd., and as a construction supervisor for China Mobile and local power companies. He has gained a massive amount of engineering experience and built a network of connections after years of work in the construction industry. In 2001, Mr. Bin started to undertake his own engineering projects and gradually focused his business on electrical installations, while building up his own engineering team consisting of his fellow villagers.

With the expansion of the engineering teams and the business, Mr. Bin established his first company – Sichuan Yuandian Installation Engineering Corporation, which specialized in the provision of installation services for electrical power, electro-mechanical, and fire protection projects. At this time, Yuandian was too small as a company, and was not qualified to bid for engineering projects. This meant that Mr. Bin had to pay other qualified companies to submit his tender under their names. In its infancy, the company only had five managerial staff, who were all family members, and they were: Mr. Bin responsible for market expansion; his father responsible for logistics and administration; his eldest brother in charge of engineering projects; and two of his cousins responsible for other management affairs.

Due to the small size of the company, small number of staff and lack of diversification of the business, the family members were able to operate and manage the company smoothly through concerted efforts, despite their poor education background. Mr. Bin's father was sincere, hard-working and had experience in doing business housework, so was able to reliably shape logistical affairs. Mr. Bin's eldest brother was a contractor and undertook the repairing of houses and the construction of roads. He also had experience in leading construction, and easily became familiar with the electrical installation business. Mr. Bin's two cousins came from rural areas and had only just started to work since graduating from the junior high school. They had experience in managing restaurants and were soon acquainted with and adjusted to the management of engineering teams.

As the head of the company, Mr. Bin had to negotiate with potential customers by himself, and sometimes lived and worked with his workers together at the construction site. The first project during the start-up period was to re-install electric meters for a residential building containing 14 households. The revenue generated by the project was 5,000 RMB (about 335 Euro), and there was almost no profit after paying the workers their salaries (the five family members received no salaries). However, despite the low return, Mr. Bin and his company worked on the project carefully and conscientiously, and completed it to a satisfactory standard before the deadline. This attitude and approach earned him recognition from the industry, and afterwards his company began to cooperate with larger customers, including China Oil & Foodstuffs Corporation, Sun Hong Kai Properties, Fulin Industrial Group, Chengdu Media Group and New Hope Group. Mr. Bin displayed outstanding talents in the field of electric power installation, but he was still not satisfied with his current achievements.

In 2005, Yuandian obtained its qualification for submitting tenders, and another group of Mr. Bin's close and distant relatives, including some cousins, joined the company. These relatives were appointed to intermediate-level and basic-level positions, and the number of employees in the company reached 30. Meanwhile, Mr. Bin married, and in 2006 his wife joined Yuandian Installation, was put in charge of finance, and obtained 10% of the shares of the company. At this time, Mr. Bin's eldest brother left Yuandian in pursuit of his own ambitions, and Mr. Bin's second eldest brother joined the company as a replacement. Note that Mr. Bin's second eldest brother had once worked for his engineering team and later had served as a project engineer for other larger-scale engineering companies, which allowed him to accumulate considerable experience in management.

In 2008, Mr. Bin established his second company – Sichuan Yuandian Water and Electric Power Engineering Design Consulting Corporation (Yuandian Design Corporation), to further extend his business scope by providing customers with cost-effective, high-quality, all-round services in design, construction, inspection and maintenance. More than 50 fellow villagers came to Chengdu to find employment from him, and they were appointed to intermediate- and basic-level positions in the engineering and technology departments.

During this time, Mr. Bin had always disciplined himself to continue studying and learning, and had never given up on his scholarly pursuits, regardless of whether he was working as an employee or starting up his own business. As his companies continued to develop, he felt it increasingly difficult to manage them and in 2009, he began to study for an MBA at Southwest Jiaotong University, after which he served as the chairman of the University's MBA Association and the vice chairman of the University's Alumni Association. During his MBA studies, he met elite individuals from various industries, and often shared management experiences with them or discussed with them the excellent management approaches of successful enterprises at home and abroad. The pursuit of an MBA provided Mr. Bin a social platform, upgraded his mindset, and motivated him to expand his business properly.

In 2010, Mr. Bin established Sichuan Bin Valley Technology Corporation (Bin Valley Technology Corporation) and Sichuan Shengfeng Water and Electric Power Engineering

Design Consulting Corporation(Shengfeng Consulting Corporation), which indicated the diversification of his interests into the technology sector. Simultaneously, he began to recruit professional managers into high and intermediate-level managerial positions in the administration, accounting and materials supply departments, and other new business segments. For example, Mr. Bin offered a generous salary to the general manager of the technology segment at the time to join him, due to his years of experience in solar power research, development and manufacturing.

Mr. Bin allocated 20% of the shares of Bin Valley to his wife and the number of his employees was now more than 100. In 2011, he recruited his MBA classmates who were competent and had a wide network of connections to the top managerial positions in the consultation and business departments (e.g., President Office, Planning Department, and the Marketing Department). The head of the President Office was the director of China’s MBA Association and a close friend of Mr. Bin, and the head of the Planning Department was Mr. Bin’s MBA classmate from Southwest Jiaotong University, and the executive chairman of the University’s MBA Association. The head of the Marketing Department was also his classmate and is now the chairman of the University’s MBA Association. In the Alumni Association, these three people are the most intimate friends of Mr. Bin.

Mr. Bin also continued to recruit competent professional managers for top managerial positions in the important business segments and functional departments, such as the engineering, accounting, and human resources departments. The general manager of the Engineering Segment, who had considerable management experience and resources in the electrical power industry, was solicited to join him by a generous salary. In the same year, Mr. Bin led the Planning Department to formulate Bin Valley’s first five-year strategic plan, which indicated that after acquiring the necessary expertise, Bin Valley will branch out into six business segments (engineering, technology, commerce and trade, investment, finance and culture). He also set up Baicaoyuan Investment Management Corporation (Baicaoyuan Investment Corporation) and put a retired solider who had strong connections to the government in charge. In 2012, when the head of the technology business segment departed, Mr. Bin invited his uncle, who had years of experience in management and sales, to be a replacement responsible for reorganizing the team and developing new technologies. In 2013, Mr. Bin invited some of his old friends to be responsible for high-level management of new business segments, such as the culture and sports segments. For example, the main center forward of the Men's Sichuan Basketball Team had been his friend for nearly 20 years and was invited to take the helm of the Sports Business Segment.

Unfortunately, Mr. Bin's second eldest brother often disagreed with Mr. Bin, and the accounts associated with his economic activities were not clear and caused losses to the company. He was averse to the company's punishment and left the company in 2013.

By 2014, Bin Valley consisted of sixteen companies, and was registered in Hong Kong, with about 300 employees. At this time, Mr. Bin made a ten-year plan for Bin Valley and selected talents from his MBA classmates worldwide to prepare for the establishment of branches in several major cities across China. In 2015, Bin Valley set up its sub-companies in Zhejiang Province, Xian City, Shenyang City and Yunnan Province, and the influential members of the local MBA alumni were recruited to serve as the general managers responsible for constructing executive teams, exploiting their social resources, finding appropriate projects and conducting business by using the expertise and qualifications of the headquarters in Chengdu. Mr. Bin's connections with his MBA alumni provided many new channels to recruit professional managers.

4.3.2 Strategic Turning Points of Bin Valley Group

Reviewing Bin Valley's development history, it can be seen that it has undergone four strategic turning points, as shown in Table 4-1.

Table 4-1 Strategic turning points of Bin Valley

Serial number	Year	Indicators of strategic turning	Influence on enterprises
1	2006	Structural changes of family members in the company (Mr. Bin's wife joined and gained shares. His father and eldest brother left. His second eldest brother joined.)	Improve cohesion and management ability
2	2009	Mr. Bin joined the MBA alumni and his mindset started to change	Improve leadership and modernize management
3	2011	Bin Valley made its first five-year strategic plan and decided to branch out into six business segments, and introduced pan-family members and professional managers into the company	Expand business, improve trust and enrich management resources
4	2014	Bin Valley made its second five-year plan, and broke into the national market from Sichuan Province. Bin Valley will explore the Sichuan market with Chengdu as the base, explore the national market with Beijing as the base, and build regional operation centers in provincial capitals.	Bin Valley begins to implement its strategy for business expansion across the country and enters its "second start-up period"

Source: interviews with the Planning Department

4.3.3 Organizational Structure and Family Involvement of Bin Valley Group

A family business is an organic combination of the "family" system and the "corporation" system. These two systems have different characteristics, with the former being a closed entity that favors and focuses on consanguinity and family relations, and rejects or ignores non-family members. The latter is an open economic entity, which pursues profits and must interact with the outside environment during the competition and cooperation processes. The combination of the closed family system and the open corporation system makes it a real challenge for a family business to establish a stable and an efficient form of governance.

Family involvement, or the level of family involvement, is what distinguishes a family business from a non-family business, and this refers to the extent at which the founder/owner's family members are involved in the business' governance. It is the family involvement that endows the family enterprise with unique properties (Chua et al., 1999; He et al., 2007; Chen, 2008). And in the research on family business, this class of properties is called familiness (Habbershon and Williams, 1999). Familiness is used to represent the set of resources and abilities generated during the interactions among the family, business and individual members of the family. Generally speaking, familiness provides an explanation for various relationships within the family business and a method for distinguishing the family business from the non-family business. Family involvement includes ownership involvement, control power involvement, participation of family members in corporate management, and the inheritance of family ambitions, philosophies and cultures.

The Confucian culture runs throughout the history of China, and family culture is the core of the Confucianism. The concept of “home” is the essence of the Chinese culture and the most dominant guideline on the behaviors of the Chinese people. Family is a complete unit of property rights and also the ultimate emotional destination for family members (Wang, 1995). Family is not only the core of the social, economic and cultural life of the Chinese people, but also the dominant factor in the political life (Yang, 1998). The family culture accumulated in China across thousands of years has enormous influence on corporate operation & management and the life cycle of a family business (Chu, 2000). China’s family culture lays the cultural foundation for the prosperity of China’s family businesses (Han and Zhen, 2004).

Family culture has guided the thinking and behavior of the Chinese people, and shaped the current form of property rights and organization within China’s family businesses. The rules of China’s family culture include the relationships between the roles of family members, family ethics, the family framework and family recognition (Yang, 1998). Under the influence of the family culture, China’s familial relationships have naturally merged into the business world, and they grow along with family businesses.

These family relationships have arbitrarily led the owners of the Chinese family businesses to operate their enterprises like a patriarchy. In the family businesses, the management mostly consists of fathers, sons, siblings and other relatives, and the family bonds may throw the enterprise into chaos and disorder, because the family members may act beyond their power, and incompetence is usually tolerated (Fu and Li, 2011). Chinese family businesses are a cultural product of paternalism, and family members are highly devoted to the business operation and management (Redding, 1993). The family culture stresses cohesion and mutual assistance, which leads to shared values and alignment in the Chinese family business, which reduces the business' transaction costs.

Fukuyama (1995) noted that China is a country with a low degree of trust, and that trust is more likely to exist among people with kinship ties. People tend to trust people who are more closely related to them, and if in an enterprise there is no high degree of trust that transcends kinship ties, the low degree of trust will prompt the assignment of important positions to family members and outsiders to be excluded.

China's family culture can be extended to any organization and interpersonal relationships outside the family, and any association or organization, including a country and an enterprise, can be regarded as an extension of family. Such pan-familism has two representations: (1) the scope of family members extends beyond kinship ties to include interpersonal relationships, such as neighbors, relatives, schoolmates, co-workers, and other people sharing the same beliefs (Peng, 2000); (2) the influence of family culture extends beyond family (Xiang, 2002). Pan-familism is an outstanding feature of the Chinese culture, and differentiates a Chinese family business from a Western family business (Chu, 2004).

Habbershon and Williams (1999) devised the concept of familiness in order to describe the idiosyncratic resources and capabilities of family businesses due to system interaction. The idiosyncratic resources are grasped by a family business and are the product of the interaction between families, family members and family businesses (Cabrera-Suarez et al., 2001; Habbershon and Williams, 1999). Familiness mirrors the systematic relationships between families, family members and family businesses (Habbershon, 1999, 2003, 2006), and is the outcome of the interactions of the family in ownership, corporation management and the succession of family intentions. It also embodies the unique and diversified resources owned by a family business (Habbershon, 1999, 2003, 2006; Chrisman, Chua and Steier, 2005; Chrisman, Chua, and Litz, 2003), and these resources can be used to gain strategic advantages in terms of corporation leadership, culture, social network, internal relations, capital, business governance, decision making and knowledge.

Based on the theories above, the discussions in Chapter 5, and the interviews with the founder, family members, and non-family intermediate and high-level managerial personnel of Bin Valley, it was determined that Bin Valley's family involvement was very strong during the start-up period (2003-2008), but weakened when Bin Valley expanded (2009-2015) and started to be influenced by pan-familism. During the start-up period, Mr. Bin, his wife, his parents, his brother, and his close and distant relatives all worked at Bin Valley for the purpose of obtaining employment from family relatives, and to assist Mr. Bin with operating the enterprise, with the expectation of being allocated more control as the enterprise grew. Later, some of Mr. Bin's grown relatives, relatives of Mr. Bin's wife, and some schoolmates and old friends (pan-family members) joined Bin Valley in order to obtain employment from family relatives, assist Mr. Bin with the development of the family business and to fulfill their own ambitions. Family involvement into the the business in each year is shown in Table 4-2.

Table 4-2 Variation of family involvement in Bin Valley

Year	Management												Ordinary staff			Total number of staff
	High level			Intermediate level			Basic level			Total						
	Number of positions	Number of families	Ratio of family members	Number of positions	Number of families	Ratio of family members	Number of positions	Number of families	Ratio of family members	Number of positions	Number of families	Ratio of family members	Number of positions	Number of families	Ratio of family members	
2011	7	5	71%	14	7	50%	28	7	25%	49	19	39%	98	21	21%	166
2012	9	5	56%	18	8	44%	36	8	22%	63	21	33%	126	10	8%	210
2013	10	6	60%	20	8	40%	40	8	20%	70	22	31%	190	8	4%	260
2014	13	7	54%	26	9	35%	52	9	17%	91	25	27%	213	6	3%	304
2015	14	7	50%	28	9	32%	56	9	16%	98	25	26%	214	6	3%	312

Source: sorted out by author

From in-depth interviews that the internal research group carried out with Mr. Bin and some of the high and intermediate-level management personnel, it was learned that the company's structures evolved with its development and has undergone several structural adjustments. In the start-up period, the founder managed the teams directly, while in the growth period, some departments with specific management functions were established. In 2011, the company had relatively mature organizational structures, e.g. the headquarters supplemented with sub-companies, as shown in Fig. 4-1.

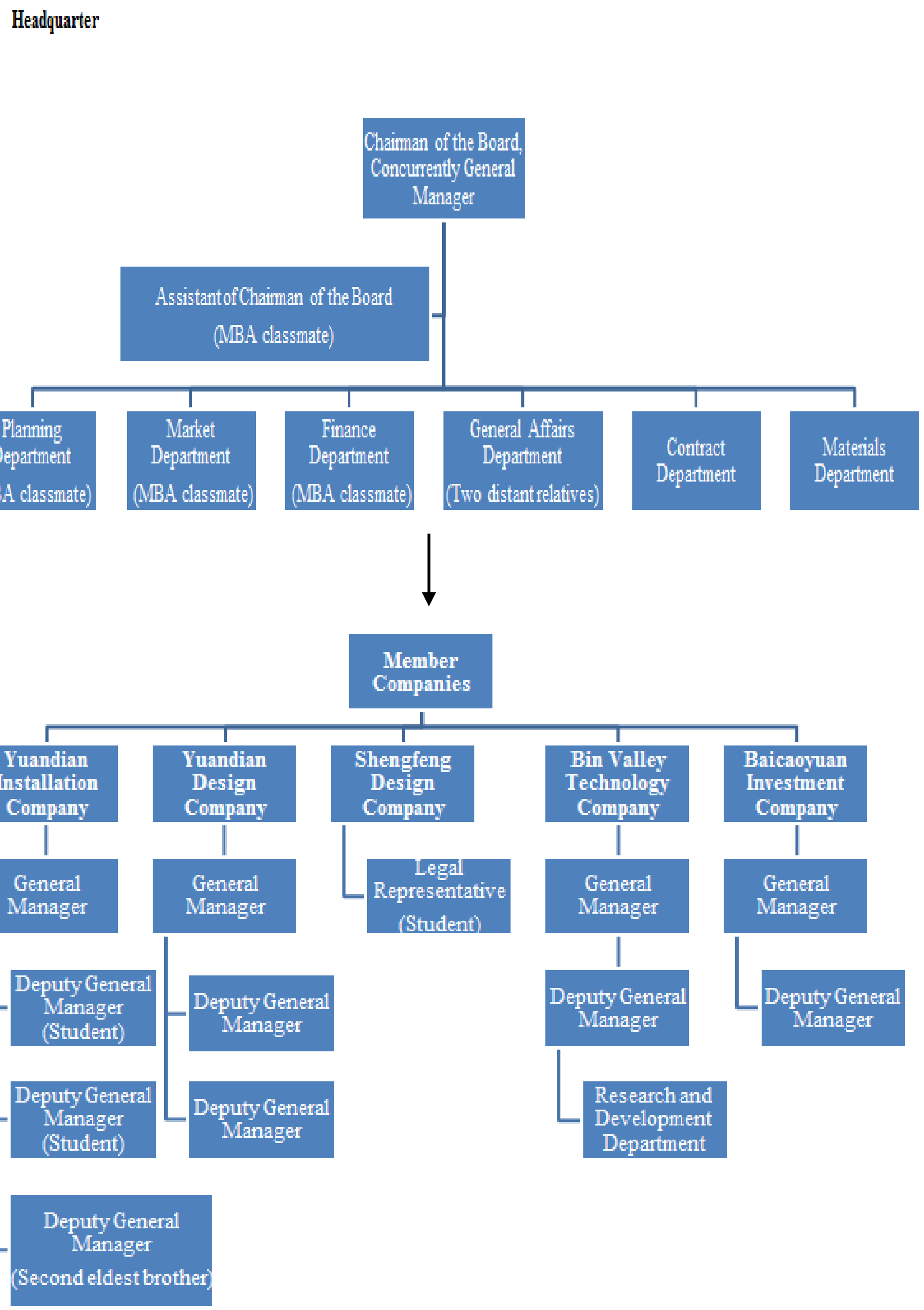

Figure 4-1 Bin Valley Group's corporate structure and family involvement in 2011

Source: interviews with the Planning Department

From interviews with Mr. Bin's wife and the assistant of the President, it was learned that the organizational structure shown in the figure had the following problems:

(1) The managerial relationships were complicated, and the functions of each department as well as the relationships of the headquarters with each sub-company were all unclear. The President of the Group could not exercise effective supervision and control over the sub-companies, and the policies were too basic and not conveyed effectively. Each of the sub-companies existed as a legal entity and carried out their own business independently, so the functional departments of the headquarters could not guide the sub-companies comprehensively. The organizational structure lacked a central department to send messages upstream or downstream and coordinate the transmission of instructions across the entire company. The structure was so slack that exercising control over sub-companies became largely dependent on the President's own personal commands.

Management inefficiency was caused by the lack of a closed-loop management process, and at one point, some sub-companies signed contracts privately without submitting requests for approval from the contracts department of the headquarters. It wasn't until the breach of a contract occurred that the headquarters became aware of the violations, which inflicted direct losses to the company.

(2) The second and third levels of managerial structure in some sub-companies were not complete, and some branches were understaffed with unusual modes of operation. For example, the Yuandian, Shengfeng and Baicaoyuan branches were staffed by general managers or deputy general managers as their decision makers, but no staff were employed at intermediate and basic-level positions to be responsible for executing their instructions. This implied that the new business segments of the company were still in their infancy because they had qualifications and resources but lacked a complete team to actually operate the business.

To compensate for this, in the second half of 2011 the Planning Department of Bin Valley modified the company's original five-year strategic plan, as shown in Fig. 4-2.

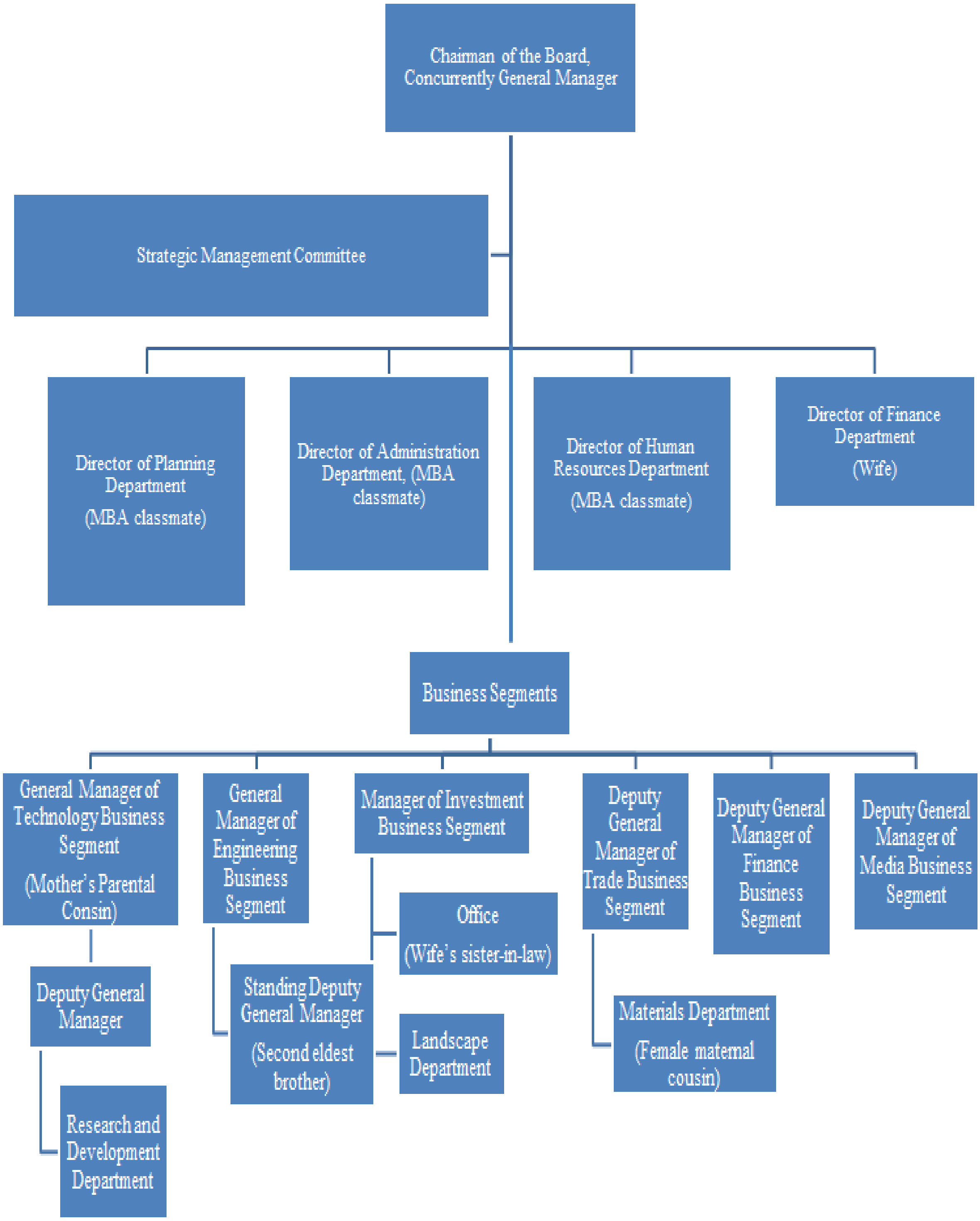

Figure 4-2 Bin Valley's modified corporate structure and family involvement in 2011

Source: interviews with the Human Resources Department

The characteristics of this structure were that it applied the mode of "centralized decision-making and decentralized operation", and relied on the divisional system to design the management structure, which highlighted the heightened status of strategic decision making. By incorporating policy formulation, management, and production & operations into the company's overall strategy, it could exploit the advantages associated with the independent operations of each business segment, and facilitate the harmonious and rapid development of Bin Valley.

From interviews with the directors of the Human Resources Department and the Business Centers, it was learned that the organizational structure in Fig. 5-2 still had the following problems:

(1) The relationships between functional departments and business centers were more of managerial relationships rather than collaborative relationships, and despite the heightened status of functional departments, the relationships were oriented more towards control rather than support and collaboration.

(2) The President of Bin Valley served concurrently as the general managers of many business centers. This over-centralization of the control power made it difficult for him to allocate his energies and resources appropriately. By appointing directors of the investment, finance, trade and cultural centers to deputy general manager roles and assigning himself as the general manger implied that Mr. Bin still had some doubts about the abilities of the professional managers of the new business segments. However, these directors thought that Mr. Bin did not delegate sufficient power to them, which impeded their operations and management.

(3) For many of the business segments, a lot of the second and third levels of the management structures were incomplete and understaffed, and how the businesses of these segments were conducted was not normal. For example, the management personnel of the financial and cultural segments only consisted of deputy general managers and lacked management teams, which prevented the normal operations of the businesses.

The strategic environment in which Bin Valley operates is changing. For instance, China's macro economy is slowing down, investment in infrastructure is reducing, policy control is being exercised over the real estate industry, considerable support is being given to the cultural industry, and profound reform is being done on the financial industry. Taking these factors and the actual situation of the company's operating performance into account, the Planning Department of Bin Valley optimized the company's organizational structure in the middle of 2013.

The characteristics of this structure were that it based the design of the management structure on the association-based divisional system, highlighted the dominance of strategy, performance, cost and market management, incorporated policy-making, management, production & operations and project management into the overall strategy of Bin Valley. It promoted mutual development and collaboration among business segments, and strengthened the motivation of each business segment for interdependent operation. At a higher level, it also established the Board of Directors and the Trade Union, which represented the democracy of the enterprise, and laid the foundations for the transition of the company to a modern enterprise system.

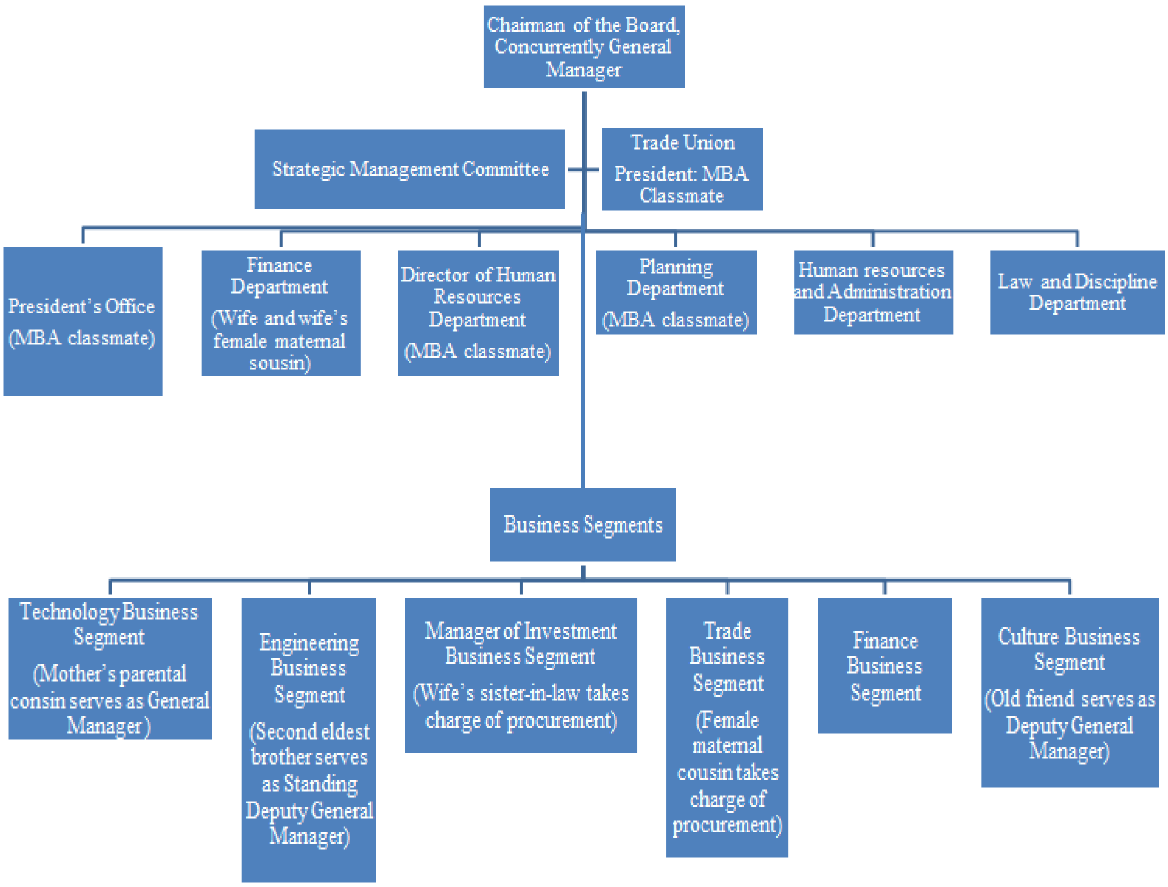

Figure 4-3 Bin Valley's corporate structure and family involvement in 2013

Source: interviews with the Planning Department

This structure yields a closer correlation and promotes collaboration between departments and higher management efficiency. However, from interviews with Mr. Bin's wife, assistant of the President, and the director of the Human Resources Department, it was learned that the biggest problems of the organizational structure in Fig. 5-3 were the higher requirements imposed on industrial expertise and the professionalism of the five functional departments. All of the business segments operated in parallel with each other and needed inter-department collaboration. Business segments found it challenging to get accustomed to each another, which increased the risk of the work coming to a halt and impeding development. The board of directors only consisted of Mr. Bin and his wife, which made it ineffective at fulfilling its supervisory and decision-making purpose.

With the detailed implementation of Bin Valley's first five-year plan, the company went through ten years of development, and its diversified developments began to take shape. In 2014, Mr. Bin devised the goal of entering the national market, requested the Planning Department to design Bin Valley's next ten-year development strategy, and further improved the organizational structure of the company, as shown in Fig. 4-4.

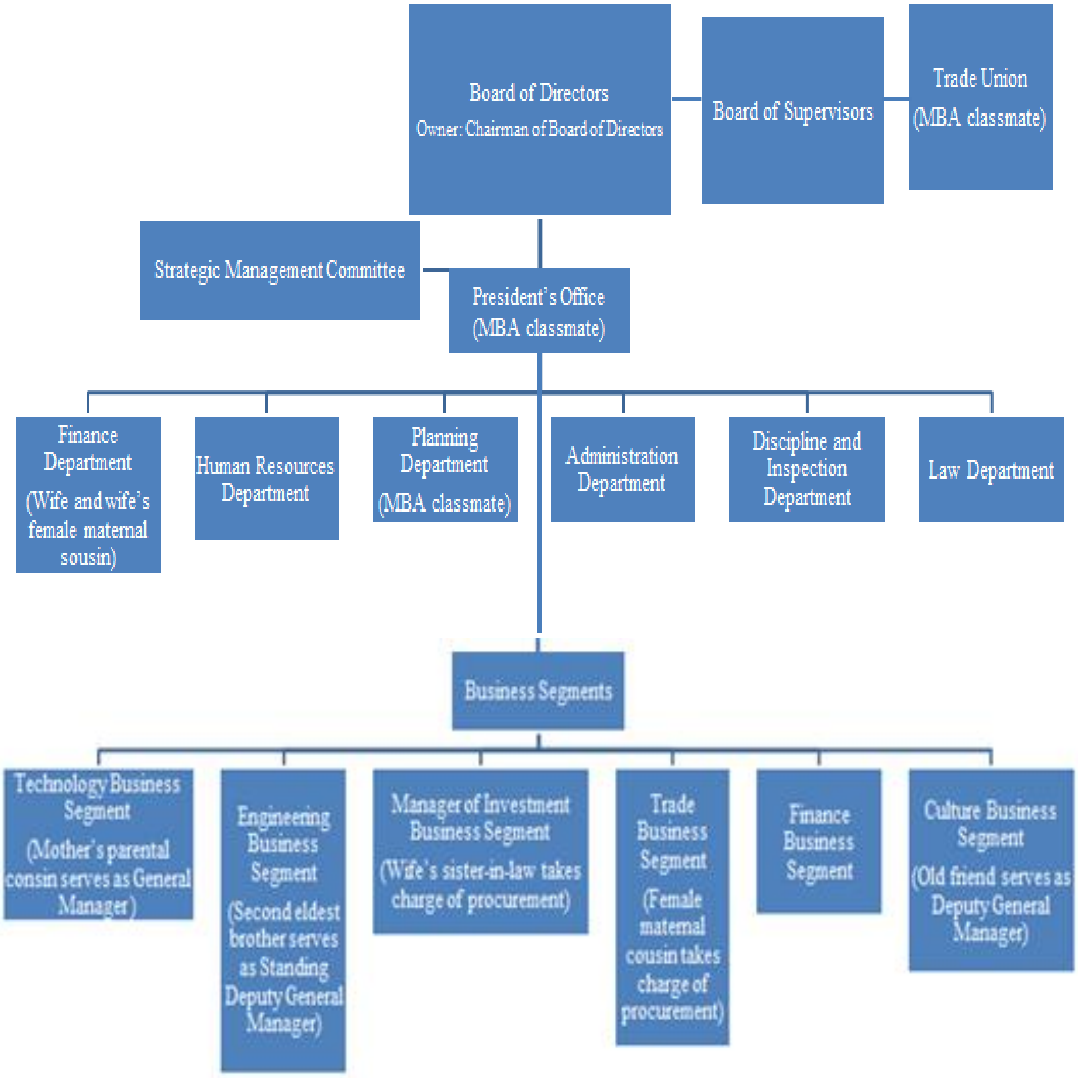

Figure 4-4 Bin Valley's corporate structure and family involvement in 2014

Source: interviews with the Planning Department

Figure 4-4 shows that based on the previous matrix organizational structure, Bin Valley introduced some changes to its governance structure. The Board of Supervisors was introduced to improve the structure of the Board of Directors, and in terms of functional departments, the President's Office was awarded a higher status and better staffed. The Human Resources, Administration, Law, and the Discipline Inspection Departments were separated from one another for the purpose of strengthening Bin Valley's supervision and enhancing Bin Valley's work efficiency.

Mr. Bin also proposed an innovative organizational model consisting of a "hexahedron + spherical center", which provided a 3-D representation of the interactive management relationships between the six business segments and the six functional departments, as shown in Fig. 4-5.

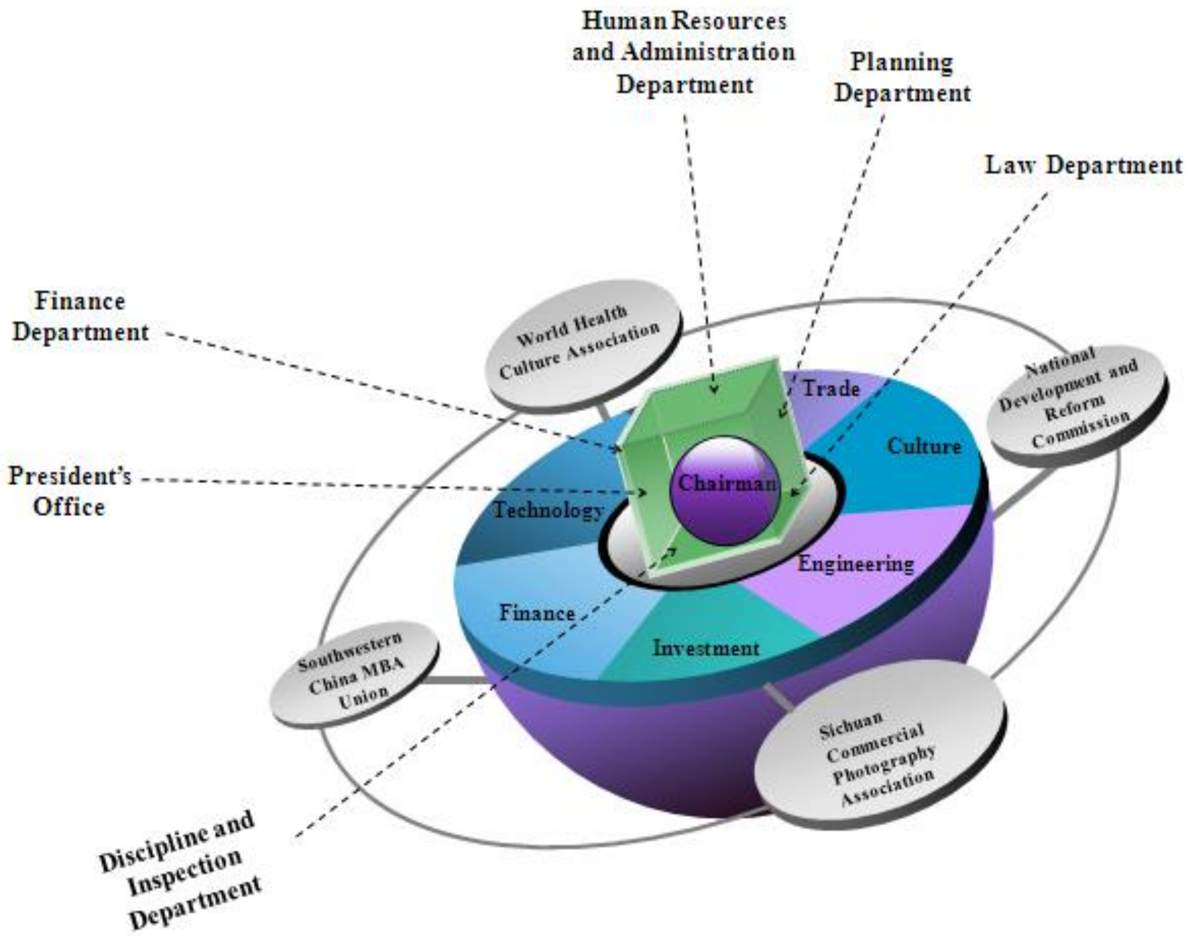

Figure 4-5 Bin Valley's "Hexahedron + Spherical Center" structure

Source: Made by the Planning Department

As shown in Fig. 4-5, the owner (the President) is represented as the core of the sphere, while the functional departments and business segments are akin to the Earth's mantle and continental plates or crust, respectively. The core of the sphere provides the power to drive and balance the rotation of the sphere. This also demonstrates the governance characteristics of Bin Valley Group, and how the leaders of this family business prefer the centralization of power.

This structure also has connections with four external social institutions: the National Development and Reform Commission, the World Health Culture Association, the MBA Union of China, and the Commercial Photography Association of Sichuan. These institutions are Bin Valley's strategic cooperation platforms that offer external resources and businesses to the company. Bin Valley also externalizes this 3-D organizational model, which was uniquely designed by Bin Valley Group, and based on its actual situation and practical development.

In his interviews, Mr. Bin summarized the advantages of this governance structure as follows: it optimizes the functional structure of governance; it deepens the managers' understanding of the businesses; it clarifies and deepens the relationships between departments and business segments; and it enables leaders to exercise more effective control over the organization.

However, there is no real perfect governance structure, and interviews with the management personnel of the functional departments and business segments showed that this spherical structure has the following potential problems:

(1) Loads at the core of the sphere. The dynamic forces of such a large and complex organization are almost completely dependent on the President's ability to control and manage the company, which imposes high requirements on his discernment, decision-making ability and tolerance to pressure. When the core of the sphere is stable, the organizational structure can operate stably, but any loss of dynamic force from the core of the sphere will cause a chain of reactions that may even lead to violent earthquakes at the continental plate level of the model. This requires the four professional committees to share the burden with the President, and convert the violent earthquake that erupts suddenly into less frequent, smaller, manageable tremors.

(2) Smooth connection between the six departments and the six business segments. The increased number of functional departments (there were five in 2013) complicates the relationships between them and adds difficulties to how they communicate with each other and the business segments. According to the strategic plan and design of Bin Valley, the key to the diversification strategy is to internalize the communication within various departments and maintain effective control over the company's operations. If communication between functional departments and business segments runs into trouble, the business will be impeded and could come to a local or large-scale standstill. Thus, the components of the structure should improve the mutual understanding and communication of the functional departments

and business segments, as well as their expertise and coordination capabilities.

(3) Combination of the internal structure with the external structure. Whether the internal structure (i.e., the various functional departments and business segments of the company) is effectively integrated with the external structure (i.e., social resource platforms), is essential to the effective operation of this 3-D structure. Therefore, the components that join the internal and external structures should be developed to complement one another for mutual development.

4.3.4 Governance Structure of Bin Valley Group

Generally, family businesses need to confront two governance issues, the first of which is the relationship between the family members' personal interests and the control over the family business, which often results in conflict between the business and investors. Aghoin and Bolton (1994) analyzed how family businesses allocated control power between the family and investors, and found that investors were worried that their investments and interests wouldn't be adequately protected because they had to compete with family members. If a family business had trouble in financing, the family members may have had to give up control. Status-based control is the best method to allocate control power, and states that the control power should be allocated to the entrepreneurs when the enterprise prospers and only be allocated to the outside investors otherwise. Villalonga and Amit (2006) regarded the principal-agent problem within family business as the principal-agent problem between insiders and outsiders, which may generate an entrenchment effect. For example, a family business may form a cross-shareholding arrangement in order to avoid being acquired by others, and the business may then choose to behave conservatively and thus lack ambition, much to the dismay of other investors.

Stulz (1988) thought that the relationship between the value of the enterprise and the shares of the family takes a reverse-U form. That is, with increases in the shares of the family, the value of the enterprise increases at first, but then declines. This conclusion was verified by the empirical research by Mock et al. (1988), McConnell & Servaes (1990) and Demsetz & Villalonga (2001), which further proves the value of the fluctuation effect caused by the separation of enterprise proprietary from the control power over the enterprise. Claessens et al. (2002) and Cronqvist & Nilsson (2003) discovered that a corporation's value increases with the family's cash flow rights, but if the family's control power exceeds its cash flow rights, then the enterprise's value decreases.

The second issue needing to be confronted is the internal governance of family businesses. If a family business is controlled by one person and the interests of the family is represented by the enterprise's founder, then the value of the family business may increase, however, if the scheme for separation between control and ownership is poorly designed, when the family business is passed onto the next generation who are not competent enough, the value of the family business is very likely to decrease. The empirical studies by Anderson and Reeb (2003), Barontini and Caprio (2006) and Andres (2007) proved that an enterprise controlled by the founder is in a better position to increase its value, and the studies by Anderson and Reeb (2003), Barontini and Caprio (2006) and Villalonga and Amit (2006) confirmed the negative effect that may occur when the enterprise is passed down to the next generation.

This case study on Bin Valley is focused on the second issue, i.e. the internal governance structure, which is aligned with control and ownership. The goal of modern corporate governance structure is to optimize the combination of the two powers in order to boost efficiency and gain a competitive advantage in the market.

4.3.4.1 Ownership

In the first ten years of Bin Valley, Mr. Bin and his wife owned all the shares, and they hoped to establish their authority and reduce transaction costs in order to ensure stable development of the enterprise and protect family interests. Bin Valley's incentives for professional managers were largely dependent on delegation of control and cash salaries. Since the 11th year, Bin Valley has started to allocate some shares to professional managers and some family members to tackle the principal-agent problem generated by the separation of control from ownership. The reason behind this behavior was that in order to achieve diversification of the business across the country, Bin Valley needed sufficient human resources, but the family members available were not qualified enough. The inability to meet the resource demands prompted the enterprise to recruit many non-family professional managers to oversee company operations together with the family members. The recruited professional managers were allowed to share profits with family members and shoulder the risks for the purpose of improving their loyalty and enthusiasm, as shown in Table 4-3.

Table 4-3 Overall situation of ownership

Development states	Family ownership	Reasons and motivations
2003-2013	100%	Ensure stable development of the enterprise and protect family interests
2014-2015	90%	Adapt to the separation of ownership from control, stimulate rapid development of the enterprise, and encourage professional managers

Source: based on recorded interviews with the Planning Department

Table 4-4 further indicates the change in shareholding structure of Bin Valley, where in the first ten years of Bin Valley, the shares were centralized by Mr. Bin and his wife, and other family members had no shares. Since the 11^{th} year, the shares began to be allocated to other family members and non-family high-level management personnel, indicating the transition from the founder-dominant governance model to a hybrid governance model (Lu, 2010).

There are profound reasons behind the change in the company's shareholding structure. The scale of the company was small in the first 10 years, and its stock shares were highly centralized in order to make good use of the family system, improve corporate governance, adapt to external changes, and stabilize the development of Bin Valley. The stock shares were monopolized by Bin and his wife, because they knew that disagreement among family members decreases cohesion. For example, Bin's father and oldest brother quit due to a disagreement with him in 2006, and in 2013, Bin's second oldest brother also parted ways with him due to a divergence in corporate development. Hence, in the early stages, Bin was unwilling to entrust company operations to others except himself and his wife, and this is the manifestation of his centralized and cautious style as a corporate leader. Since 2014, Bin Valley has entered the expansion period, and in addition to the accumulation of pan-family members, i.e. schoolmates, friends, and neighbors (this phenomenon is consistent with the common pan-family tendency among Chinese family businesses), Bin Valley has recruited more professional managers. As a result, the proportion of family members that occupied managerial positions was gradually reduced to less than the proportion of non-family managerial personnel. In this context, ownership diversification of the family and the company was inevitable, and Mr. Bin and his wife began to allocate stock shares to some family members and some non-family high-level managerial personnel.

Table 4-4 Distribution of shareholding structure

Development stages	Shares of high-level management		Shares of intermediate-level management		Shares of basic-level management	
	Family members	Non-family members	Family members	Non-family members	Family members	Non-family members
2003-2013	100% Owner and his wife President & CFO	0	0	0	0	0
2014-2015	90% Owner and his wife(President & CFO) occupies 80%, and the remaining 10% goes to Standing Deputy General Manager of Engineering Business Segments, General Manager of Technology Business Segment (Mr. Bin's mother's maternal cousin), Deputy General Manager of Culture Business Segment (Mr. Bin, s friend), Assistant of President (Mr. Bin's classmate), Director of Planning Department (Mr. Bin' s classmate)	10% Shared by Director of Human Resources Department, Director of Administration Department, General Manager of Engineering Business Segment , General Manager of Trade and Commerce Business Segment , General Manager of Investment Business Segment , Genera, Manager of Finance Business Segment, General Manager of Culture Business Segment	0	0	0	0

Source: based on interviews with the Planning Department

From Table 4-4, it can be seen that the delegation of control precedes the delegation of ownership. Five years after the foundation of Bin Valley in 2008, when the business began to be diversified, the MBA degree that Bin had gained heightened his awareness of modern management and company governance. In addition to ensuring the stock rights were held by family members, Mr. Bin truly felt a need to overcome the limitations of personal and family decisions by introducing experienced consultants as his think tank. Meanwhile, he gradually made the management positions available to non-family members and recruited non-family professionals to participate in company operation & management. In particular, he recruited a batch of MBA classmates in 2011 into management roles to perform strategic planning. After the strategic plan was made, six business segments were gradually set up and more skilled and experienced professional managers joined Bin Valley. In order to motivate the directors of the business segments, Mr. Bin delegated the control and decision-making power based on the loyalty and performance of the directors, giving discretion to directors over the operation and management of their business segments. In the 10th year of Bin Valley, 20% of the control had been delegated to professional managers, and since then, more control power has been delegated until only 70% was remained in the hands of family members.

Table 4-5 Distribution of control in the history of Bin Valley Group (family relation, position and ratio)

Development stages	Ratio of control of the high-level management (%)		Ratio of control of the intermediate-level management (%)		Ratio of control of the intermediate-level management (%)		Motivations
	Family members	Non-family members	Family members	Non-family members	Family members	Non-family members	
2003-2008	100	0	0	0	0	0	The scale of the company is small. The business is not diversified, and the management hierarchy is not complex. The management personnel mainly consists of key family members. The non-family members concentrate in technological posts or other ordinary posts and have no control power. The concentration of the control power in the family members facilitates the generation of an interest community based on kinship
2009-2013	75	15	5	5	0	0	Professional managers are recruited due to the increasing scale of the company and the higher complexity of the management. Some control is allocated to them to improve their enthusiasm.
2014-2015	55	20	10	10	2	3	More control power is allocated to the high-, intermediate and even basic-level non-family members for the purpose of adapting to external changes, unleashing operation & management vigor and achieving sustainability.

Source: based on interviews with some high- and intermediate-level managerial personnel

In summary, the allocation of stock rights and control as well as the appointment of important positions in Bin Valley mostly rely on kinship ties. From this stance, Bin Valley's development can be classified into the following stages: home system (2003-2004), family system (2005-2007), the early stage of pan-familism (2008-2010), the middle stage of pan-familism (2011-2012) and the late stage of pan-familism (2013-2015). In the home system, Mr. Bin's family had all the power, and in the family system, blood and near relatives possessed the control power. The core power of the enterprise then began to be delegated to the family members of the founder, and pan-family members started to join the company and be assigned to basic positions, such as technological and production posts. During the early stage of pan-familism, while the control power of the company was distributed among the entire family, pan-family members began to be allocated some control power and occupy core posts for engineering management. In the middle stages of pan-familism, pan-family members occupied more control power and occupied more intermediate-level management posts, and in addition to engineering posts, they were appointed to new posts in investment and cultural management. During the latter stage of pan-familism, relatives left Bin Valley and pan-family members gained more control power over the new management posts in engineering, investment and cultural management. The endogenous factor in this process was the fact that the owner began to trust the pan-family members.

4.3.5 Corporate Performance of Bin Valley

Bin Valley has branched out into the engineering, technology, trade, investment, finance and cultural fields, and it entered these areas gradually instead of simultaneously. The development of each business segment is unbalanced and the performance difference among these segments is significant, as shown in Table 4-6.

The table shows the revenues and profits of the company and each of its business segments for the last four years. It can be seen from the data that the engineering business segment contributes most to the company's revenue and has been increasing in its profits, but the cultural, technology and investment business segments have not yet achieved profitability.

Table 4-6 Corporate performance of Bin Valley Group from 2012 to 2015

<table>
<tr><th colspan="3"></th><th>Engineering</th><th>Technology</th><th>Trade</th><th>Investment</th><th>Finance</th><th>Culture</th><th>Total</th></tr>
<tr><td rowspan="4">2012</td><td rowspan="2">Revenues</td><td>RMB
(unit:10,000 RMB)</td><td>120,000</td><td>200</td><td>0</td><td>0</td><td>0</td><td>200</td><td>120,400</td></tr>
<tr><td>Euro
(unit: 10,000 euros)</td><td>804</td><td>1.34</td><td>0</td><td>0</td><td>0</td><td>1.34</td><td>806.68</td></tr>
<tr><td rowspan="2">Profits</td><td>RMB
(unit:10,000 RMB)</td><td>900</td><td>-90</td><td>0</td><td>-180</td><td>0</td><td>-80</td><td>550</td></tr>
<tr><td>Euro
(unit: 10,000 euros)</td><td>60.3</td><td>-6.03</td><td>0</td><td>-12.06</td><td>0</td><td>-5.36</td><td>36.85</td></tr>
<tr><td rowspan="5">2013</td><td rowspan="2">Revenues</td><td>RMB
(unit:10,000 RMB)</td><td>18000</td><td>10</td><td>0</td><td>0</td><td>300</td><td>50</td><td>18360</td></tr>
<tr><td>Euro
(unit: 10,000 euros)</td><td>1206</td><td>0.67</td><td>0</td><td>0</td><td>20.1</td><td>3.35</td><td>1230.12</td></tr>
<tr><td rowspan="3">Profits</td><td>RMB
(unit:10,000 RMB)</td><td>1300</td><td>-120</td><td>0</td><td>-130</td><td>100</td><td>-60</td><td>1090</td></tr>
<tr><td>Euro
(unit: 10,000 euros)</td><td>183.3</td><td>-16.92</td><td>0</td><td>-18.33</td><td>14.1</td><td>-8.64</td><td>82.42</td></tr>
<tr><td>Euro
(unit: 10,000 euros)</td><td>107.2</td><td>-16.08</td><td>0</td><td>-4.69</td><td>13.4</td><td>-13.4</td><td>86.43</td></tr>
</table>

Source: based on financial statements from Bin Valley Group

Table 4-6 Corporate performance of Bin Valley Group from 2012 to 2015 (continued)

			Engineering	Technology	Trade	Investment	Finance	Culture	Total
2014	Revenues	RMB (unit:10,000 RMB)	19000	0	0	0	500	200	19700
		Euro (unit: 10,000 euros)	1273	0	0	0	33.5	13.4	1319.9
	Profits	RMB (unit:10,000 RMB)	1600	-240	0	-70	200	-200	1290
		Euro (unit: 10,000 euros)	107.2	-16.08	0	-4.69	13.4	-13.4	86.43
2015	Revenues	RMB (unit:10,000 RMB)	20000	50	100	200	800	80	21230
		Euro (unit: 10,000 euros)	1340	3.35	14.1	13.4	112.8	11.28	1422.41
	Profits	RMB (unit:10,000 RMB)	1800	-180	20	-50	500	-120	1970
		Euro (unit: 10,000 euros)	1206	-120.6	1.34	-3.59	33.5	-16.92	131.99

Source: based on financial statements from Bin Valley Group

Based on in-depth interviews with the founder of Bin Valley and directors of each business segment, a detailed analysis can be performed on the operation of each business segment.

(1) Engineering: the traditional business through which Bin Valley managed to secure a foothold since the start-up period. It mainly involves installation, design and maintenance of electric power, electro-mechanical and fire-protection systems. Generally speaking, Bin Valley's engineering business is highly qualified and influential. In the electricity industry, which is monopolized by state-owned enterprises, Bin Valley's sub-company – Yuandian – is ranked among the top 10 private electrical engineering corporations in Sichuan.

The first ten years of Bin Valley coincided with the prosperity of the real estate industry and the government's enormous investment in infrastructure. In this situation, Bin Valley's engineering business was able to gain rapid development, and its output value and profits soared, which made the engineering business segment the main source of Bin Valley's cash flow. This can be seen from the financial data for 2012 and 2013. However, with the Chinese government's regulation of the macro economy and the elapse of the peak of the real estate and construction industry, the scale and profits of this business segment have since been decreasing, as can be observed from the financial data for 2014 and 2015.

In terms of the team's structure, the management of the engineering business segment consists of family and non-family members. The general manager of the engineering business segment is a well-paid professional manager, and the deputy general manager is the President's second eldest brother, who is responsible for market expansion. In 2014, the President's second eldest brother was replaced by the President's apprentice, and another two apprentices were appointed as deputy general managers responsible for project management and commerce. These people constitute the pillar of the engineering business segment, and many of the intermediate and basic-level personnel are Mr. Bin's close and distant relatives and fellow villagers. The proportion of family members in the engineering business segment is higher than any other department and business segment.

(2) Technology: this is the first business that Bin Valley branched out into, and in 2010 Mr. Bin was acutely aware of the potential of the solar power industry and decided to

diversify into this area. He chose the director of this business segment, established the project and recruited staff (over 10 employees at most) himself. Some of the funds from the revenue generated by the engineering business were diverted to procure experimental equipment and production lines. In addition to cooperating with manufacturers that boasted advanced component manufacturing technology, Bin Valley engaged itself in solar power research and development for the purpose of producing solar power devices as soon as possible.

Preliminary results were achieved in 2011, and due to the support from the Panxi local governments, Bin Valley was awarded solar power renovation projects in several villages and communities. Bin Valley also ventured to submit tenders for projects in competition with local electricity companies, however, due to the rapid increase in the solar power production scale across the globe and the changes to China's subsidy policies for solar power investment, the entire solar power industry receded and many manufacturers collapsed. Meanwhile, the first general manager of the Technology Business Segment (professional manager) strongly disagreed with Mr. Bin, violated financial regulations, and was forced to leave the company. The rest of the team was also disbanded, and the experiment and production facilities were left idle.

In the middle of 2012, the President's uncle was assigned as the new general manager of the Technology Business Segment, and a new team was constructed that consisted of three people, including a solar power expert as the chief engineer and a senior technician as an engineer. Mr. Bin learned from his previous experience, changed the business direction and did not invest recklessly in the solar power industry, which required heavy investment, high costs and faced fierce market competition. Instead, based on insights about market segmentation and market changes, he decided to self-develop and specialize in solar power-based rat eradication technology. After one year of hard work, Bin Valley obtained two patents for rat eradication devices, one patent for aesthetic design, and five patents for other practical technological innovations.

In 2014, Bin Valley collaborated with some institutions to develop a power generation system based on residual gas and exhaust heat. In 2015, Mr. Bin and the general manager of the Technology Business Center visited Mongolia and procured an order for their novel power generation system. Despite remarkable achievements in technological research, Bin Valley's ability to translate research results into profit and expand the technology market is very limited, and as a result the technology business segment has few sales (the largest income from an order is only 500,000 RMB, or 33,500 Euros) and suffers losses each year.

(3) Trade: the trade business segment originally relied on the engineering business segment to sell engineering equipment, wires and cables. Later on, it obtained the rights to sell other products (e.g., switches, distribution boxes and fire-protection equipment) and started to engage in the small-scale supply of goods to a few engineering companies.

This business segment has neither achieved independence nor thrived, and the team of this segment was dependent on the supply of goods to the engineering business segment. Its economic profit was not accounted for independently, and there was only one family member in its team, i.e., the cousin of Mr. Bin, who was responsible for supplies procurement and worked conscientiously on quality and cost control for Bin Valley.

In 2015, the recruitment of a professional manager introduced the new idea of combining the trade business with the health preserving culture, and specializing in the sale of marketable health preserving products through the use of the World Health Culture Association. By implementing this idea, the business started to earn revenue independently and was able to achieve profitability of 200,000 RMB, or 13,400 Euros.

(4) Investment: the investment business segment started operating with its participation in the Chengdu 198 Project (Baicaoyuan Corporation in Wenjiang). This project covered an area of about 86,666 m^2 and was initiated in 2011 to create infrastructure to support nurseries, fertile land and vegetation. In 2012, the Chengdu Government adjusted its planning and intended to turn this area into a round-the-city ecotope of Chengdu. Baicaoyuang is in the Jinsha Lake area, and due to ambiguity of the government's policy, the entire project came to a standstill in June, 2014.

The main purpose of the project was to construct an ecological farm that specialized in nursery stock and vegetable growth. By 2014, Bin Valley had invested over 20 million RMB (2.82 million Euros) into the project, but the project had been suffering losses, because it had not completed its construction, had not been put into operation, had not been transferred at a higher price, and had no cash flow. Moreover, Bin Valley bought into two investment companies in 2013, which relied on the Alumni Association of Southwestern University of Finance and Economics.

Mr. Bin received training at the Southwestern University of Finance and Economics, made the acquaintance with new school mates, and developed awareness of capital operations. After two years of development, the company achieved profitability and earned a dividend of 2 million RMB (134,000 Euros) to compensate for the loss of this business segment (as shown in the financial data for 2015). As for the management team of this business segment, only the wife of Mr. Bin's brother-in-law served as the director of the procurement department for Baicaoyuan and she worked hard to choose nursery stock, which achieved considerable cost savings. Other members of the management team were all professional managers who had a wide network of social connections but limited professional experience.

(5) Finance: Bin Valley bought into a petty loan company in the High-Tech Zone of Chengdu in 2013 and became the second largest shareholder engaged in petty loan, callable loans and guarantees. As shown in the financial data for the 2013-2015 period, the operation performance was mediocre, and the management team of this business segment purely consisted of professional managers.

(6) Culture: since 2012, to grasp the opportunity presented by the national policy to promote the cultural industry, Bin Valley has branched out into the cultural industry by making movies and feature films, and films of various annual meetings, forums and performances. At the start of 2013, Bin Valley established a culture company in Beijing – which is considered to be the center of the culture industry in China. Later, Bin Valley carried out the project of constructing a Chinese-French Town, which is a tourist and cultural real estate project in Bailu Town, Pengzhou City. Also, the company has hosted a series of international and domestic cultural events to showcase the brand of Bin Valley Culture in the field of culture and art.

In 2014, Bin Valley registered with the World Health Culture Association in Hong Kong, and since then, under the banner of Bin Valley Culture, the company has built up its four business sub-segments in sports, movies, health culture and tourism. However, all sub-segments operated at a loss for 2013-2015, except for the moderately profitable tourism sub-segment and the slightly profitable sports sub-segment. As for the management team of this segment, the deputy general manager of the sports sub-segment was an old friend of Mr. Bin, who helped to obtain the managerial authority of the China Basketball Association in Sichuan and Chongqing. Mr. Bin’s brother-in-law’s wife was transferred from Baicaoyuan to this segment in 2014, where she was put in charge of the procurement of the tourism sub-segment and contributed to the construction of the Chinese-French Town. Some distant relatives of Mr. Bin also worked as ordinary workers in this segment.

(7) From the analysis on the operations of Bin Valley in the last four years, it can be observed that Bin Valley performed well and achieved stable progress in both revenue and profitability. However, the development of the six business segments was unbalanced, and more specifically, the engineering segment contributed to over 90% of Bin Valley’s revenue and profit each year and was the pillar of the entire company, despite the annual decrease in is contribution from 99.7% for 2012 to 94.2% for 2015.

The technology segment earns no profit and has been continuously running at a loss, but it represents the strategic direction that Bin Valley intends to follow in the long term in order to boost Bin Valley’s core competitiveness. It wasn’t until 2015 that the trade segment earned enough revenue to generate profit, and it is the company’s circulation platform. Investments were made in the investment business segment in the first three years, but it was always at a loss and did not achieve profitability until 2015. Afterwards, it becomes the company’s operational platform.

Among the new business segments, the finance segment is the best-performing business, and the proportion of its revenues reached its highest level of 3.8% in 2015. The finance segment has always been profitable and its profit percentage peaked at 62.5%, making it the company’s capital platform. The culture business segment has been earning income but the income is small, and it had its best performance in 2014, when it generated income of 2 million RMB. Despite this, it has always operated at a loss and this was up to 1.2 million RMB in 2015. However, the culture business segment provides a propaganda platform for the company.

4.3.6 The Life Cycle and Governanace Model of Bin Valley Group

Gersick (1998) classified the life cycle of family businesses into the start-up period, the formalization/expansion period and the maturity period. The purpose of this study is to find appropriate governance models for different life cycles and improve economic efficiency. Based on the supporting theories in Chapter 2, the governance model of family businesses can be classified into contractual governance, relational governance and dual governance. We performed a case study on Bin Valley, where the 12-year development history of Bin Valley can be divided into the start-up period, growth period and the speed-up period. The three stages of Bin Valley will be analyzed in terms of their implementations of contractual governance, relational governance and dual governance.

Before the analysis, the family members are classified based on how closely related they are to Mr. Bin, as follows: Type 1 - blood relative (wife, daughter, son, parents and siblings); Type 2 - close relative (maternal and paternal cousins, and in-laws); Type 3 - distant relative (relatives whose family connection is only from several generations in the past); and Type 4 - pan-family members (fellow villagers, schoolmates and friends). The choice of governance models across different stages of Bin Valley is shown in Fig. 4-6.

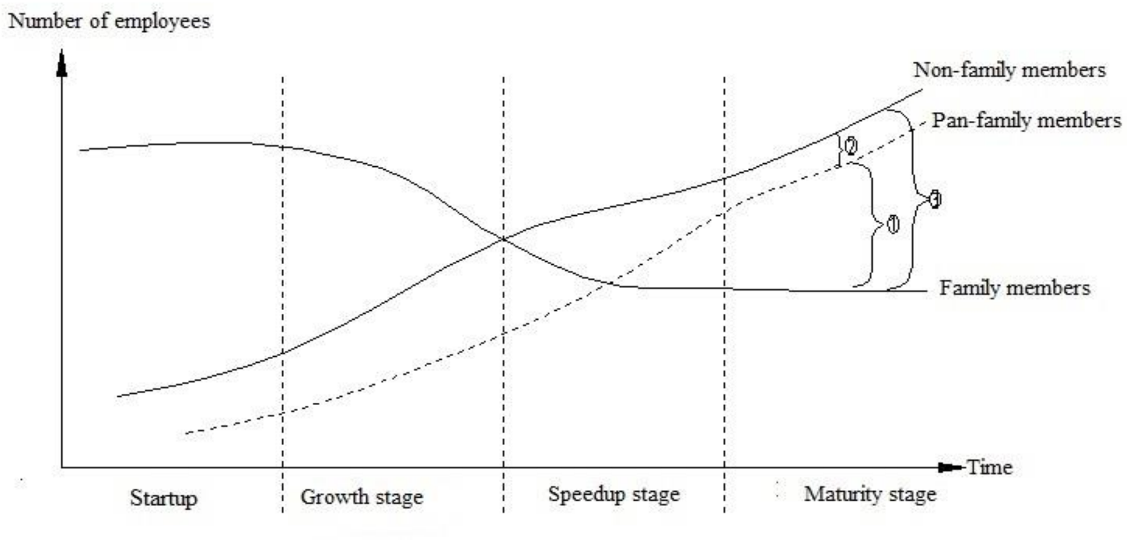

Figure 4-6 Variation of governance models across different stages of Bin Valley

Source: made by the author

4.3.6.1 Start-up period (2003-2008)

Bin Valley was born as a family and it was initially run by both the founder and the family members. Later on, more family members, pan-family members and non-family members joined Bin Valley, and control and ownership significantly overlapped with each other. Bin Valley was an interesting community that relied on contractual governance and was free of the principal-agent problem. Hence, there were few management problems and family members made concerted efforts for the survival of the enterprise.

Relational Governance:

Governance objects during this period included family members and pan-family members in Table 4-7.

Table 4-7 Governance objects during the start-up period of Bin Valley Group

Names	Relationship with Mr. Bin	Position	Family Involvement	Time of joining and leaving Bin Valley
Xie Yan	Wife	CFO	Ownership: 20% Control: ★★★★	Joined in 2006
Bin Tao	Father	Head of Logistics and Administration	Ownership: 0 Control: ★★★	Joined in 2003 and left in 2006
Bin Kai	Eldest brother	Project Manager	Ownership: 0 Control: ★★★★	Joined in 2003 and left in 2006
Bin Peng	Second eldest brother	Project Manager	Ownership: 0 Control: ★★★★	Joined in 2006 and left in 2013
Bin Hongbo	Elder Paternal Cousin	Captain of Engineering Team	Ownership: 0 Control: ★★★	Joined in 2003
Bin Hongjie	Younger Paternal Cousin	Deputy Captain of Engineering Team	Ownership: 0 Control: ★★★	Joined in 2003
Anonymous	Other close and distant relatives	Technician or ordinary staff	Ownership: 0 Control: 0	Joined in 2006
Anonymous	Fellow Villagers	Technician or ordinary staff	Ownership: 0 Control: 0	Joined in 2008

Note: it is difficult to quantify control, and thus we represent it with ★'s on a scale of 1-5, where one star indicates the lowest level of control, and five stars mean the highest level of control.
Source: based on data from the Human Resources Department

As discussed in Chapter 4, most of the small- and medium-sized family businesses in China adopt relational governance, which is a rational choice under certain constraints. In what follows, a case study will be performed on Bin Valley to analyze what the constraints and the criteria of a rational choice are.

(1) Resource orientation: trust

Trust is defined as the probability estimated by an individual that another individual or a group of individuals perform a specific action. This estimation is made before he can monitor this specific action and has influence on his own actions (Gambetta, 1986). After thousands of years, social connections have linked Chinese family businesses together, and the strength of these links is determined by the properties of the trust that the Chinese people put in their interpersonal relationships. "Certain constraints" refers to how the logic that the Chinese people apply in their social and economic lives differs from the law and contracts that operate in Western countries, because the Chinese people regulate their social and economic lives using their interpersonal connections. These interpersonal connections embody Chinese ethics and parallel the laws and contracts of Western countries.

China is a country with a low degree of trust (Fukuyama, 1995) and the Chinese tend to distrust outsiders (Smith, 1989; 1994). The Chinese people's trust is built upon kinship ties, and is a special type of trust that is maintained via consanguinity or a patriarchal structure (Weber, 1995). The trust within the family is very attractive to a family member running a business for the following reasons: (1) it is easy to establish cooperation between family members and resolve disagreements, thereby ensuring the authority of the patriarch over the enterprise; (2) the family members share common interests, making it easy to establish the same targets and improve cohesion; (3) the high level of kinship-based trust offers more protection of property; (4) in the case of financial predicaments, the relatives of the entrepreneur are willing to work without being paid in order to help the enterprise survive a crisis; and (5) the family members are more willing to maintain secrecy about the inner workings of or irregularities within the enterprise.

In its first five years, Bin Valley relied on the natural trust between family members to develop from a small private enterprise to a large enterprise, and managed to establish a foothold in the electric power engineering market previously monopolized by state-owned enterprises. Family members accounted for a high proportion of the high- and intermediate-level management positions in Bin Valley, as shown in Table 4-8.

Table 4-8 Variation of the proportions of family members during the start-up period (2003-2008)

Years	Proportion of family members in the total number of staff (%)	Proportion of family members in high- and intermediate-level management positions (%)
2003	90	100
2004	88	95
2005	85	90
2006	80	88
2007	76	85
2008	72	80

Source: based on the data from the Human Resources Department

For small-sized, medium-sized or start-up companies, the scale of capital is small, and the businesses and management structure are relatively simple, which puts them in a good position to implement relational governance. Firstly, the natural trust between family members fosters loyal and trustworthy relationships, which simplifies the supervisory and incentive mechanisms of the enterprise and reduces transaction costs. Secondly, the family patriarch's authority and differential mode of association improves the self-adapting and self-regulating abilities in terms of work division and cooperation within the enterprise, promoting the stability of the organizational structure in the family business. Thirdly, family management is deeply rooted in family culture, and since family is a team itself, the family business will find it easy to cultivate a spirit of teamwork while implementing family management. This will benefit the family business, and it is therefore fully reasonable for small- and medium-sized family businesses to implement family management and specifically, the relational governance model.

In this way, during its first five years, Bin Valley relied on family members to establish a foothold in the market, and afterwards worked towards improving its corporation management and expanding the business.

(2) Governance object

Chinese family businesses' governance objects are the family members and their interpersonal relationships during the start-up period. Family members are linked by marriage, kinship ties or adoption, but differ in terms of educational background and the way they think and conduct themselves. This can be observed from the variations in the relationships between family members at Bin Valley across its development history.

The family relationship of Bin Valley relies on kinship ties and marriage, and when Mr. Bin succeeded in starting his own company, he invited his parents, and eldest and second eldest brothers to work with him. After getting married, he run his company with his wife, and at the very beginning, everyone made concerted efforts to overcome the difficulties that were encountered. When they needed to borrow money for projects, Mr. Bin's father used his pension to pay worker salaries, and Mr. Bin' s wife lived with him on the construction site. Mr. Bin's mother took charge of logistics and his two brothers also helped by managing the construction teams. Most of the workers consisted of very loyal and hard-working family members or fellow villagers, and it is due to their family spirit, collegiality and unity that the Sichuan Yuandian Installation Company (the predecessor of Bin Valley) managed to gain a foothold in the electric power engineering market.

All of Bin Valley's shares were owned by Mr. Bin and his wife, while other family members could only earn salaries, bonuses or subsidies. With the increase in the scale of the company and the accumulation of the wealth, the relationship between family members turned complex, and the family members were becoming increasingly discontent with the existing benefit scheme. This problem, combined with their disagreement on the developmental direction of the company and grievances within the family, prompted the eldest brother and father to quit in the middle stage of the start-up period.

In Bin Valley's relational governance, the control power and ownership was delegated based on the kinship ties of Mr. Bin and the variation of trust he had with the family members listed previously. Based on the theory of Fei Xiaotong (1939), the differential mode of association of Bin Valley is shown in Fig. 4-7.

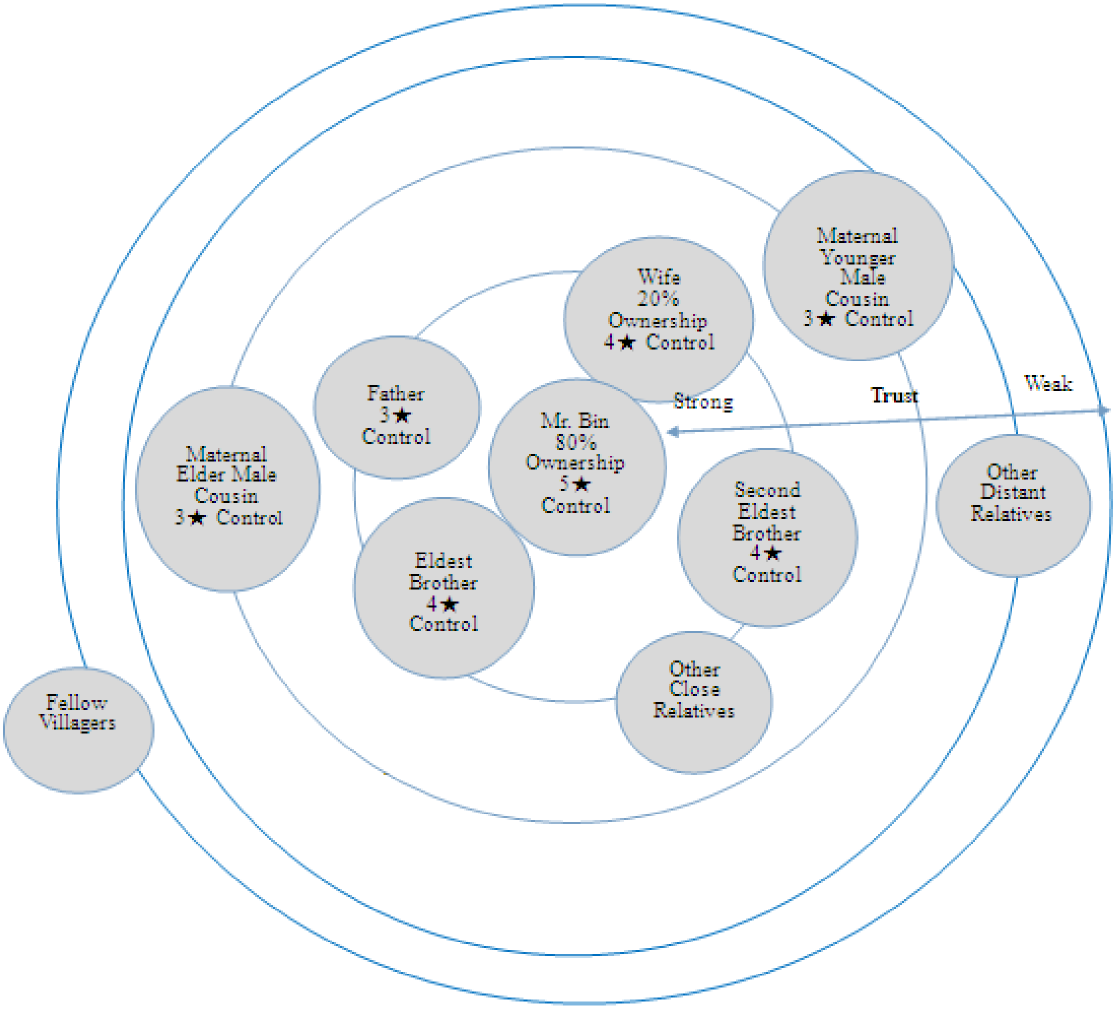

Figure 4-7 Differential mode of association of Bin Valley's relational governance structure during the start-up phase

Note: the control power is represented by ★'s

Source: based on data from the Human Resources Department

Figure 4-7 shows that in the control power allocation scheme, Mr. Bin is at the center of the concentric circles, and the circles further from the center reflect how family members are less close to the founder and thus allocated less control power. In the start-up period, the innermost circle denotes the Type-1 family members, i.e. blood relatives, who are the top-level executives of the company and occupy the most important positions. His wife is closest to him and has the most complete control power, and his father, eldest brother and second eldest brother have occupied positions in the enterprise and are allocated different levels of control power.

The second circle denotes the Type-2 family members, i.e. close relatives. Among these close relatives are his elder paternal cousin and younger paternal cousin, who are the closest to Mr. Bin, and were appointed to the intermediate-level management positions with some control power. Other close relatives who were more distant to Mr. Bin, occupied the basic-level management positions, and were not allocated any control power.

The third circle denotes the Type-3 family members, i.e. distant relatives, the fourth circle denotes the pan-family members, who are mostly fellow villagers, and the outermost circle denotes non-family members. All these groups are channeled into technological or other ordinary positions and have no control power. From the organizational structure of the company, and the relationship between the circles and the levels of management positions, it can be seen that those located in the first and second circles are more trusted and appointed to higher-level management positions. Therefore, the criterion for occupational promotion is mostly reliant on how close their kinship is to the founder.

(3) Governance Effect

It was learned from the interview with Mr. Bin and other management personnel that the relational governance that Bin Valley implemented at the start-up stage was very instrumental in ensuring stable development of the company and avoiding external risks. However, negative effects began to manifest after a period of time.

The initial positive effects of relational governance at Bin Valley were as follows:

(1) Stability of the staff – Although more family members joined Bin Valley in the development phase, the turnover rate remained low.

(2) Decrease in moral hazards – Compared to non-family members, the family members of Bin Valley followed the founder longer and developed a more profound and mutual understanding with him. They were very dedicated and chose to stay with the company in the face of difficulties out of unwavering loyalty.

(3) Improve the degree of trust and decrease transaction costs – Bin Valley's family members were very trustworthy and communicative with each other, and they often talked face to face. This reduced information exchange costs, fostered the achievement of consensuses, and heightened their sense of belonging.

(4) Boost corporate performance – As a Chinese proverb goes, "opportunities of time

vouchsafed by Heaven are not equal to advantages of situations afforded by the Earth, and advantages of situations afforded by the Earth are not equal to the union arising from the accord of men." Cohesion and unity yield approaches to difficulties and achieve synergy, which produces greater efficiency and performance.

Generally speaking, relational governance was a management model that matches the corporation scale, the operational environment and the patriarch's style. This model united family members towards the same goal, and enabled Bin Valley to evolve from an unknown small-scale electrical engineering company with an annual revenue of several hundred thousand RMB to a large-scale corporation, which increased its revenue by thousands of times to over 10 million RMB in 2008. Even when taking inflation into account, the improvement in performance was very substantial.

However, the following negative effects were observed:

(1) Limited in capability – Most of the high and intermediate-level managerial staff in Bin Valley did not receive a higher education or professional training, and by default, pan-family and non-family members were only assigned to ordinary positions. This meant that they did not have enough opportunities to train themselves and accumulate managerial experience.

(2) Limited resources – Family members were generally allergic to non-family members, and they had neither received a college education nor worked in other companies. They had few connections to the outside world and were incompetent at gaining external resources that could have benefited Bin Valley's development.

(3) Internal Discord – The disunity and dispute over the distribution of benefits between family members is an accelerant for a family business's decline. Su and Li (2004) argued that a family business's achievements are positively correlated with fair negotiations among family members, but negatively correlated with selfishness and tense relationships among family members.

During the start-up stage of Bin Valley, Mr. Bin treated his father, brothers and wife with considerable respect, and was willing to discuss Bin Valley's operational strategies and management with his other family members. He really counted on their thoughts, ideas and support during the transformation of several projects, and as a result, the relationship among family members and the top-level management of the enterprise was very stable and harmonious. Concerted efforts were made to boost Bin Valley's rapid development, but with his own personal development in operational skills, Mr. Bin was concerned the corporation's development, operation and management were accelerating too fast for his family members, and felt that they could not keep pace with him and the company's development. In this context, he had to act more decisively, and some family members did not distinguish their roles at home from their roles in the company and showed disregard for his decisions. Complaints arose against the founder's refusal to share stock rights with other family members, and internal discord with the family inevitably broke out. Mr. Bin's eldest brother quarreled with him and left, and was followed by his father when he chose to quit and retire due to a disagreement.

4.3.6.2 Growth Stage (2009-2013)

With the increase in the scale of the company during this period, more and more pan-family members and non-family members joined Bin Valley, and ownership started to be separated from control. However, this only meant that control was beginning to be delegated, while ownership still belonged to the family members and the principal-agent problem surfaced. The conflicts between family members and pan-family and non-family members began to occur, and the discord amongst the family members was becoming more serious.

Relational Governance

At this stage, Bin Valley applied relational governance to the family members, as shown in Table 4-9.

Table 4-9 Objects of Bin Valley relational governance during the growth stage

Name	Relationship with Mr. Bin	Position	Family Involvement	When They Joined and Left Bin Valley
Xie Yan	Wife	CFO	Ownership: 20% Control: ★★★★	Joined in 2006
Bin Peng	Second eldest brother	Standing General Manager of Engineering Business Segment	Ownership: 0 Control: ★★★★	Joined in 2006 Left in 2013
Bin Hongbo	Elder Paternal cousin	Captain of Engineering Team 1	Ownership: 0 Control: ★★★	Joined in 2003
Bin Hongjie	Younger Paternal Cousin	Captain of Engineering Team 2	Ownership: 0 Control: ★★★	Joined in 2003
Jiang Liang	Wife's mother's maternal cousin	General Manager of Technology Business Segment	Ownership: 0 Control: ★★★★	Joined in 2011
Tang Yu	MBA classmate	Assistant of Chairman of the Board of Directors	Ownership: 0 Control: ★★★★	Joined in 2011
Huang Gui	MBA classmate	Director of Marketing Department	Ownership: 0 Control: ★★★★	Joined in 2011 and left in 2012
Yuan Feng	MBA classmate	Director of Planning Department	Ownership: 0 Control: ★★★★	Joined in 2011
Li Ping	Student	Deputy General Manager of Engineering Business Segment	Ownership: 0 Control: ★★★	Joined in 2006
Anonymous	Distant or close relatives	Technical or ordinary positions	Ownership: 0 Control: 0	Joined in 2006 or 2011 and some left in 2012 or 2013
Anonymous	Fellow villagers	Technical or ordinary positions	Ownership: 0 Control: 0	Joined in 2006 or 2011 and some left in 2013

Source: based on data from the Human Resources Department

(1) Resource orientation: trust

After 2009, more family members and professional managers joined Bin Valley, and these professional managers were generally close friends and classmates of Mr. Bin. Since

Bin Valley implemented diversification in 2011, another group of professional managers with MBA qualifications joined Bin Valley, most of whom were acquainted with Mr. Bin when he studied for his MBA and developed great mutual trust with him. These close friends and classmates could be classified as pan-family members. Due to these ties and cooperation, the family members currently at the company began to be supplemented with these close friends, classmates, and neighbors. As a result, the proportion of family members occupying high and intermediate-level management positions was decreasing, as shown in Table 4-10.

Table 4-10 Variation of the proportion of family members during the growth stage of Bin Valley (2009-2013)

Years	Ratio of family members to the total number of staff (%)	Ratio of family members to high and intermediate-level management personnel (%)
2009	60	75
2010	50	65
2011	45	58
2012	33	52
2013	20	36

Source: based on data from the Human Resource Department

Despite the decline in the proportion of family members occupying high and intermediate-level management positions and the increased capital scale of the company, Mr. Bin was still naturally inclined to trust his family members. This phenomenon can be seen from responses provided in the surveys that were conducted across the company for three years in a row since 2013, as summarize in Table 4-11. The surveys were anonymous and classified into two types: family members and non-family members, and each type was further divided into management staff and non-management staff. Mr. Bin was unwilling to admit this tendency, but most of his staff felt this way.

Table 4-11 Survey on the trust for staff across Bin Valley (2013)

Identify of respondents	Level of their positions	The degree of trust they felt they have won from Mr. Bin		
		High	Intermediate	Low
Family member	Managerial staff	70%	20%	10%
Family member	Ordinary staff	68%	25%	7%
Non-family members	Managerial staff	50%	30%	20%
Non-family members	Ordinary staff	60%	25%	15%

Source: based on internal questionnaires

(2) Governance Object

During the early stages of the growth period, Bin Valley mainly applied relational governance to family members and non-family members, and the conflict between family members began to manifest itself. Mr. Bin's second eldest brother smoke in office and Mr. Bin disallowed that, but he never listened. During the 10th year of the company's development (2013), Mr. Bin's second eldest brother left Bin Valley Group over a disagreement he had with him, but the companies established by the second eldest brother were still responsible for contracting and outsourcing business from Bin Valley Group. Since then, the number of blood relatives of Mr. Bin (Type-1 family members) working at Bin Valley has dramatically decreased, and the current working family members mostly consist of close or distant relatives and pan-family members (Types 2-4).

Bin Valley's relational governance structure at this stage meant that ownership and control was still being allocated based on how close family members were to Mr. Bin and how much trust they had gained from him. Differential mode of association for Bin Valley's relational governance during this stage is shown in Fig.4-1.

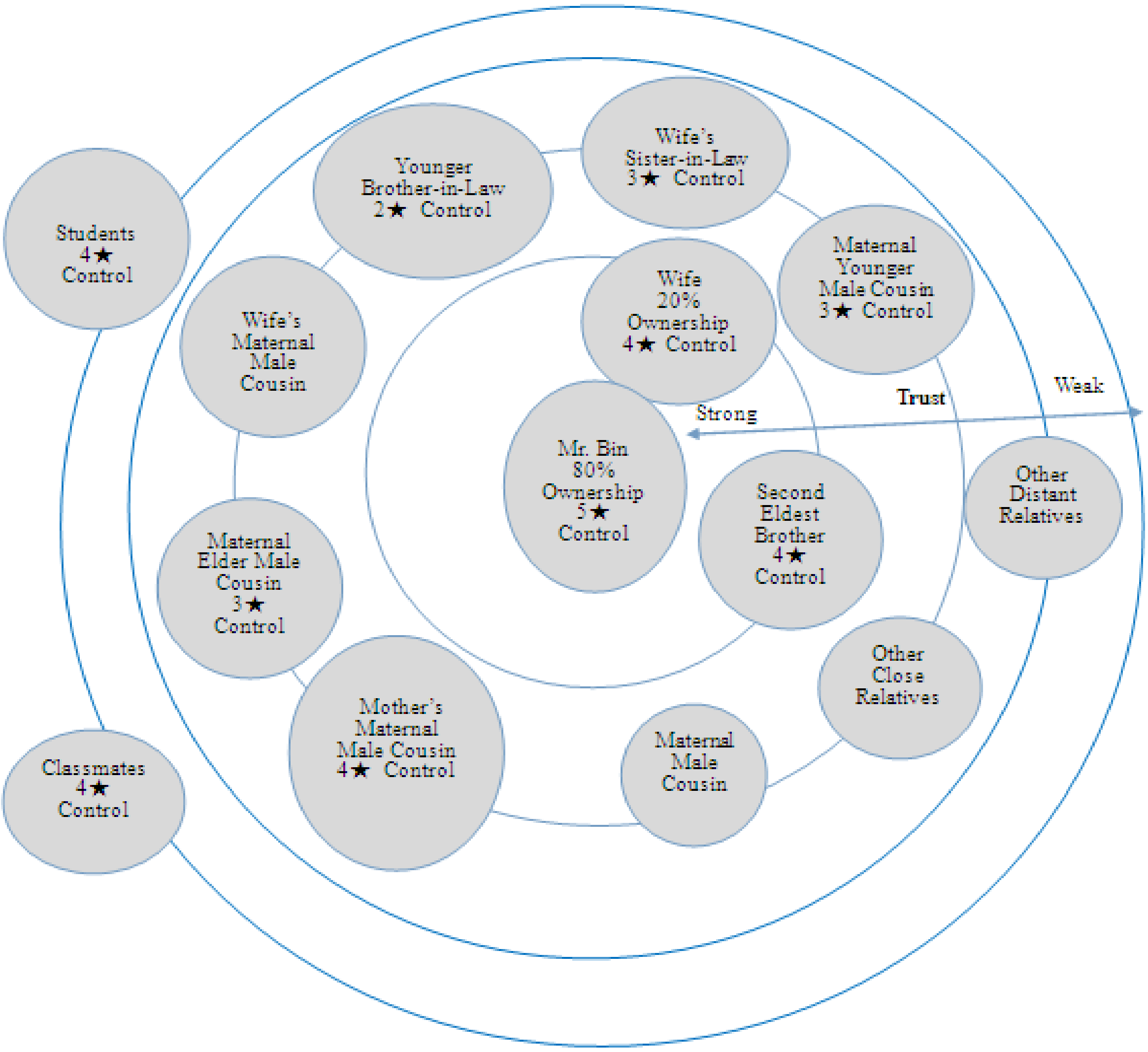

Figure 4-8 Differential mode of association of Bin Valley's relational governance model during the growth stage

Note: We use ★ to express control.

Source: based on data from the Human Resources Department

Figure 4-8 shows that in the control power allocation scheme, Mr. Bin is at the center of the concentric circles, and the circles further from the center imply that these family members are not very close to the founder and are thus allocated less control power. The fourth circle is an exception because some pan-family members are still able to enjoy great power. In the growth period, the first circle denotes the Type-1 family members, i.e. blood relatives, who are the top-level executives of the company and occupy the most important positions, and Mr. Bin's wife, who is closest to him, has the most control power. His second eldest brother had once occupied a position in the enterprise and was allocated enormous control power.

The second circle denotes the Type-2 family members, i.e. close relatives. Among these close relatives, Mr. Bin's mother's maternal cousin was the closest to him, and therefore was assigned a high-level position in the enterprise and allocated a large amount of control power. Mr. Bin's elder and younger paternal cousins were appointed to intermediate-level management positions and allocated moderate control power, and his in-laws also came to join Bin Valley. Mr. Bin's younger brother-in-law and his wife occupied intermediate-level management positions and had some control power, while Mr. Bin's maternal cousin-in-law was made an ordinary staff member with no control power.

The third circle denotes the Type-3 family members, i.e. distant relatives, who were all placed into technological and other ordinary positions and had no control power. The fourth circle denotes the pan-family members, which consisted of fellow villagers, schoolmates, apprentices and friends. The schoolmates, friends and apprentices were appointed to high-level positions and had large amounts of control power, while all of the fellow villagers were dispersed in technological and other ordinary positions, and had no control power.

The outermost circle denotes the non-family members, who could be given high-level positions or technological and other ordinary positions. The first three circles relate to the relational governance structure, while the fourth circle relates to relational and contractual governance, and the outermost circle relates to contractual governance (discussed below). From the organizational structure of the company and the relationship between the cycles and the levels of management positions, it can be seen that those located in the first and second cycles are more trusted and the criterion for occupational promotion is mostly reliant on how close their kinship is to the founder.

(3) Governance Effect

It was learned from the interviews with Mr. Bin and other management personnel that the relational governance Bin Valley implemented at the growth stage was very instrumental in ensuring the rapid and stable development of the company, however, it did not occur without some negative effects.

Positive effects of the relational governance structure were as follows:

(1) Stabilize the staff. The turnover data from 2011-2013 implied that the stability of family members contributed to the development of the company, and the company's turnover rates were 21% for 2011, 35.6% for 2012 and 30% for 2013. Compared to the rising turnover across the company year after year, the family member turnover rate for 2011-2013 decreased to 18%, 15% and 12%, respectively.

(2) Low moral hazards. Compared to non-family members, the family members of Bin Valley followed the founder longer and developed a more profound mutual understanding with him and between themselves. They were very dedicated and chose to stay with the company even in the face of difficulty out of unwavering loyalty.

(3) Trustworthy and loyal. This can be identified from the surveys conducted on family members in 2013. According to their answers to questions on the corporation's strategies (in Table 6-10), most of the family members occupying management positions were aware of the plans and were hopeful about the company's future. The family members at the basic-level management positions knew little about the corporation strategies but were still hopeful about the company's future. According to the answers to questions about interpersonal relationships within the company (in Table 4-11), Bin Valley's interpersonal relationships were harmonious and some of the family members thought that Mr. Bin valued his kinship ties and took care of family members. This meant that they were willing to stay in Bin Valley for the long term.

Table 4-11 Answers of family members to questions about corporation strategies (2013)

Identity of respondents	Level	Distribution of their answers			
		Know the strategy and hopeful of the future	Know the strategy and not hopeful of the future	Don't know the strategy but hopeful of the future	Don't know the strategy and not hopeful of the future
Family members	Management positions	70%	10%	15%	5%
Family members	Non-management positions	60%	10%	20%	10%

Source: based on internal questionnaires

Table 4-12 Answers of family members to questions about loyalty in the survey (2013)

Identity of respondents	Levels	Distribution of their answers			
		Willing to serve on a long-term basis	Depend	Unwilling to serve on a long-term basis	Undecided
Family members	Management positions	70%	10%	15%	5%
Family members	Non-managemen t positions	80%	8%	10%	2%

Source: based on internal questionnaires

(4) Boost corporate performance. The performance data on Bin Valley and each of its segments for 2009-2013 as shown in Table 5-2 demonstrates that after 10 years of development, Bin Valley has evolved from an unknown small-scale electrical engineering company with an annual revenue of several hundred thousand RMB to a large-scale corporation, with an increased revenue of over 10 million RMB. Even considering inflation, the performance improvement was very substantial at several thousand-fold. This was because during this 10-year development period, Bin Valley adopted relational governance as the main governance model, and the characteristics of relational governance for each stage were adapted to the company's scale, life cycle, environmental changes and the founder's approach.

On the other hand, the negative effects of the relational governance structure was as follows:

(1) Limited in number. The total number of family members and pan-family members recruited by Mr. Bin was limited and the rate of increase in numbers was slow.

(2) Limited in ability. Most of the high and intermediate-level managerial staff in Bin Valley were the family members who did not receive a higher education or professional training. Furthermore, due to the use of the family system in the company, most of the non-family members were assigned to ordinary positions, and did not have enough opportunities to train themselves and accumulate managerial experience. Moreover, for many of the family members currently working in the company, their expertise was limited to engineering projects and was not up to speed with the new businesses and the company's diversification strategy. The pan-family members were mostly invited by Mr. Bin to the

company to serve as consultants or high-level executives, and there were no other channels to introduce more pan-family members.

(3) Internal discord. Unless properly settled, the disunity and dispute over the distribution of benefits between family members will accelerate the family business's decline. In the first 10 years of development, the relationship between family members was as harmonious at home as it was in the company, and concerted efforts were made to boost Bin Valley's rapid development.

After receiving MBA and DBA degrees, which taught him skills and abilities in company operations, Mr. Bin's mindset was improved and horizons were broadened, however other family members achieved little progress in terms of developing their knowledge and management philosophies. The widening gap between Mr. Bin and other family members resulted in increasingly serious disagreements over corporation development ideas and operation & management issues, making him feel that they could not keep pace with him and the company's development, and he therefore had to be more decisive.

Some family members did not separate their roles at home from their roles in the company and showed disregard for the decisions made by Mr. Bin. Complaints arose against the founder's refusal to share stock rights with other family members, and inevitably, internal discord broke out amongst the family. In 2013, his second eldest brother requested to leave due to frequent disputes with Mr. Bin. And Mr. Bin usually quarreled with his wife over company operation issues. At one point, the tense relationships in the family made Mr. Bin feel that Bin Valley was unstable, and forced him to consider the transformation of Bin Valley's governance model.

Contractual Governance

The family system (relational governance) is an effective governance model during the start-up period, however, when a family business's development extends beyond the scope of available family resources, it becomes necessary to introduce professional managers and establish some form of contractual governance. Under these circumstances, we analyze Bin Valley's contractual governance during its growth period.

(1) Resource Orientation: Capabilities

It is vital for family businesses to absorb external resources, especially managerial capabilities and funds, and the externalization or decentralization of property rights of the business has a direct influence on its development and competitiveness. The model proposed by Li on market expansion and the lack of management ability, argued that a large-scale family business with assets over 10 million RMB is in urgent need of non-family management expertise, and that this need for external management expertise increases proportionally with the number of such enterprises. Therefore, for a private economy that adopts the family system as the dominant model of governance, it is economically reasonable to allocate the remaining control power from family members to the recruited non-family managers through a professional management structure.

In its infancy, Bin Valley relied on the kinship ties and mutual trust between family members to reduce transaction costs, and imposed few requirements that were dependent on the competency of the management staff. However, the increasing scale of the business laid down more requirements that demanded a higher level of competency from the management staff.

Especially since obtaining his MBA, Mr. Bin had learned about modern business administration and drew inspiration from his entrepreneurial classmates. He was acutely aware of the need for professional managers and to develop a strategy to manage talent that would be instrumental to the development and transformation of Bin Valley. He realized that the talent strategy should be the top priority over other enterprise strategies, and for many of the family members currently working at the company, their expertise was limited to engineering projects and was not sufficient for the new business ventures and the company’s diversification strategy.

The pan-family members were mostly invited by Mr. Bin to the company to serve as consultants or high-level executives, and there were no other channels to introduce more pan-family members. Professional managers, therefore, had to be recruited for the new business segments and more requirements were allocated to them.

(2) Governance Object

Bin Valley mainly applied contractual governance to non-family members, which included professional managers and ordinary staff. It can be seen from Tables 6-2 and 6-3 that Bin Valley valued its staff's capabilities when it decentralized its control and ownership after it entered the growth period. The status of non-family members within the enterprise (i.e. the importance of the positions that they held and the control power that they were allocated) increased with the degree of Bin Valley's implementation of contractual governance. The proportion of non-family members occupying management positions increases gradually and is greater than the family members, as shown in Table 4-13.

Table 4-13 Distribution of Bin Valley's non-family members and their positions (2009-2013)

Staff / Year	Professional Managers			Ordinary Staff		
	Level of Management	Position	Power	Level of Management	Position	Power
2009-2010	Intermediate-level management	Accounting, Administration, Technology Management	Control	Ordinary Staff	Accounting, Administration, Marketing, Engineering Management, Production and Technology	N/A
2011	High- and intermediate-level management	Accounting, Administration, Human Resources, Engineering, Technology and Investment Management	Control	Ordinary Staff	Accounting, Administration, Human Resource, Marketing, Engineering Management, Technical Market, Engineering Projects, Technology, Production and Investment Management	N/A
2012	High- and intermediate-level management	Accounting, Administration, Human Resource, Engineering Projects, Technology, Investment and Culture management	Control	Ordinary Staff	Accounting, Administration, Human Resource, Engineering Projects, Technology, Investment and Culture management	N/A
2013	High- and intermediate-level management	Accounting, Administration, Engineering, Technology and Investment, Finance and Culture Management	Control	Ordinary Staff	Accounting, Administration, Engineering, Technology and Investment, and Culture Management	N/A

Source: interviews with the Planning Department

We can see from the table that Bin Valley began to recruit professional managers in its sixth year (2009), most of whom were appointed to the intermediate-level management positions responsible for finance, administration and new technology segments, all of which require comprehensive management ability. They also had certain control power, and this can be regarded as the beginning of the establishment of contractual governance. In the eighth year (2011), Bin Valley formulated its diversification strategy and recruited more professional managers into high-level management, the engineering business segment and other emerging fields within the company. More control power was allocated to these professional managers, which reflected the importance that the founder attached to professionalism, and can be seen as the growth stage of contractual governance. As further diversification occurred at the company in its ninth and tenth years (2012-2013), professional managers were allowed to work in the more emergent fields and were allocated more control power, which marked the popularization stage of contractual governance.

While implementing contractual governance, the family business needed to deal with two issues: the relationship between ownership and control (i.e. the separation of ownership from control), and the principal-agent problem. The former meant that when the family business absorbed entrepreneurial capabilities, it needed to maintain its control over professional managers. That is, the family business hands over its general control (management and operation) to professional managers, who must consult with the President (i.e. the founder) before making important decisions, and the President (i.e. the founder) still has the final say.

Sharing or allocating the rest of the control between the family and the professional managers is a positive means of exercising control over the enterprise for the family, but it also generates the principal-agent problem. Refusing to adequately delegate the control power results in inefficiencies, but the delegation of control power is risky because there are various uncertainties and may cause opportunism. In light of these two issues, Bin Valley chose a steady and proactive approach by grasping its ownership firmly, gradually decentralizing decision-making power and quickly handing over managerial authority.

(3) Governance effect

From the survey conducted by Bin Valley’s internal research group on the non-family members, Bin Valley's financial statements in 2013 and its turnover rates for 2011-2013, it can be seen that Bin Valley's implementation of contractual governance during its first ten years contributed to the development of the company, expansion of the business, enhancement of the brand and the management of the company. However, choosing the wrong people for some business segments and making the wrong decisions caused enormous losses.

The positive effects of contractual governance were：

(1) Professional managers' expertise. These professional managers were recruited from the available talent pool or recommended by pan-family members, and had received professional training, experience and expertise in different industries. These skills and experiences were what Bin Valley sought in order to sustain its growth.

(2) Widespread social resources. The professional managers had worked for years and constructed a large social network. This allowed them to bring or expand existing business resources to complement the family members' lack of resources, and was one of the reasons why Bin Valley's performance made a breakthrough since the implementation of the diversification strategy in 2011. In particular, Bin Valley's new business segment of finance achieved profitability due to the professional managers.

The negative effects of contractual governance were:

(1) Instability of non-family members. The non-family members were more unstable than the family members, and this can be seen from the company's turnover rate of 21%-35.6% for the 2011-2013 period. Most of those leaving the company were non-family members, and an analysis of the questionnaires is shown in Table4-14.

Table 4-14 Answers of non-family members to questions about loyalty in the survey (2013)

Identity of respondents	Levels	Distribution of their answers			
		Willing to serve on a long-term basis	Depends	Unwilling to serve on a long-term basis	Undecided
Non-family members	Management positions	60%	10%	20%	10%
Non-family members	Non-management positions	65%	15%	15%	5%

Source: internal questionnaires

Furthermore, it can be seen from the valid 235 questionnaires (completed by management and non-management personnel) that some non-family members argued the rule of man was serious during corporation governance. They thought that some regulations were devised unreasonably and arbitrarily, the rule of law was lacking, mistrust existed between family members and non-family members, and communication and the mutual understanding was inadequate between them. They also attributed ineffective implementations of the regulations to the family members, and so were not very hopeful about the future of the company. Most of the staff valued harmonious relationships with colleagues in the company, and when there was tension with other staff, they chose to leave. Non-family members were therefore not as loyal as family members to the company.

(2) High moral hazards. As discussed above, the contractual governance theory includes “ownership-control separation” and the principal-agent problem. It would have taken time for Bin Valley to evaluate and acquaint itself with professional managers, and during the growth period of contractual governance, the company took the superficial capabilities of professional managers over deeply understanding their motivations and ethics. As a result, professional managers in charge of the technology business segment embezzled Bin Valley’s funds by conspiring with outsiders and incurred losses of over 500,000 RMB (about 34,000 euros) to Bin Valley.

Dual Governance Model and Its Mutual Relationship

As seen from the analysis above, a family business applies different governance models during different stages of its life cycle. At the start-up period, relational governance dominates, and when the family business matures, it needs to implement contractual governance. These two governance models have their respective advantages, economic rationality and disadvantages, and while transforming the traditional family business, instead of being used alone, the two models could supplement each other. In this section, we will analyze the substitutability and complementarity of the dual governance model that consists of the two governance models used during the growth period of Bin Valley.

(1) Substitutability of the Dual Governance Model

Chapter 2 mentioned that different family businesses may choose different governance models, and a family business will adopt different governance models during different stages of its life cycle. At the start-up period, family businesses implement relational governance, but when a family business reaches maturity, relational governance may become unsuitable for the increasing complexity of corporate management, which highlights the need for contractual governance. At this stage, the family business begins to delegate its control power, decision-making power and stock rights to family members, pan-family members and non-family members successively. From the discussion on governance structure of the company in Section 6.2, it can be seen that the different levels of management positions and control power are allocated dynamically between family members and non-family members, from the family and pan-family system stages, to the subsequent growth and popularization stages of contractual governance. This indicates that the transition between the two governance models and the allocation of these powers is accompanied by the regularization of the contractual system. For example, under the relational governance at the start-up stage, Mr. Bin paid salaries, bonuses and delegated powers to family members mostly in an oral and arbitrary manner, and his decisions on these matters changed frequently or were made repeatedly. After the implementation of contractual governance during the growth period of the company, various regulations were formulated, and the functions of the human resource department were enhanced. A Law Department and a Discipline Department were established, and formal regulations on basic wages, performance-related pay, and bonuses of family members, non-family members and Mr. Bin himself, were all devised, standardized and systematized. The appointment and dismissal of certain positions required written notice with Mr. Bin’s signature, and labor and business contracts were signed in compliance with current laws and regulations. Supervision was increased on family and non-family members, and Mr. Bin's second eldest brother left the company under this supervisory system.

(2) Complementarity of the Dual Governance Model

For small family businesses that implement relational governance, under the rule of the patriarch the network of connections based on blood ties or kinship creates a very strong inter-dependency between family members. Information flows smoothly within the family business and the motives of family members are all highly consistent. Even though the family business is not formally structured at this stage, it can still run efficiently at very low transaction costs, and respond acutely and timely to market changes. The patriarch is able to obtain relevant information simply through his network of connections based on blood ties or kinship, or through observation, and he can make corresponding decisions accurately, reliability and at a low cost. As a consequence, supervisory and incentive mechanisms are simple but effective.

In its infancy, Bin Valley did not have various managerial mechanisms or a complete organizational structure, and its business relied on parents, brothers, relatives and fellow villagers to compete in the engineering market. Mr. Bin himself lived and worked together with his workers, thereby gaining a considerable understanding of every staff member. He solved internal issues quickly, with a kinship-based management style, and they responded to external changes together. In this context, the scale and business of their company increased, and since then, Bin Valley's staff has mainly consisted of the patriarch, family members, pan-family members, professional managers, and ordinary staff.

The private social network that Mr. Bin had previously used to collect information before making decisions was no longer suited for this new situation. For one thing, this type of information collection system was irregular, disadvantageous to implementations of the company's incentive, competition and constraint mechanisms, and made it difficult to make strategic transformations in the face of market changes, which all posed risks to the business. For another, in the process of business development, the patriarch was limited in his ability to collect information, and family members could hide information from each other for the sake of their own interests, reducing the reliability of the information that was actually collected.

In the case of information asymmetry, continuing to adopt the relational governance model would have greatly increased the transaction costs within the company and entailed a higher risk of failure. In this case, contractual governance can alleviate that risk, because it provides a reasonable mechanism to establish balance between family members and professional managers, and embodies ownership-control separation, power concentration and delegation systems, and incentive and supervisory systems. This improves the motivation of professional managers, unleashes the vigor of the family business, reduces exhaustion by internal strife, inhibits corruption and the special privileges of family members, and reshapes the relationship of trust between them.

However, contractual governance on its own is also not always sufficient. Moral hazards and adverse selection are the two challenges that family businesses must confront during the implementation of contractual governance. China's professional manager market is not regularized and mature, and lacks proper standards or a credited evaluation system. Hence, costs associated with the search for and negotiation with professional managers are unavoidable before entering into a contract with them. Also, the evaluation of an employer on prospective professional managers may be inaccurate, because characteristics, such as reliability and loyalty of the professional managers will not be exhibited until they actually work for the enterprise. It is very possible that the talented managers who initially appeared attractive to the enterprise, may end up behaving disloyally due to information asymmetry, and this is known as moral risk.

Another situation is when at first, the enterprise mistrusts professional managers, and they are only recruited for their remarkable expertise and low demand for salaries. The enterprise may act in bad faith and pay the professional managers smaller bonuses than what they deserve by deceiving them about the company's profits. In the long term, competent professional managers will quit and only those who are incompetent, squander the company's funds or have other ulterior motives will choose to stay, leading to the demise and ultimate collapse of the company. This is adverse selection, and the fatal limitations of relational governance and contractual governance manifest themselves during this game over trust when the scale of the family business increases.

In this case, the dual governance model that consists of relational governance and contractual governance may be relevant. That is, the enterprise's control power is allocated between both family members and professional managers. The professional managers have most of the managerial authority and the decision-making power over how the business operates, as well as some of the decision-making power over the over-arching strategy of the business and some stock rights. The family members maintain most of the decision-making power over the long term strategy and some managerial authority, and also maintain direct control over professional managers for the purposes of reducing transaction costs and complementing one another.

Lu et al. (2002) argued that family businesses should combine contractual governance with relational governance. While substituting contractual governance for relational governance in its 6^{th} – 10^{th} years, Bin Valley has gradually integrated contractual governance with relational governance. Table 6-11 shows that the non-family members in Bin Valley have extended upwards from intermediate-level to high-level positions, and their management positions which were previously confined to general departments (e.g, accounting and administration) and professional departments (e.g., the new technology segment), were now present in every department and business segment, which indicates the advanced degree of contractual governance. This can be seen from the control of the pan-family members, whom the founder of the company moved, by showing them consideration and trust, and making them feel that they are respected. Because of this, the founder was able to request that they bear responsibilities and accept institutional constraints placed on them.

(3) Dynamic Changes and Governance Effects of the Dual Governance Model

Li (2005) argued that a family business's governance model normally includes relational governance and contractual governance because of the uniqueness of the family business. Contractual governance and relational governance are not always balanced, since a family business may emphasize one model over the other. During the dynamic evolution of the dual governance model in the family business, based on the degree at which the governance model is implemented, there are four types of governance: weak relational governance and weak contractual governance; weak relational governance and strong contractual governance;

strong relational governance and weak contractual governance; and strong relational governance and strong contractual governance.

Bin Valley entered a dual governance stage in 2009, and its governance during this growth period was of the third type, i.e. strong relational governance and weak contractual governance. Table 6-7 shows the proportion of family members occupying management positions declined from 75% to 41%, and this indicates the decrease in the degree of influence that the family system had, however, the relational governance influence is still dominant. Although Bin Valley has made its first five-year plan and established some mechanisms and institutions, it has neither formulated effective incentive or supervisory mechanisms for professional managers, nor transformed its shareholding structure and provided stock incentives for compensation. This indicates that it has weak contractual governance.

Li (2005) argued that the choice of a corporate governance model is influenced by the environment, available assets, leaders' values and the ownership structure of the company, and the governance model, in turn, directly influences corporate performance. Mr. Bin insisted that ownership should be firmly held by family members during the start-up and middle periods, because this was the only way that the family could retain tight control of the enterprise, and that the incentives for the managerial staff would be determined by the owners' subjective evaluations.

As Bin Valley diversified its business and recruited more professional managers, Mr. Bin considered both talent and capability as the criteria for promoting staff. He subjected family members to learning, examination and selection mechanisms for the purpose of appointing competent family members to management positions and incompetent family members to non-management positions. The family members who frequently violated company regulations were dismissed without receiving any preferential treatment, and thus, Bin Valley implemented the dual model of weak relational governance and strong contractual governance, which helped it achieve remarkable gains in performance during its growth period. Table 5-2 shows the overall performance of the company and each business segment for the 2012-2014 period.

4.3.6.3 Speedup Stage (2014-2015)

As the scale of Bin Valley further increased, more pan-family members and non-family members joined the company, which resulted in further separation of ownership from control, further decentralization of ownership and control, and a more complex principal-agent problem. The conflicts between family members and non-family members were more serious while disagreements between family members were trivial.

Relational Governance

During this period, Bin Valley applied relational governance to family members and pan-family members in the form shown in Table 4-15.

Table 4-15 Objects of Bin Valley's Relational Governance during the speed-up period

Name	Relationship with Mr. Bin	Position	Family Involvement	When they Joined and Left Bin Valley
Xie Yan	Wife	CFO	Ownership: 10% Control: ★★★★	Joined in 2006
Bin Hongbo	Elder Paternal cousin	Captain of Engineering Team 1	Ownership: 2% Control: ★★★	Joined in 2003
Bin Hongjie	Younger Paternal Cousin	Captain of Engineering Team 2	Ownership: 2% Control: ★★★	Joined in 2003
Jiang Liang	Wife's mother's maternal cousin	General Manager of Technology Business Segment	Ownership: 1% Control: ★★★★	Joined in 2011
Tang Yu	MBA classmate	Assistant of Chairman of the Board of Directors	Ownership: 1% Control: ★★★★	Joined in 2011
Yuan Feng	MBA classmate	Director of Planning Department	Ownership: 1% Control: ★★★★	Joined in 2011
Li Ping	Student	Stand Deputy General Manager of Engineering Department	Ownership: 1% Control: ★★★★	Joined in 2006
Feng Li	Old friend	Deputy General Manager of Culture Business Segment	Ownership: 0 Control: ★★★★	Joined in 2014
Anonymous	Other Close and Distant family	Technician or ordinary staff	Ownership: 0 Control: 0	Joined in 2006 and 2011 and some left in 2015
Anonymous	Fellow villagers	Technician or ordinary staff	Ownership: 0 Control: 0	Joined in 2006 and 2011 and some left in 2015

Source: based on the data from the Human Resources Department

(1) Resources Orientation: Trust

Since 2014, the number of family members working at Bin Valley has gradually decreased, the number of pan-family members has remained stable, and the number of professional managers has increased dramatically. Trust, which was previously based on kinship ties, now relies on capability, and this type of trust is weaker and more difficult to improve compared to the start-up and growth periods. During this period, the proportion of family members in high and intermediate-level management positions continued to decrease, as shown in Table 4-16.

Table 4-16 Proportion of Family Members in Bin Valley during Speed-up Stage (2014-2015)

Year	Proportion to all staff (%)	Proportion to high- and intermediate-level management positions (%)
2014	15	31
2015	13	26

Source: based on the data from the Human Resources Department

Table 4-17 Survey on the Trust across Bin Valley Group (2014-2015)

Identity of respondents	Position	How much trust they think they have won from Mr. Bin (2014)			How much trust they think they have won from Mr. Bin (2015)		
		High	Middle	Low	High	Middle	Low
Family members	Managerial staff	70%	20%	10%	65%	25%	10%
Family members	Ordinary staff	75%	20%	5%	70%	20%	10%
Non-family members	Managerial staff	45%	35%	20%	40%	40%	20%
Non-family members	Ordinary staff	50%	30%	20%	45%	45%	10%

Source: based on internal questionnaires

(2) Governance objects

During the speed-up stage, Bin Valley mainly applied relational governance to family members and pan-family members, and the conflicts between family members were more violent. After Mr. Bin's second eldest brother left due to disagreements with him, he had no blood relatives in the company except for his wife. The other people that remained in the company were close and distant relatives, and pan-family members (Types 2-4).

Bin Valley continued to implement relational governance, and allocated the control power and ownership based on kinship ties and the level of trust workers had won from Mr. Bin. The biggest change was that the stock rights began to be decentralized, and the differential mode of association of Bin Valley's relational governance is shown in Fig. 6-3.

Figure 4-9 shows that in the control power allocation scheme, Mr. Bin is at the center of power, and the circles further away from the center imply that the family members are not very close to the founder and are thus allocated less control power. The family members who are Types 1, 2 and 4 are allocated certain amounts of control and ownership, while the outermost circle represents the non-family members, who occupy high or intermediate-level management, technical or ordinary positions. The first three circles, fourth circle and the outermost circle denote relational governance, dual governance, and contractual governance, respectively.

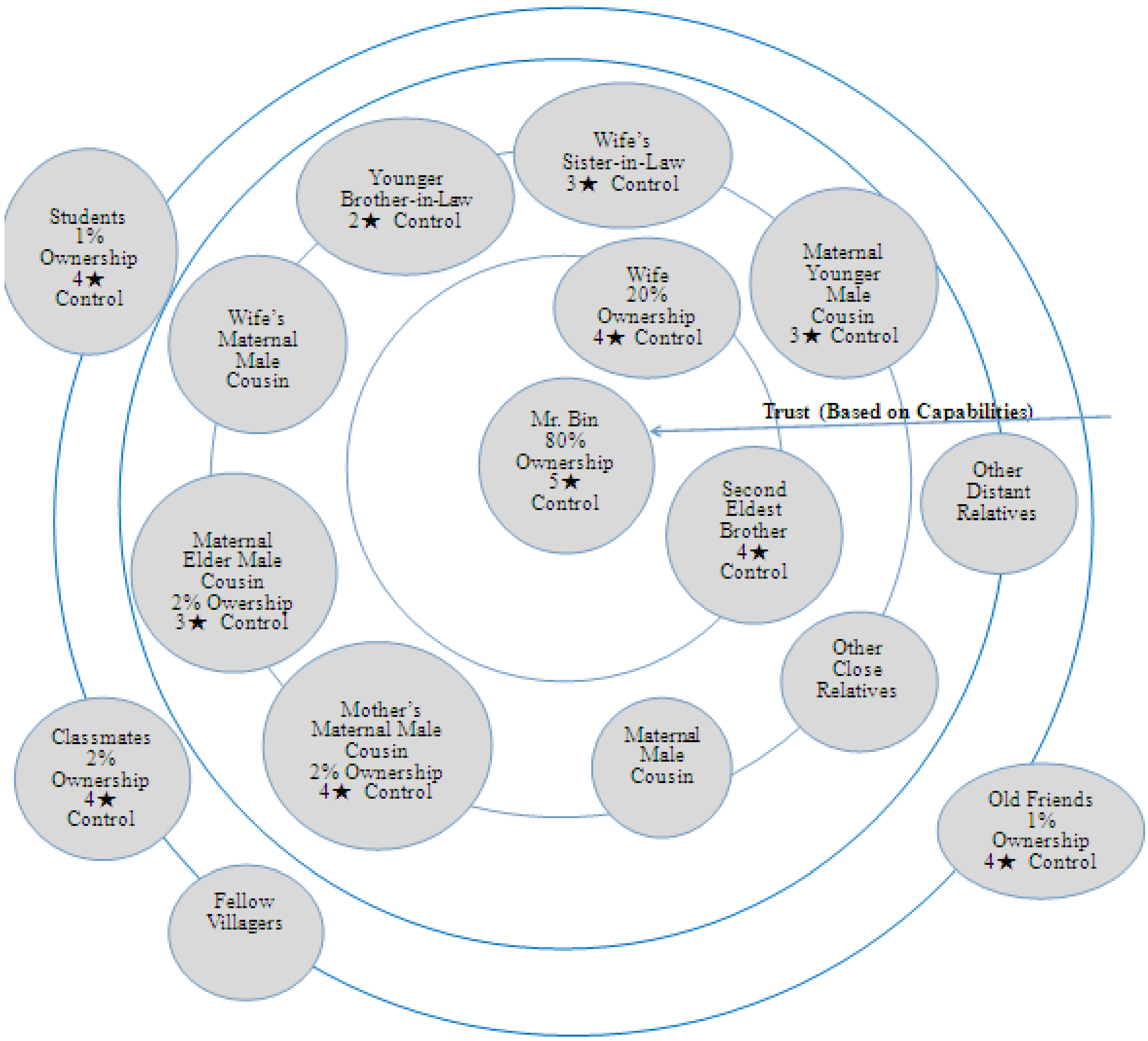

Figure 4-9 Differential mode of association of Bin Valley's relational governance during speed-up

Source: based on data from the Human Resources Department

(3) Governance effect

It was learned from the interview with Mr. Bin and other management personnel that the relational governance that Bin Valley implemented at the speed-up stage was instrumental in ensuring the stable development of the company, however, there were also some negative effects.

Firstly, the positive effects can be summarized as follows:

① Stability of the staff. The turnover data from 2014-2015 implied that the stability of family members contributed to the rapid development of the company. The company's overall turnover rate was 32% for 2014 and 35% for 2015, and compared to this rising rate across the company year after year, the family member turnover rate from 2014-2015 had decreased to 10% and 8%, respectively.

② Trustworthiness and loyalty. This can be seen from the surveys conducted on family members in 2014 and 2015, and according to their answers to questions about corporation strategies (in Table 4-19), most of the family members occupying management positions were aware of the corporation’s strategies and were hopeful about the company’s future. The family members holding non-management positions knew little about the corporation’s strategies but were still hopeful about the company’s future.

According to their answers to questions about interpersonal relationships in the company (in Table 4-20), most of the management personnel thought that Bin Valley’s interpersonal relationships were harmonious. Some of the family members thought that Mr. Bin valued kinship ties and gave preferential treatment to family members, and that the family members from the same clan were more trustworthy and communicative with one another. Many of them were willing to work at Bin Valley for the long term.

(4) Improve Bin Valley’s performance

According to the performance of Bin Valley and each of its business segments for 2014-2015, revenue for 2013 reached 180 million RMB and topped 200 million RMB in 2015. Relational governance has been implemented throughout the past 12 years, and the reason behind the remarkable performance of the company was that the different characteristics of relational governance at each stage were suited for the company’s operation scale, life cycle, target market environmental changes and leadership style.

However, the negative effects can be summarized as follows:

(1) Deepening gap between family members and non-family members

The family system-based relational governance model persevered, and because of this, many non-family members and family members participated in the corporation’s management and operations. Although the founder had switched to a system management approach, preferential treatment was still given to family members in certain matters, which led to discontent among non-family members, especially for those occupying management positions.

On the other hand, when the founder praised non-family members for their outstanding performance in public or awarded huge bonuses, the incompetent family members would feel like they had fallen into disfavor and worried about the possible loss of their jobs. In this context, the family and non-family members were guarded and envied each another, and pan-family members were under pressure from both sides.

Table 4-18 Answers of family members to questions about corporation strategies in the survey (2014-2015)

Identify of respondents	Positions	Distribution of their answers in 2014				Distribution of their answers in 2014			
		Know the strategy and hopeful of the future	Know the strategy and not hopeful of the future	Dont know the strategy but hopeful of the future	Don’t know the strategy and not hopeful of the future	Know the strategy and hopeful of the future	Know the strategy and not hopeful of the future	Don’t know the strategy but hopeful of the future	Don’t know the strategy and not hopeful of the future
Family members	Management positions	70%	10%	10%	10%	65%	15%	10%	10%
Family members	Non-management positions	55%	5%	30%	10%	60%	10%	20%	10%

Source: internal questionnaires

Table 4-19 Answers of family members to questions about loyalty in the survey (2013)

Identify of respondents	Levels	Distribution of their answers				Distribution of their answers			
		Willing to serve on a long-term basis	Depend	Unwilling to serve on a long-term basis	Undecided	Willing to serve on a long-term basis	Depend	Unwilling to serve on a long-term basis	Undecided
Family members	Management positions	70%	10%	10%	10%	68%	12%	15%	5%
Family members	Non-management positions	75%	15%	5%	5%	70%	10%	10%	10%

Source: internal questionnaires

(2) Internal discord

As the enterprise expanded throughout the country, Mr. Bin's vision for the company further improved and he made more connections with higher social classes, which allowed more professional managers to be recruited. In this context, his focus was no longer on family members, and some of the company ownership was allocated to these new managers he had chosen. This caused new imbalances between the family members, and the quarrels between the family members continued. Mr. Bin often had conflicts with his wife over the company's operation, but not as violently as during the growth period, and these inharmonious relationships in his family prompted him to consider further improving the company's governance structure.

Contractual governance

We will now analyze the characteristics of contractual governance in Bin Valley during the speed-up period.

(1) Resources orientation: capabilities

During the speed-up period, Bin Valley's development accelerated and its six business segments expanded across the country. Mr. Bin was eager for new professional talent and made most high and intermediate-level positions open to non-family members. He also considered an individual's capability as the primary criterion for selecting talent and paid them higher salaries than what the family members earned. The competent department managers who performed well and won the trust of the founder were allocated stock rights in the company (totaling a 10% share in the company).

(2) Governance object

Bin Valley mainly applies contractual governance to non-family members, which includes professional managers, ordinary staff, and those who do not have kinship ties with and are not geographically close to Mr. Bin. From Tables 6-2 and 6-3, it can be seen that since Bin Valley entered the speed-up period, the allocation of ownership and control has been based on the employee's capability, and the status of non-family members has been elevated in the company with the increase in the degree of contractual governance.

Table 4-20 Resources distribution of Bin Valley's non-family members and their positions (2009-2013)

Staff / Year	Professional Managers			Ordinary Staff		
	Level of positions	Post	Power	Level of positions	Post	Power
2014-2015	High and intermediate-level management	Accounting, Administration, Engineering, Technology, Investment, Finance, Culture Management and Branches nationwide	A little ownership and some control	Ordinary Staff	Accounting, Administration, Engineering, Investment, Technology, Culture Management and Branches nationwide	A little control

Source: based on interviews with the Human Resources Department

The table above shows that Bin Valley was further diversified during its 11th year (2014-2015) and its business has expanded across the country. More professional managers were recruited and allocated more control, which can still be regarded as the popularization of contractual governance.

During this period, Bin Valley needed to deal with two relationships in its implementation of contractual governance: the separation of ownership from control and the principal-agent problem. To address the former issue, Bin Valley should consider the distribution of the control power (e.g., decision-making and operation authority), and design the shareholding structure to generate more motivation in the workers. Meanwhile, the principal-agent problem is more complicated in the context of recruiting more professional managers and implementing contractual governance more widely, because the control over distant branches faces a higher possibility of opportunism and a higher level of moral risk. Bin Valley takes a careful approach to these relationships, by endeavoring to allocate the ownership, further delegating the decision-making power, and boldly conceding the managerial authority.

(3) Governance effect

From the surveys conducted by Bin Valley's internal research group on the non-family members, Bin Valley's financial statement for the 2014-2015 period, and its turnover rates for the 2013-2015 period, it can be seen that Bin Valley’s implementation of contractual governance contributed to the development of the company, expansion of the business, enhancement of the brand and management of the company. However, the risks associated with choosing the wrong people for some business segments and jobs, and making wrong decisions were revealed again.

The main positive effects were as follows：

(1) Professional managers’ expertise were improved

After recruiting and dismissing professional managers during the growth period, Mr. Bin could gauge the quality and capability of a professional manager more accurately and use them in his company more appropriately. Due to the increasing scale of the company and the overall strategy for nationwide expansion, Bin Valley was more attractive to excellent MBA holders. Employing such people meant that the expertise of the management personnel was improved and their knowledge structure was more comprehensive.

(2) Widespread social resources were introduced

These professional managers had worked in industry for years and established a wide network of social connections across the country. The managers working in Bin Valley’s satellite branches could expand business locally and integrate local resources with the main headquarters of the company. It was due to the active roles of pan-family members and other professional managers that Bin Valley succeeded in establishing strategic cooperation with China’s four most influential social platforms.

Negative effect:

(1) Instability of non-family members

Non-family members were very unstable, and the turnover for 2014 and 2015 was 36% and 38%, respectively. Many of those leaving the company were non-family members, and this can be seen from the employee questionnaires shown in Table 4-21.

Table 4-21 Answers of family members to questions about loyalty in the survey (2014-2015)

Identity of respondents	Levels	Distribution of their answers in 2014				Distribution of their answers in 2015			
		Willing to serve on a long-term basis	Depend	Unwilling to serve on a long-term basis	Undecided	Willing to serve on a long-term basis	Depend	Unwilling to serve on a long-term basis	Undecided
Non-family members	Management positions	50%	20%	20%	10%	60%	15%	15%	10%
Non-family members	Non-management positions	60%	25%	10%	10%	65%	15%	10%	10%

Source: internal questionnaires

Furthermore, it can be seen from the valid 290 questionnaires (completed by management and non-management personnel) that half the non-family members felt the rule of man was serious during corporation governance. They believed that some regulations were devised unreasonably and arbitrarily, the rule of law was lacking, mistrust existed between family members and non-family members, and the communication and a mutual understanding were inadequate between them. Meanwhile, they attributed ineffective implementation of the regulations to frequent violations by family members, and as a result, were not very hopeful about the future of the company (the confidence index of non-family members about the future of the company hovers around 50-60% but is less than family members overall). Most of the staff valued harmonious relationships with colleagues in the company, and if there was tension with other staff, they would choose to leave, rather than address or confront it.

(2) High moral hazards

As discussed above, the contractual governance theory includes the “ownership-control separation” and the principal-agent problem, and it takes some time before Bin Valley has fully evaluated and become familiarized with its professional managers. During the growth period of contractual governance, Bin Valley preferred the capabilities of professional managers over their ethical behavior, and as a result, managers in charge of the cultural business segment fabricated contracts and embezzled Bin Valley’s funds by conspiring with tenants, which incurred losses of over 1 million RMB (about 67,000 Euros) to Bin Valley.

Dual Governance Model and Its Mutual Relationship

Bin Valley started to apply dual governance in 2009, and the substitutability and complementarity of the dual model has displayed the following characteristics:

(1) Substitutability of the Dual Model

In 2014 and 2015, Mr. Bin assigned the internal survey group to carry out surveys on members of the company including himself. Analyses of the data from the in-depth interviews with some high and intermediate-level personnel were performed and revealed the substitutability of the dual governance model. For example, the opinion of Mr. Bin about the amount of authority allocated to and the degree of trust put on professional managers and family members, was different from the opinions of close and distant relatives and professional managers. Mr. Bin thought that he treated themoral staff equally and delegated the power based on the competency and performance of the staff, but he feared that the management personnel might not correctly understand his instructions and use the power inappropriately.

The family members felt that Mr. Bin did not trust and appreciate them as much as before, and more and more professional managers thought that the founder did not delegate as much power to them as they needed and that he trusted his family members more during a critical time. Hence, during the transition from relational governance to contractual governance, not only the founder, but also the family and non-family members found it difficult to accommodate and adapt to the changes. This reflects the conflicts in a family business when the closed family system and the open enterprise system exist concurrently.

(2) Complementarity of the Dual Governance Model

In its 11th year (2014-2015), while substituting contractual governance for relational governance, Bin Valley also attempted to combine them, i.e. Mr. Bin proposed that all staff of the company, including family and non-family members, should follow the regulations of the company. By dismissing his second eldest brother, Mr. Bin declared that all staff were equal before the rules and none of the family members would get special treatment or privileges. He also proposed to construct power separation and delegation mechanisms to develop a sense of trust between superiors and subordinates, and establish a novel type of family culture to cultivate affection among the staff, regardless of their position or origin.

(3) Dynamic Changes and Governance Effect of the Dual Governance Model

It can be seen from Table 6-7 that the proportion of family members in management during the speed-up period decreased from 38% to 30%, which implied that the family involvement had declined and that the relational governance had weakened. On the other hand, some of the new systems, such as the performance evaluation system, met objections after trial runs and could not be implemented further. This meant that the incentive and constraining systems remained incomplete and that contractual governance was still weak.

The model has therefore changed from the third type (strong relational governance and weak contractual governance) to the first type (weak relational governance and weak contractual governance).

The governance model has a direct influence on the economic performance of the enterprise, and implementing the dual governance model yielded substantial gains in the subsequent years, as shown in Table 5-2, which describes the performance of the company and the business segments for the 2014-2015 period. However, the company lost momentum afterwards and the development speed slowed down. The company's revenue was 180 million RMB (about 26 million Euros) in 2013 and increased to 210 million RMB (about 30 million Euros) in 2015. The increase of 16.7% was significantly less than the increase of 50% from 2012 to 2013. After some consideration, Mr. Bin attributed this to the fact that the target set for each business segment was too small to incite the motivation of professional managers and family members, and depriving his family members of their privileges had reduced their cohesion and capacity for hard work.

(4) Strategic improvement in the dual model

To promote the development of the company, Mr. Bin took measures to switch to the fourth type of governance (i.e. strong relational governance and strong contractual governance) by strengthening both governance models.

4.3.6.4 Maturity Stage

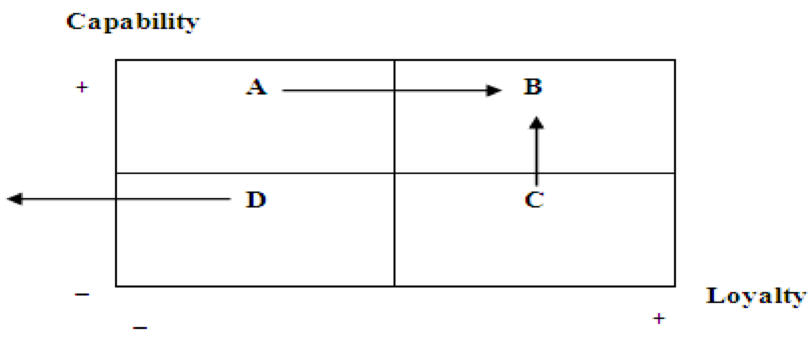

Figure 4-10 Governance model of Bin Valley Group during maturity stage

Source: made by the author

Bin Valley Group has stepped into maturity stage since 2016 and we can tell that its contractual governance gradually prevails over its relational governance. In this process, ownership and control continues to separate, with the gap between family members and non-family members widening, and such problems have brought Mr. Bin to deliberate over the governance model of Bin Valley Group. In Figure 4-10, the horizontal axis refers to loyalty while the vertical axis refers to capability, with A representing those who are capable but not loyal enough and C representing those who are incapable but loyal. D represents those who are neither capable nor loyal. In addition, B represents those who are both capable and loyal. Among these four types of employee, Bin Valley needs to eliminate D. For A and C, Bin Valley Group ought to improve their loyalty and capability respectively. It is worthy to note that B is the ideal type of employees, since their loyalty and capability are both satisfactory, which may fulfill the requirements for the sustainable development of Bin Valley Group.

To put it simply, Bin Valley Group will eliminate those who are incapable and disloyal, hoping to have employees who are both loyal and capable. To reach this goal, Bin Valley will implement the dual governance model between strong relational governance and strong contractual governance.

Chapter 5: Discussion

This thesis studies family business, drawing on relevant domestic and foreign literature, such as the definition of family businesses, Chinese family culture, agency theory, contract theory, three circle model, familiness, relational governance, contractual governance and dual governance model.

This thesis applies the research method of single case study and selects Bin Valley Group as the case of its field work. Through processing and analyzing Bin Valley's data, this thesis draws its conclusions.

Historically, Chinese family businesses have gone through the following phases: before 1949, 1949-1978, 1978-1992, 1992-2002, 2002-2012 and after 2013 and its developmental path is as follows: home business —— family business ——pan-familism—— widely held public company. A family business may implement relational governance, contractual governance and dual governance model.

Bin Valley Group was founded in 2003, with Mr. Bin as its founder. This thesis mainly elaborates Bin Valley Group's strategic turning points, organizational structure, family involvement, ownership, control, relational governance, contractual governance and dual governance model during different stages, i.e. startup stage, growth stage, speedup stage and maturity.

5.1 Conclusion

(1) Bin Valley has evolved from a construction team to a diversified corporate group that involves itself in culture, engineering, technology, investment, finance and trade, and its expansion still continues. In 2003, Bin Valley Group came into existence as an engineering team. In 2005, its founder established two construction design company. In 2006, its founder sets up a technology company. In 2008, its founder purchased an investment company. Afterwards, Bin Valley Group's media company, micro-loan company, trade company and

football club were gradually established. After all these notable events, Bin Valley Group has become a diversified corporate group, which incorporates engineering, technology, culture, investment, finance and trade. In the meantime, it has expanded its market from Chengdu to Beijing, Hangzhou, Chongqing and Xiamen.

Since Bin Valley Group was founded in 2003, it has experiencing four strategic turning points: In 2006, its family members' structure shifted and family members improved their managerial capability; In 2009, its founder began to read for MBA and changed his managerial ideas; In 2011, it made its first five-year strategic planning and this marked the beginning of its nationwide strategy. The ultimate goal of Bin Valley Group is to evolve into a national widely held public company that encompasses engineering, technology, investment, finance, trade and culture, with its revenues growing into trillions of RMB, as well as to possess the up-to-date management and the most powerful market competiveness. Also, it aims to recruit large amounts of experts and patents to cultivate its ever-lasting innovativeness and competiveness. By shaping a rational shareholder structure, it targets a stable and continuous development and builds up a mighty corporate image. In order to reach this ultimate goal, Bin Valley Group has invested substantially in finance and talent pool.

(2) Since startup, Bin Valley Group's family system and corporate system has shown inconsistency of goal. Family system emphasizes domination over control and ownership (family interests), while corporate system stresses maximization of profits, rational distribution of power, performance and capability (equitable treatment). The main conflicts are how to distribute control and ownership between family members and non-family members, as well as different positions. When Bin Valley Group entered speedup stage, such conflicts have become more prominent, with its corporate performance increasing comparatively slowly from 2014-2015.

(3) Bin Valley Group has implemented different governance models during different stages, in accordance with its status quo. It always tries to strike a balance between capabilities and trust to implement dual governance model and maximize the interests of the entire business, but its governance model is still far from perfect.

(4) It is not uncommon for both contractual governance and relational governance to

co-exist in a company and governance structure will never remain unchanged. A company may adopt different governance model during different phases and the case study of Bin Valley Group shows that an enterprise adjusts its governance model continually.

(5) Growth stage is the most special and representative. Through twelve years' exploration of Bin Valley Group, we can deduce that Bin Valley should set up formal institutions to govern its employees to help Bin Valley get on the right track and Bin Valley needs to implement strong relational governance and strong contractual governance. Bin Valley Group hopes that its family members will become more professionalized while improving the loyalty of non-family members.

(6) Empirical research shows that only under strong relational governance and strong contractual governance can a family business perform exceptionally well. Bin Valley Group should strive for such a governance model, in order to increase its corporate performance and achieve stable development.

(7) Relational governance and contractual governance can convert into each other. When family businesses apply relational governance to family members in order to maintain their loyalty and trust, it should also implement contractual governance because family members need to be more professionalized. The goal is to transform family members into professional managers (pan-family members). For non-family members, family businesses should continue to motivate them and equal those who are loyal enough with family members, thus to transform them into pan-family members.

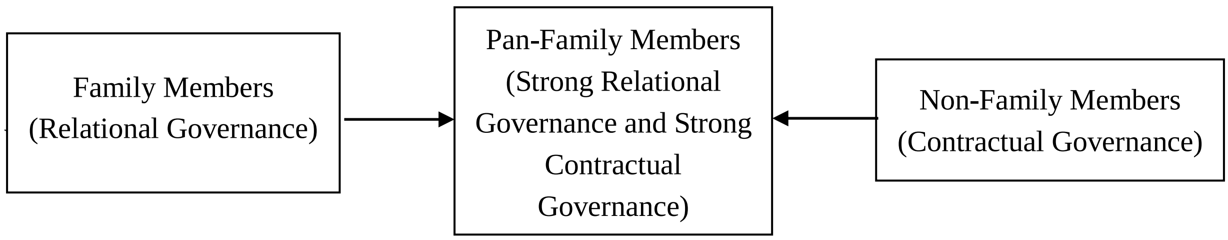

Figure 5-1 Ultimate goal of the dual governance model

Source: made by the Planning Department

5.2 Recommendations on Governing Family Members and Non-Family Members

Bin Valley Group’s family values advocate loyalty, consolidation and indomitable spirits to boost Bin Valley Group’s development and say no to privilege. Such values urge family members unite with non-family members to achieve harmony. Based on Bin Valley Group’s family values, Bin Valley Group needs to cultivate a pan-familism culture to govern its family members and non-family members—the dual governance model between strong relational governance and strong contractual governance.

5.2.1 Recommendations on Governing Family Members

①Bin Valley Group should lead them to grasp more opportunities to train, learn and practice to be more professionalized.

②Bin Valley Group should help them get rid of their misbehavior (they should not always assume that they have privilege) and regulate their conducts.

③Bin Valley Group should make good use of their power as family members to maintain their rights of speech, right of decision-making and managerial authority. They need to stabilize the company, increase business added value and enhance their professional skills.

5.2.2 Recommendations on Governing Non-Family Members

① Bin Valley Group should build up its team of professional managers.

② Bin Valley Group should establish its supervisory and discipline mechanism to achieve a balance in power.

③ Bin Valley Group needs to improve the loyalty of non-family members, for example, Bin Valley may host basketball games to strengthen its cohesive force and help non-family members who are in financial trouble.

5.3 Research Limitation

This thesis adopts single-case study and integrate relevant theories on family business governance with the status of Bin Valley Group. However, Bin Valley Group is still a relatively "young" enterprise and it has just entered its maturity phase, with its life cycle being incomplete. Additionally, some respondents of the questionnaires and interviews might be unwilling to reveal their opinions, in case that their personal interests were in conflict with corporate interests. Furthermore, the case study of this thesis only touches on a family business involved in the industries of engineering, technology, culture, investment, finance and trade. Therefore, the conclusions of this thesis can only serve as reference for similar family businesses to Bin Valley Group.

5.4 Future Research

With the globalization of world economy, traditional managerial model has to shift to cutting-edge managerial model. A family business should choose its most suitable governance model during different stages, oriented by its corporate performance. This thesis hopes that the dual governance model between strong relational governance and strong contractual governance will push Bin Valley to be a widely held public company, in addition to being an example for Chinese family businesses.

This thesis may help Chinese family businesses to choose their governance model in accordance with their status quo and characteristics. Also, it hopes that Bin Valley Group can continue to transform itself further, to verify the conclusions of this thesis. By applying multiple-case study instead of single-case study and selecting different family businesses in different cycles as the cases, we will draw more valuable conclusions.

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Appendix 1: Questionnaire 1

Respondent	Family Members among Managerial Staff			
Question 1	Do you know Bin Valley's strategic goal?			
Item	Very much	I know it	Not much	Not at all
Question 2	What do you think of Bin Valley's prospects?			
Item	Getting better	Levelling off	Getting worse	Not clear
Question 3	Do some staff act beyond their power?			
Item	Very often	Sometimes	Rarely	At least I never find it
Question 4	Are you clear about your responsibility and power?			
Item	Very much	Relatively clear	Not much	Not at all
Question 5	What do you think of Bin Valley Group's interpersonal relationship?			
Item	Very good	Fairly good	Slightly bad	Very bad
Question 6	What do you think of non-family members' behavior and conduct?			
Item	Very good	Fairly good	Just-so-so	Bad
Question 7	Are you willing to work for Bin Valley Group for the long term?			
Item	Yes	Unsure	No	Never think about it
Question 8	What prevents you from performing better?			
Item	Immediate superiors	The gap between family members and non-family members	Lack of recognition and trust	Teamwork
Question 9	What do you think of Bin Valley Group's efficiency?			
Item	Very good	Fairly good	Just-so-so	bad
Question 10	Do you think Bin Valley Group's performance evaluation system is effective?			
Item	Yes	Useless	Ineffective at all	I don't know
Question 11	Besides salary, what do you value the most?			
Item	Improvement of capabilities	Work environment	Interpersonal relationships	Prospects of industry
Question 12	What do you think of Bin Valley's management system?			
Item	Very effective	Just-so-so	Ineffective	Its management system is problematic
Question 13	What problems does Bin Valley Group have in terms of management, decisions, regulations, interpersonal relationships, differentiated treatment between family members and non-family members?			
Answer				

Appendix 2: Questionnaire 2

Respondent	Family Members among Ordinary Staff			
Question 1	Do you know Bin Valley's strategic goal?			
Item	Very much	I know it	Not much	Not at all
Question 2	What do you think of Bin Valley's prospects?			
Item	Getting better	Levelling off	Getting worse	Not clear
Question 3	Do some staff act beyond their power?			
Item	Very often	Sometimes	Rarely	At least I never find it
Question 4	Are you clear about your responsibility and power?			
Item	Very much	Relatively clear	Not much	Not at all
Question 5	What do you think of Bin Valley Group's interpersonal relationship?			
Item	Very good	Fairly good	Slightly bad	Very bad
Question 6	What do you think of non-family members' behavior and conduct?			
Item	Very good	Fairly good	Just-so-so	Bad
Question 7	Are you willing to work for Bin Valley Group for the long term?			
Item	Yes	Unsure	No	Never think about it
Question 8	What prevents you from performing better?			
Item	Immediate superiors	The gap between family members and non-family members	Lack of recognition and trust	Teamwork
Question 9	What do you think of Bin Valley Group's efficiency?			
Item	Very good	Fairly good	Just-so-so	Bad
Question 10	Do you think Bin Valley Group's performance evaluation system is effective?			
Item	Yes	Useless	Ineffective at all	I don't know
Question 11	Besides salary, what do you value the most?			
Item	Improvement of capabilities	Work environment	Interpersonal relationships	Prospects of industry
Question 12	Please make comments on the relationship between family members and non-family members.			
Answer				
Question 13	What problems does Bin Valley Group have in terms of management, decisions, regulations, interpersonal relationships, differentiated treatment between family members and non-family members?			
Answer				

Appendix 3: Questionnaire 3

Respondent	Ordinary Staff among Family Members			
Question 1	Do you know Bin Valley's strategic goal?			
Item	Very much	I know it	Not much	Not at all
Question 2	What do you think of Bin Valley's prospects?			
Item	Getting better	Levelling off	Getting worse	Not clear
Question 3	Do some staff act beyond their power?			
Item	Very often	Sometimes	Rarely	At least I never find it
Question 4	Are you clear about your responsibility and power?			
Item	Very much	Relatively clear	Not much	Not at all
Question 5	What do you think of Bin Valley Group's interpersonal relationship?			
Item	Very good	Fairly good	Slightly bad	Very bad
Question 6	What do you think of non-family members' behavior and conduct?			
Item	Very good	Fairly good	Just-so-so	Bad
Question 7	Are you willing to work for Bin Valley Group for the long term?			
Item	Yes	Unsure	No	Never think about it
Question 8	What prevents you from performing better?			
Item	Immediate superiors	The gap between family members and non-family members	Lack of recognition and trust	Teamwork
Question 9	What do you think of Bin Valley Group's efficiency?			
Item	Very good	Fairly good	Just-so-so	bad
Question 10	Do you think Bin Valley Group's performance evaluation system is effective?			
Item	Yes	Useless	Ineffective at all	I don't know
Question 11	Besides salary, what do you value the most?			
Item	Improvement of capabilities	Work environment	Interpersonal relationships	Prospects of industry
Question 12	Please make comments on the relationship between family members and non-family members.			
Answer				
Question 13	What problems does Bin Valley Group have in terms of management, decisions, regulations, interpersonal relationships, differentiated treatment between family members and non-family members?			
Answer				

Appendix 4: Questionnaire 4

Respondent	Ordinary Staff among Non-Family Members			
Question 1	Do you know Bin Valley's strategic goal?			
Item	Very much	I know it	Not much	Not at all
Question 2	What do you think of Bin Valley's prospects?			
Item	Getting better	Levelling off	Getting worse	Not clear
Question 3	Do some staff act beyond their power?			
Item	Very often	Sometimes	Rarely	At least I never find it
Question 4	Are you clear about your responsibility and power?			
Item	Very much	Relatively clear	Not much	Not at all
Question 5	What do you think of Bin Valley Group's interpersonal relationship?			
Item	Very good	Fairly good	Slightly bad	Very bad
Question 6	What do you think of non-family members' behavior and conduct?			
Item	Very good	Fairly good	Just-so-so	Bad
Question 7	Are you willing to work for Bin Valley Group for the long term?			
Item	Yes	Unsure	No	Never think about it
Question 8	What prevents you from performing better?			
Item	Immediate superiors	The gap between family members and non-family members	Lack of recognition and trust	Teamwork
Question 9	What do you think of Bin Valley Group's efficiency?			
Item	Very good	Fairly good	Just-so-so	Bad
Question 10	Do you think Bin Valley Group's performance evaluation system is effective?			
Item	Yes	Useless	Ineffective at all	I don't know
Question 11	Besides salary, what do you value the most?			
Item	Improvement of capabilities	Work environment	Interpersonal relationships	Prospects of industry
Question 12	Please make comments on the relationship between family members and non-family members.			
Answer				
Question 13	What problems does Bin Valley Group have in terms of management, decisions, regulations, interpersonal relationships, differentiated treatment between family members and non-family members?			
Answer				