TIES THAT BIND: THE EMERGENCE OF ENTREPRENEURS IN CHINA

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ERIM REPORT SERIES *RESEARCH IN MANAGEMENT*	
ERIM Report Series reference number	ERS-2000-44-ORG
Publication status / version	November 2000
Number of pages	24
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Address	Erasmus Research Institute of Management (ERIM) Rotterdam School of Management / Faculteit Bedrijfskunde Erasmus Universiteit Rotterdam PoBox 1738 3000 DR Rotterdam, The Netherlands Phone: # 31-(0) 10-408 1182 Fax: # 31-(0) 10-408 9020 Email: info@erim.eur.nl Internet: www.erim.eur.nl

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Library of Congress Classification (LCC)	5001-6182	Business
	5546-5548.6 5548.7-5548.85	Office Organization and Management Industrial Psychology
	HD62.5	New business enterprises. Starting a new business, Entrepreneurship
Journal of Economic Literature (JEL)	M	Business Administration and Business Economics
	M 10 L 2	Business Administration: general Firm Objectives, Organization and Behaviour
	H 32 H 11 M13 O53 P 21 P 3 Z1	Public Economics: Firm Structure and scope of government Firm organization and Market Structure Entrepreneurship Planning, Coordination and Reform Socialist institutions and their transitions Cultural Economics
European Business Schools Library Group (EBSLG)	85 A	Business General
	100B 240 B	Organization Theory (general) Information Systems Management
	85 B	Small Business Management, Entrepreneurship
Gemeenschappelijke Onderwerpsontsluiting (GOO)		
Classification GOO	85.00	Bedrijfskunde, Organisatiekunde: algemeen
	85.05 85.08	Management organisatie: algemeen Organisatiesociologie, organisatiepsychologie
	85.00	Bedrijfskunde, organisatiekunde
Keywords GOO	Bedrijfskunde / Bedrijfseconomie	
	Organisatieleer, informatietechnologie, prestatiebeoordeling	
	Economische hervormingen, Ondernemerschap. Institutionele economie, Culturele verschillen, China	
Free keywords	Evolutionary economics, organisational change, dealing with uncertainty and risk	
Other information		

Ties that bind: The Emergence of Entrepreneurs in China*

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JEL-Classification:
H 32, H 11, M13, O53, P 21, P 3, Z1

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* The article benefits from the collaboration with Judith Mehta, University of East Anglia, who helped to set up the Data set II in 1999, and the assistance of the Shanxi University of Finance and Economics. The fieldwork was sponsored by the Dutch Royal Society for Art and Science, and by the Trustfonds Erasmus University of Rotterdam. Helpful comments by B. Nooteboom, L. Polos and Bruno S. Frey are acknowledged.

INTRODUCTION

Institutional and evolutionary economics have argued for some time that the "immediate determinants" of growth, such as productivity or investment are not enough for explaining the economic development of a country. Instead the organisation of firms, and the firm's response to risk or policy changes are crucial when it comes to exploiting resources, market chances and technical advances[1]. Thus, for example the success of China's economic reforms is based on Chinese entrepreneurship, rather than on an increase in total factor productivity[2]. New ways needed to be found for co-ordinating commercial activities "outside the plan", amongst which the establishment of (non-state) firms was certainly one of the most challenging tasks. Subsequently, the empirical question in what follows focuses on the establishment and functioning of new firms, their interaction and their response to the business environment they face. However, what started as an attempt for finding an economic explanation for Chinese entrepreneurship in comparison the European cases of socialist transformation ended with a new research agenda. For empirical and theoretical reasons it can no longer be assumed that there is only one form of entrepreneurship in China. Instead, different forms of entrepreneurship leading to different forms of firms can be expected. Another rather striking result of the research is that "culture matters" in the sense that different forms of entrepreneurship and firms will emerge due to different cultures within China. For this reason, a comparative study of entrepreneurship within China is needed before one can claim there is only one specific form of Chinese firm or Chinese entrepreneurship. One way to model such a frame for comparative studies will be presented below. After a short description of the field study and a summary of the empirical results, Institutional Economics will be employed to identify those factors that shape the behaviour of all potential entrepreneurs. The paper finishes by arguing that these factors do also explain the different forms of entrepreneurship and firms which can be expected to emerge within China.[3].

Insert Table I about here

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[1] Richard R. Nelson, *The Sources of Economic Growth.* (Cambridge, MA: Harvard University Press, 1996). Richard R. Nelson, "How New is New Growth Theory?", *Challenge* 40, 5 (1997) pp. 29-58.

[2] Paul Krugman, "The Myth of Asia's Miracle", *Foreign Affairs* (Nov./Dec.1994) pp. 62-78.

[3] Part of the empirical research will appear in Barbara Krug and Laszlo Polos, „The Strawberry Growth Underneath the Nettle: The Emergence of Entrepreneurship in China", *Asian Pacific Journal of Management* 2000 (forthcoming). The economic model will be presented at the Annual Meeting of the International Society of New Institutional Economics, Sept. 22-24. 2000, Tuebingen, Germany.

THE FIELDWORK

The reason for choosing Shanxi is that the province represents the hinterland: At the beginning of the reform half of Shanxi's counties had standards of living below the poverty line, and the water problem is acute. Though more industrialised than other provinces in the same situation its industry was almost completely controlled by coal mining. In 1995 Shanxi had a population of 30.77 million (2.5% of the national population) and GDP p.c. was only 73% of the national average. Throughout the eighties and till 1994 Shanxi’s rate of growth was consistently below the national average. The individual sector was small, joint ventures rare, foreign trade added up (1995) to only 10% of provincial GDP (compared to the national figure of over 40%). And yet, suddenly in 1995, 1996 and presumably in 1997 and 1998 also, Shanxi’s growth rates outstripped China as a whole. Something must have happened. We know from other studies that what had happened was that the provincial Party-state machinery got their act together and facilitated growth either by state investment, property rights change, or industrial policy. For example, Shanxi no longer exports coal but electricity, thus having created workplaces with a higher added-value within its own boundaries. Another change is that the state assisted by establishing companies which work in coal mine related business, thus promoting diversification. In a further move the government facilitated private entrepreneurship. Unlike some coastal provinces, Shanxi could not rely on foreign direct investment or on overseas communities whose background could be located within the province. In short Shanxi had to rely on "endogenous growth" strategies: Both resources and business strategies had to be built up without the help of foreigners or Overseas Chinese.

The empirical data used in the following consists of two sets: Data set 1 is based on all interviews, open and standardised 1993, 1996, 1997, and 1999 in Shanxi. One hundred and four business units were identified as firms according to the following definition: (Non-State) firms are those business units which are (1) exposed to competition in at least one factor or product market, and (2) can claim at least part of residual profit. When profit went to one person or one family, the firm was regarded as a private firm. When profit was divided among individuals and/or institutional owners, the firm was regarded as a partnership or corporation. When profit was divided according to a sharecropping contract, between individual, the manager, the village, and the village leadership, the model would be a common, i.e. a jointly owned resource[5]. When profit was divided according to registered capital, or in other words, paid dividends, the firm was regarded as a "shareholding" company following the expression Gufen-

[5] The model for jointly owned resources is found in Elinor Ostrom, *Governing the Commons* (Cambridge: Cambridge University Press 1990).

company. Likewise, those persons who crucially contributed to the building up and/or running of a firm were regarded as entrepreneurs, irrespective of whether they were Party cadres or state officials.

In contrast, data set 2 making use of the knowledge and information gained in the years before is based on a standard questionnaire filled out by 27 entrepreneurs in 1999. The difference between the two data sets is that the first focused on the business environment while the second focused on private exchange, the emergence of long-term business relations, the ways how to enforce business relations, and the ways how to learn new business practices.

PRIVATE ENTREPRENEURSHIP IN SHANXI PROVINCE

The overall picture, which emerges from the formal interviews and the informal talks reveals that it was neither "The" market" nor central political decisions which unleashed private entrepreneurship. On the contrary, as will be discussed later the co-existence of both made private entrepreneurship in China an as risky, uncertain venture as in other economies in transition. The interviews reveal, rather, that private entrepreneurship was self-organised in villages rather than in urban agglomerations, and in co-operation with local cadres and state agencies rather than by waiting for or complying with national legislation[6]. Most strikingly the lack of resources, such as electricity, transport lines, supplies etc., was dismissed as a factor in the establishment of a firm. Thus, 24 of the 27 respondents found the availability of roads and railways, and - surprisingly - communication (Internet, fax, telephone) adequate. 19 (in the case of energy) and 20 (in the case of land) were satisfied with energy and land, however stressing their individual access to the small real estate market, and the need to improve the water situation in the province. 15 out of 27 found the availability of local supply sufficient, and 8 more stressed that they did not have to worry as they had long term contracts with big (foreign) firms and SOEs which ensured enough input[7]. Instead, lack of organisation and institutions was mentioned: for example, the lack of managerial skill, as well as the unavailability of financial services, which only 12 (in the case of managerial skill) and 15 (in the case of support from banks) found adequate. Looking at all the interviews, one cannot but see that the success in Shanxi relied on three devices, elaborated on presently:

[6] In so far the analysis suggests a refutation of the model of corporatism in China. Yet, as will become clear in what follows corporatism in an economic analysis is the outcome of individual and collective action in the political market. Depending on the *rules of the game* in the political market more state corporatism or mores societal corporatism can be expected. The point made in this paper is that the *weak institutions* in China do not allow us to predict which kind of corporatism, if any, dominates. Different kinds of corporatism can emerge and co-exist in different localities. Likewise, the forms can change over time. For the discussion of corporatism see Jonathan Unger and Anita Chan, “China, Corporatism, and the East Asian Model” *The Australian Journal of Chinese Affairs* 33 (1995), pp. 29-53: Victor Nee, “Organisational Dynamics of Market Transition: Hybrid Forms, Property Rights, and Mixed Economy in China”, *Administrative Science Quarterly* 37 (1992), pp. 1-27, and his somewhat different view in Victor Nee, The Role of the State in making a Market Economy”, *Journal of Institutional and Theoretical Economics* 156 (2000), pp. 64-88.

1. Reviving old economic institutions
2. Hijacking social organizations
3. Building up new business practices.

On one side this outcome looks trivial: To employ old, new and elements transferred from another area comprehensively delineate the pools of possible devices for any change. Yet, on the other side, it can also be argued that these findings are nothing but ad hoc solutions, representing a "chance" element or a Shanxi-specific solution. The last argument cannot be taken up till the fieldwork is taken to another province. However, the Shanxi data sets can help to investigate whether these three devices implicate that tradition is behind the re-building of China's economic institution, or whether there is another (economic) rationale that is employed by economic actors.

As Institutional Economics points out the establishment of long term business relations is the single most crucial element in entrepreneurship. Firms, almost by definition, are the nexus of long term contracts. Likewise, in order to survive firms need to establish predictable and reliable relations with other firms, business partners in the factor, product and capital market, if not with the different layers of government. It is from this perspective that the three devices, revival of old institutions, hijacking social organisations, and the creation of new business practices, need to be assessed. The following will present two illustrative examples for each case by no means claiming that there are not more.

REVIVING OLD INSTITUTIONS

The advantage of using past economic institutions is that their economic use and value is known or remembered[8]. Two of such institutions were found in Shanxi, sharecropping and the use of contracts.

The Use of Contracts

Although the Chinese law tradition concentrated mostly on what would be called today administrative law and punitive law, commercial contracts were by no means unknown[9]. Nevertheless it came as a surprise that 18 out of the 27 respondents interviewed in 1999 used contracts in their business dealings[10]. The contracts were more than written letters of intent. Thus, for example, the contracts specified length of business arrangement, price, quantity, product specification, quality, exceptional

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[7] Those companies usually processing output of SOEs are often a management buy-out within the conglomerate of state firms. They may face an unpleasant surprise when the SOE is forced to look for profitable ways of production as the ongoing reforms intend.

[8] For a general analysis see. Robert H. Frank, *Passion within Reason: the Strategic Role of Emotions* (New York: Norton, 1988).

[9] Chen, P., *Chinese Legal Tradition under the Mongols* (Princeton, NJ: Princeton University Press, 1979), pp. 3-40. Huang, R. *1587. A Year of No Significance. The Ming Dynasty in Decline* (New Haven and London: Yale University Press, 1981); Lucie Cheng and Arthur Rosett, "Contract with a Chinese Face: Socially Embedded Factors in the Transformation from Hierarchy to Markets, 1978-1989", *Journal of Chinese Law* 5(2) (1991) pp. 143-244.

[10] This finding is however supported by a study on Chinese legal culture executed in Shanghai. In the latter case, for example, "ninety one per cent of the respondents agreed to the statement that an agreement to purchase an automobile

circumstances under which *force majeure* would apply, and the procedure to be adopted in the event of a dispute or non-compliance to the contract[11]. Items not always specified in the otherwise comprehensive agreements were the “right to inspect the production site of the business partner” (in 5 cases), and procedural provisions in case something were to go wrong (in 4 cases). Only in 2 cases did respondents insist on the tradition of oral agreements.

When asked how the contracts were enforced the following picture emerged: out of the 22 respondents only three would automatically take recourse to the law, while 19 would start with bilateral negotiations, sometimes relying on a friend or external arbitrator (14 cases). If this procedure should fail 6 would finish the business relationship, while 7 would go to court. When asked informally what the courts are good for if they are not used, the following explanation was given by two Chinese colleagues: A court might be needed to identify the harming party and its "wealth position" but would be a "too expensive" way to negotiate compensation.

Unfortunately, it was only after these answers pointed to a more general pattern of behaviour that the obvious question was asked, namely what use contracting offers if not litigation. Despite the fact that the answers were not included in the questionnaires, they give a clear picture: Contracts are used predominantly in order to avoid ambiguity. As one respondent put it, not knowing much about the business, and not knowing much about business practices in other parts of China or other sectors to write down the precise terms of a business relation is seen as a useful device to avoid "trouble" (respondent 014).

A comparison with the former (imperial) legal tradition shows to which extent an old institutions such as contracts got aptly modified to fit today's purpose. The change is rather drastic: While in the past private contracting outside the tenancy system and foreign trade was met with suspicion as it seemed to indicate that both partners did not know the "appropriate way" to deal with each other[13], if it were not seen as an indicator for personal character deficiencies, today's contracting acknowledges and insists on the ambiguity in relations, might these be based on different local cultures or the uncertainty a new business environment creates. It could be argued that the institution that got revived is the contract system that existed before Ming-dynasty since the Ming-reforms aimed at weakening the private

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would be more effective if it were in writing", in Pitman B.Potter, “Socialist Legality and Legal Culture in Shanghai: A Survey of Geti”, *Canadian Journal of Law and Society* 9,2 (1994) pp. 41-72.

[11] The respondents were asked whether there was a written, verbal or no agreement on the following items: price per unit, other price formula, date at which payment to be made, length of business arrangement, precise quantity of goods to be supplied over fixed period, minimum quantity to be supplied over fixed period, length of interval between order and delivery, specification of the product, right to change specification, compensation for changes in specification, quality of goods to be supplied, rights to inspect the other's production site/process, promise to do one's best, exceptional circumstances under which *force majeure* will apply, circumstances under which negotiation can take place, procedure to be adopted in the event that one sides fails to fulfil the agreement, procedure to be adopted in the event of a dispute.

[13] For the history of China's legal tradition see literature in footnote 9.

dispute settlement notion by their insistence to enforce moral law. Yet, this does not change the overall picture, namely that one old institution was selected and revived.

That contracts are powerful devices to enhance predictability and accountability is not hard to see. Economists would argue that they are powerful transaction cost saving devices as they allow effective monitoring and enforcement of the performance of both contractual partners[14]. The Shanxi entrepreneurs, as seen above, do not use contracting for this purpose. When asked why they use contracts without using the accompanying enforcement agencies like in the West, the respondents said that they knew better devices for enforcing agreements. One, most commonly used, way is that they would enter a contract only with somebody they would trust. In other words, trust and contracting are not seen as substitutes, let alone mutually exclusive. Instead they re-enforce each other: Without trust no contract, and without ambiguity-reducing contract no trust[15].

Sharecropping

Sharecropping was known in China for more than one thousand years. It is a lease contract where the owner of a resource expects a certain fixed sum and a share on net return. The higher the share the resource owner asks the higher the risk he personally takes, but simultaneously the higher his share on the innovation rent. If, for example the resource owner asks for thirty per cent of net return, this means s/he bears only thirty per cent of total loss/profit. Yet, her/his share of any productivity increasing measure is also only thirty per cent. If, on the other hand, s/he asks for sixty per cent, s/he accepts the major share in case of a loss/profit while expecting to profit most from innovation and productivity increases[16].

A look at data set 1 reveals that most of the companies visited started with assets transferred from either State-owned companies or the village leadership (70 out of 104). In 44 cases sharecropping contracts were used to transfer resources to the managerial control of the lessor. It is worth noticing that some of these managers were able to buy these assets after a couple of years, and by doing so turned a state firm into a private enterprise (12 cases). That managers quickly could accumulate enough capital for such a Management-buy-out might be explained by the agreed upon sharing parameter in the original contract. As data set 2 shows, the majority of the sharecropping arrangements left at least fifty percent in the hands of the manager. Apparently, pessimistic cadres shied away from taking on more than half of

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[14] For example in Richard Cooter, and Thomas Ulen, *Law and Economics* (Reading, MA: Addison-Wesley, 1997), pp. 161-2; Barbara Krug, "Comment to Qian Yingyi", *Journal of Institutional and Theoretical Economics* 156,1 (March 2000a) pp. 175- 179

[15] Stephen Macauly,."Non-Contractual Relations in Business: A Preliminary Study", *American Sociological Review* 28 (1963) pp. 55-67.

[16] Stephen Cheung, "Transaction Costs, Risk Aversion, and the Choice of Contractual Arrangements". *Journal of Law and Economics* 12 (1969) pp. 23-42; Stephen Cheung, *The Theory of Share Tenancy* (Chicago, IL: University of Chicago Press, 1969b); Joseph E. Stiglitz, " Incentives and risk sharing in sharecropping", *Review of Economic Studies* (April. 1974) pp. 219-255. Barbara Krug, "Privatisation in China: Something to learn from?", in Herbert Giersch (ed). *Privatisation at the Turn of the Century.* (Berlin: Springer, 1997b), pp. 269-296.

the loss in case of a business failure, not trusting that the manager would come up with organisational changes and innovation which would turn the firm into a profitable venture. Subsequently, whenever innovation occurred the manager then could claim the greater share. S/he became rich, or, at least rich enough to buy out assets step by step.

To conclude from the widespread use of sharecropping that China's tradition offered a blueprint for privatisation and economic success is however short-sighted. Sharecropping arrangements were not copied but adapted to fit present conditions. While such arrangements were in the past used in land deals only and constituted the specific Chinese form of share tenancy[18], today such an arrangement is used for leasing out industrial assets and land for industrial sites. Moreover, the lessor is no longer a private person (landowner) but a collective agent, such as the village or State-owned enterprise. As the literature shows sharecropping arrangements are efficient devices for risk sharing and the sharing of the innovation rent. Moreover they help to establish predictability in particular with respect to what is expected from the lessor, how profit is shared, and how individual investment and innovation gets remunerated. They help to streamline behaviour as well as stabilise expectations. Finally, they provide an effective way for re-allocating resources to private actors in a situation where private property rights were unknown. Unlike what was attempted in some European socialist economies where privatisation asked for enough private savings to buy assets, China found a way that allowed entrepreneurs with ideas but not enough capital to gain control over assets to start a business[19].

HIJACKING SOCIAL ORGANISATIONS FOR FOSTERING BUSINESS RELATIONS

It seems to be common knowledge that both the family and the village were the cause of China's rapidly developing private sector. The field study in Shanxi suggests a modified view, namely that both institutions were hijacked for entrepreneurial purposes. As economists would argue, the advantage of such a practice is that these institutions allow the employment of social routines in behaviour and social sanctioning mechanisms for economic transactions in an environment of ill-functioning markets and ill-functioning law[20]. Another result is that the Shanxi-data warns against taking the notion of the family or the village too literally. As will be seen presently, the family plays no role when it comes to starting a business.

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[18] An economic analysis of sharecropping is found in the literature in footnote 16.
[19] See Barbara Krug "Moving the Mountains: Transformation as Institution Building from Below", in Juergen Backhaus and Guenther Krause (eds) *The Political Economy of Transformation: Country Studies* (Marburg: Metropolis, 1997a), pp. 127-152; and Barbara Krug, *Privatisation in China,* 1997.
[20]The "classics" are James S. Coleman, *Foundations of Social Theory* (Cambridge, MA. Harvard University Press, 1990), and Avner Greif, "Reputation and Coalition in Medieval Trade: Evidence on the Maghrabi Trades", *Journal of Economic History* 69, 4 (1989) pp. 857-883.

The family

That the family is at the core of Chinese entrepreneurship seems to be common knowledge. The business administration literature claims so[21], the dominance of family controlled Chinese multinationals in Hong Kong seems to confirm this, and economic theory points into this direction too: the family functions as a capital pooling institution, where information is freely shared and where proximity keeps opportunistic behaviour at bay. Sinologists, anthropologists and sociologists doing research on the notion of the family[22] were not so sure. For example, they stressed the fact that "lineage", i.e. extended families (in Chinese: zu), is concentrated mainly and predominantly in southern China[23]. The empirical evidence in Shanxi, i.e. a province in the North of China, shows that the notion of an extended family does not exist. The Shanxi-data sets show that the family did not play any role when it came to establishing a firm, i.e. as a capital and skill pooling institution. A general answer to the question why the family as an institution is not more often employed in Shanxi was that "if one person was poor, most probably his family is poor too". As economists would claim, this interpretation misses the advantage of the "extended family", namely that the greater size of the extended family allows relative poor family members to engage in entrepreneurship since they can mobilise capital and skill from a larger pool[24]. Another general reason heard in Shanxi is that a poor family does not want to "put all the eggs in one basket". Instead the family would insist on risk-diversification, expecting different family members to try out different business ventures. In this case economists would also agree, since it is known that the family functions as a risk-mitigating institution[25]. Thus, it is interesting to know whether the Shanxi-family is a resource pooling or a risk-mitigating institution - or both[26]. This distinction could provide a useful starting point for a comparative study of entrepreneurship within China. It would be interesting to learn whether the extended family serving as a resource pooling institution exists, and in which part of China.

The answers to three questions in data set 1 can illustrate the fact of the “missing family”:

(1) Only 20 out of the 104 (data set 1) visited entrepreneurs were a private business in the sense that all assets were in private hands. Yet, only in 3 cases did the family provide the start-up capital in

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[21] Gordon S. Redding, *The Spirit of Chinese Capitalism.* (Berlin and New York: de Gruyter, 1990); Gordon S. Redding. “The Distinct Nature of Chinese Capitalism”, *The Pacific Review* 9. 3 (1996). Richard Whitley, “Eastern Asian Enterprise Structure and the Comparative Analysis of Forms of Business Organization”’ in P.N. Ghauri and S.B. Prasad (eds.) *International Management* (London: Dryden Press, 1995), pp. 191-212.

[22] M.H. Fried, *The Fabric of Chinese Society. A Study of Social Life of a Chinese County Seat* (New York: Praeger, 1953) pp. 27-88; Maurice Freedman, *Family and Kinship in Chinese Society* (Stanford, CA: Stanford University Press1970); Kiong, T.C. “Centripetal Authority, Differentiated Networks: The Social Organization of Chinese Firms in Singapore”, in Gary Hamilton (ed) *Business Networks and Economic Development in East and Southeast Asia* (Hong Kong: Centre of Asian Studies Occasional papers and Monographs, No. 99,1991) pp. 176-200.

[23] For example Lloyd E. Eastman, *Family, Fields, and Ancestor.* (Oxford: Oxford University Press, 1988), p.19.

[24] Francis Fukuyama, *Trust. The Social Virtues and the Creation of Prosperity* (London: Penguin, 1995); Gordon S. Redding, “The Distinct Nature of Chinese Capitalism”, *The Pacific Review* 9,3 (1996).

[25] Rosenzweig, “Risk, Implicit Contracts and the Family in Rural Areas of Low Income Countries”, *The Economic Journal* 98 (1998) pp. 1148-1170; Rosenzweig, M.R. and Stark, O. “Consumption Smoothing, Migration and Marriage: Evidence from Rural India”, *Journal of Political Economy* 97 (1989) pp. 905-926.

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form of a repayable loan. This is in sharp contrast to "friends" who, mentioned 34 times, offered money if they did not form a (temporary) partnership with entrepreneur for a specific business venture, which was dissolved the moment the initiator could afford to buy out the partners.

(2) The family was mentioned only twice (in data set 2) as being consulted when financial losses asked for bankruptcy procedures[27]. This confirms that even if somebody claims a firm to be a family business, in most cases, such a firm knows one owner only.

(3) The family was mentioned only once (in data set 2) when asked to whom the respondent would turn to in case of an emergency, in the form of illiquidity or insolvency. This is in striking contrast to friends (mentioned nine times), commercial partners (mentioned 5 times), state agencies (mentioned 5 times) and capital owners (mentioned twice). The fact that banks were mentioned 19 times does not necessarily indicate a "crowding out" of traditional ways of doing things. Here, sequencing matters: a firm would first turn to a bank, and if this should fail, then they would turn to friends and business partners who are regarded as the creditor of last resort. The entrepreneur would, however, not turn to the family.

As seen from the answers, "friends" are important. Further inquiries revealed that three social groups formed the focus for friendship in the business environment of Shanxi-entrepreneurs: childhood friends, friends with whom one passed the military service together and classmates from institutions of higher education. The People's Liberation Army and "alumni-clubs with Chinese characteristics" deserve some attention. They certainly represent another example of how aptly the Chinese entrepreneurs modified inherited social custom to present day's use. While the family is concentrated in one (geographical) area, both the PLA and the universities are institutions where people from all over China meet. To the extent that comrades in the army and classmates go back to their native county after graduation, friendship allows for establishing business relations across "China" (and by doing so contribute to the establishment of an integrated national market).

In short, networks, which offer access to the national market are seen as of higher economic value than the locally concentrated family. The Shanxi entrepreneurs did not see a problem with respect to loyalty, norms of reciprocity, and emotionally based caring for each other when it came to friends. Trust, reliability, and accountability are expected to be dominant features in these networks, which subsequently should be interpreted as close substitutes for families. There might be less affection, which in a family would limit opportunistic behaviour, but on the other hand, friends are less inhibited when it comes to sanctioning misdemeanour[28]. Somebody who shirks obligations or plays foul is known quickly to all other members and, in the extreme, will be excluded from future information sharing or business deals. As was shown above, one way to enforce a contract was not to renew it but switch to another partner. By doing so, one business partner signals his mistrust to the other members of the network. In this sense a social institution, such as a network of friends, serves admirably well to the purpose of establishing predictable and accountable behaviour, as well as establishing certain business practices shared by many.

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[27] Which in the Chinese context means merely to dissolve the firm. It is worth mentioning that in twelve cases (out of 27) the respondents did not know any answer to the question of bankruptcy, indicating that they cannot go bankrupt.

[28] T. Yamagishi, and N. Takahashi, "Evolution of Norms without Metanorms", in Ulrich.Schulz, W

Does this mean that the family is completely discarded as an institution in the business sector in Shanxi? The following example (Graph 2) indicates a modified answer, namely that the family is not (or no longer) used as a resource-pooling institution. Instead the family offers a pool of reliable managers for supervising different branches of a well-established branch of the business.

Insert Graph 2 about here

In 1989 Mr. Wang[29] used RMB 5.000 he had saved from trading cloths (an occupation he had taken up in 1986) to open a workshop for household appliances. It was a friend who had suggested this business. In the workshop Mr. Wang repaired and sold electric fans, air conditionings and lamps. By doing so he acquired some experience in electronics which made him confident enough to start negotiation with Robert Bosch Car Electronics a firm to which he was introduced in 1991. In the end he got a contract as one of the official Bosch Car Electronic garages. It quickly turned out that he did not have a workforce skilled enough to fulfil the contract. He turned to a friend from his time in the army for help, who in turn managed to hire some railway engineers from a PLA engineering brigade. These technicians were crucial for the success of the garage, which turned into such a profitable business that in the course of four years (1992-1996) Mr. Wang further invested in an International Club, i.e. a posh restaurant, built up the largest catering firm in North China, opened more recreational facilities, let's say clubs, and started two construction companies in Australia. The different branches of his business in China are managed by his son and son-in-law, while one daughter is in charge of the Australian companies.

Aside from the "familial" governance structure, what is remarkable in this firm is that instead of expanding the profitable core business, i.e. car electronics, Mr. Wang invested in other sectors and other countries. It is not hard to see the advantage of investing in different sectors and countries as long as the "confiscation risk" in China remains high. The speed by which Mr. Wang diversified his business, let alone what made him change the line of business asks for an explanation. In all cases friends were decisive. This turns part of the common sense knowledge about the role of the family and the role of networks around. While (in the West) the family is seen as a resource pooling institution while networks help to monitor and enforce business relations, Mr. Wang did the opposite. He used the network as a resource, in particular knowledge and information pooling institutions, while the family provided the service for monitoring business relations. This feature was also found in the companies of other Shanxi entrepreneurs (for example respondent 019). In how far that is a coincidence or a systematic factor within Shanxi or China needs to be analysed further. It is however worth emphasising that Hong Kong conglomerates do also employ family members for supervising different branches of the business.

.Albers, U. Mueller (eds) *Social Dilemmas and Cooperation* (Berlin: Springer, 1994) pp. 311-326.

[29] Mr. Wang is a fictitious name referring to respondent No. 014.

The Village

Ever since Ming-dynasty villages and rural communities became the natural owner of natural resources (except land), the agency of last resort for civil and moral law, the basic unit of defence, and the primary collective actor in the political and social arena. Despite some attempts by Chairman Mao, this did not change much during the Mao Zedong-era. The constitution of 1982 reconfirmed this role however with major changes. Thus, for example the village became responsible for tax revenues and for generating work places[30]. So far, it could be argued the village went "back" to the institutional design of the pre-socialist era, were it not that the village provides another example for the remarkable adaptation. Certainly one of the most exciting features of institution building in China is that starting in the middle of the eighties, and unnoticed, let alone approved, by the central government, villages began to design so-called village compacts. These village constitutions established an electoral system that might not fit Western notions of democracy but which is a big step forward to the establishment of accountable government[31]. An analysis of these constitutions shows that the protection of assets, contracts and transactions, dominates each constitution[32]. At the same time so-called ethic committees were established which come close to law enforcement agencies and "courts", with a jury system not unlike the Anglo-Saxon tradition to which members are elected by the village community. It took the national government in Beijing something like five to seven years to notice that some remarkable institution-building from below had occurred. An intrinsic motivation to build up democratic institutions was not behind this development as the open interviews in data set 1 reveal[33]. Instead elections and local law enforcement agencies were seen as instrumental for the establishment of predictable and accountable state agencies.

The village's crucial role not only with respect to the establishment of firms, but also to the development of property rights can be seen in the following example (respondent 019): An aluminium processing plant started as a dilapidated Township and Village enterprise (TVE) employing not more than thirty people (Graph 1).

Insert Graph 1 about here

[30] Barbara Krug, "Privatisation In China ",1997; Qian "the Process of China's Market Transition"2000
[31] Barbara Krug "Moving the Mountain" 1997; Li Lianjiang. 1999. "The Two-Ballot System in Shanxi Province: Subjecting Village Party Secretaries to a Popular Vote", *The China Journal* 42 (1999) pp. 103-118.
[32] In 1998 sixty per cent of the villages had already held their second round of elections. The notable exception to the economic tasks of the village is the One-Child policy.
[33] See also Victor Nee, and R. Matthews, "Market Transition and Societal Transformation in Reforming State Socialism", *Annual Review of Sociology*. 22 (1996) pp. 401-435; Louis Putterman, "The Role of Ownership and Property Rights in China's Economic Transition", *The China Quarterly* 144 (1995) pp. 1049-1064; Jean C. Oi, "The Role of the Local State in China's Transitional Economy", *The China Quarterly* 144 (1995) pp. 1132-1149.Barbara Krug "Privatisation in China"1997; Lianjiang Li, "Two Ballot System" 1999; for a general analysis of villages in Shanxi see David S.G. Goodman, „Collectives and Connectives, Capitalism and Corporatism: Structural Change in China".,*The Journal of Communist Studies and Transition Politics* 11 (1995) pp. 12-32.

In order to turn the workshop around and to generate workplaces (and revenues) the village needed

- somebody with a good idea
- a complementary infrastructure, such as roads, water, electricity
- investment
- a mixture of regulation and taxation that facilitates private entrepreneurship.

In the first stage, the village established a construction company whose demand for unskilled labour allowed the securement of workplaces for excess labour in agriculture. At the same time friends of individual village leaders explored further opportunities. One (SOE) which had spun-off a construction company expressed interest in village land on the condition that it would be first converted into an industrial site. The village was expected to invest in roads and to ensure connection to the main power lines and water. Subsequently, negotiations with the electricity company of the province started in which the electricity provider promised the necessary investment and a steady supply in return for a share on net return. So far, the village had converted land into an attractive industrial site for manufacturing in which both the SOE and the province would invest. At this stage how to use the industrial site, let alone what to produce, was not yet decided upon. Later a private entrepreneur was introduced who had a connection with the largest aluminium factory in Asia, but neither the financial capital nor the land necessary for building a factory himself. He promised to broker a long-term supplier contract with the aluminium factory and further financial capital, again in return for a share on net returns. Finally, the village "economic negotiation committee" put all these different stakes together, organised trips to other provinces in order to hire the necessary skilled (and unskilled) workforce, and "designed" a set of licences, regulation, and taxation which promised that not only the start-up costs but also the running costs would remain low. In return for these services, this negotiation committee also asked for a part of the returns. In the end the ownership and governance looks as follows (graph 1): The providers of electricity and scarce financial capital own 67% of the shares, the village as provider of land and partly of workers gets 6% plus 27% for its economic negotiation committee. Three features in this elaborate ownership and governance structure deserve attention[34]:

The village facing claims on net returns prefers an official registration of the claimants as "owners". By doing so, risk is shared, limiting ex post opportunism by one of the parties, while the claims on profit are linked to the initial registered capital. Subsequently, the claims become predictable, allowing better calculation and safer accumulation of capital in the firm. By converting claims on returns into registered capital the village and the other participants establish property rights on physical, financial and social capital, something national policy still shies away from. The formation of property rights in this case acknowledges the value of the village economic committee; more precisely the social capital such an institution can provide.

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[34] Other forms of property right formation can be found in X.L.Ding, "The Illicit Asset Stripping of Chinese State Firms", *The China Journal,* Vol. 43 (January 2000) pp. 1-28.

The role the village in China played in the transformation process deserves more attention in the literature on transition economies: The Chinese example shows that a more decentralised approach which opens ways to experiment with different forms of institutions has its merits. It allows economic actors to innovate, to adapt and to choose organisations or institutions according to specific conditions. The way property rights were introduced first with respect to land and later with respect to industrial assets as shown above provide an excellent example for organisational and/or institutional innovation[35].

BUILDING UP NEW BUSINESS PRACTICES

So far the analysis suggests that entrepreneurship is the result of organisational change and the re-building of institutions rather than technical innovation or the "marketisation" of the economy. On the individual level this means that Shanxi entrepreneurs respond to signals from friends and networks, the way (Western) entrepreneurs respond to market signals. As the matter of fact, they do both: Data set 2 shows that although 10 respondents (out of 27) found price, and 14 respondents (out of 27) quality, "very important" , in "choosing to enter a business relation with X, 10 (out of 27) found "the respectability and influence of X within the local community" and 12 (out of 27) "the reputation of X for reliability" very important. If this result is representative then the way resources are allocated within networks, and how networks emerge and survive, becomes as crucial for economic development as the emergence and stability of markets.

Before the functions of networks in China will be analysed further, some general remarks on individual business behaviour can help to explain why a network is more than a label for a group which shares socio-demographic attributes, such blood relations, or place of origin[36].

The emergence of routines

A large part of business relations is based on so-called routines (or custom) which everybody knows to be “the right way of doing things”. They represent the view of how things are done, which is shared by many and leads to behavioural patterns such as, for example, regarding written contracts as the normal way to establish business relations for all partners. For this reason routines remain outside any “rational” decision making. These routines can be effective tools for keeping transaction costs down in private business deals. In order to function such routines need to be recognisable, unambiguous and

[35] For land rights see Scott Rozelle, and Guo Li, “Village Leaders and Land-Rights Formation in China”, *Amercian Economic Review* (papers and proceedings) 88,2 (1998) pp. 433-438: Louis Putterman, “The Role of Ownership”, 1995; Jonathan Unger, and Anita Chan, “Inheritors of the boom: Private Enterprise and the Role of Local Government in a Rural South China Township”, *The China Journal* 42 (1999) pp. 45-74.

[36] The following is based on the analysis in Ekkehard Schlicht, “On Custom”, *Journal of Institutional and Theoretical Economics*, 149 (1993) pp. 178-203; Thomas Schelling, *Micromotives and Macrobehavior* (New York-London: W.W.Norton, 1978); Robert Frank, *Passion Within Reason* (New York: Norton , 1988; Barbara Krug, “On Custom in Economics” *Journal of Institutional and Theoretical Economics* 155 (1999) pp. 405-428; Laszlo Pólos, Michael T.

enforceable. Subsequently, economic actors will congregate around commonly shared business practices. Each actor will choose a business partner from this pool of people who acknowledge the same or similar business routines. The advantage of doing so is that each member does not have to scrutinise and check whether, for example, the employment of contracts is advantageous or not, and whether the other side is (mis-)interpreting the use of contracts as a sign of mistrust. Economic actors assume that those from the same place of origin or those speaking the same dialect will know the same routines - and therefore start doing business with each other. For this reason it can be assumed that a Shanxi entrepreneur will prefer to do business with somebody from the same locality, rather than indiscriminately start business relations with anybody who offers favourable terms, as neo-classical economics would assume. Yet, when it comes to outsiders and "strangers", a way needs to be found that allows the screening of newcomers in order to make sure that they abide by the same routines. It is the network, which provides the necessary monitoring and enforcement, while reputation refers to the fact that a member knows the routines and abides to them. In short, the network shapes and controls the individual behaviour of potential business partners, and in particular monitors whether these can be trusted to play by the same rules.

The emergence of networks

Aside from generating a pool of business partners who share the same custom, the Shanxi-data sets confirm the assumptions about networks as discussed in the literature when they

- offer access to resources
- broker business deals
- share information and knowledge. Most importantly, they
- supply any entrepreneur with reliable partners for re-establishing business practices and institutions.

The open interviews from data set 1 revealed that the underlying assumption in Shanxi is that if one "interactively" agrees on certain practices with friends, i.e. people who are trustworthy and reliable, then these practices and institutions must be ones that facilitate "honest trading" while rewarding individual performance[37].

The Shanxi data suggest two other aspects of networks rarely found in the literature: First, there is no fixed number of networks, defined by family, place of origin, shared educational experience, etc.[38]

Hannan, and Glenn R. Carroll, "Forms and Populations", in Glenn R.Carroll and Michael. T. Hannan (eds.)*The demography of Corporations and Industries* . (Princeton: Princeton University Press, 2000) pp. 59-81.

[37] The argument was also used for the contrary case, namely that if one deals with doubtful characters, or "Party crooks", then the ensuing institutions must be ones that neither reward personal performance (and effort) nor "fairness".

[38]It is worth mentioning that all empirical studies in social psychology on Chinese attitudes toward the family and networks support the Shanxi study: Common interest in China creates stable relations and networks. Trust, loyalty or reliability do not need a family, or kin at the core. See for example, David Yau-Fai Ho and Chi-Yue, " Component Ideas of Individualism, Collectivism, and Social Organization" in U. Kim *et.al.Individualism and Collectivism* (London: Sage, 1994), pp. 137-156; Wong Siu-lun, "Chinese Entrepreneurs and Business Trust", in Gary Hamilton (ed.), *Business Networks and Economic Development in East and Southeast Asia* (Hongkong: Univerity of Hongkong, 1991), pp.13-

Instead each individual entrepreneur will use different networks for different purposes. As said before, the PLA dominates the market for skilled labour, while former classmates function as middle-men to take the business to another province or into another sector, and a comrade helps to get access to export licences. In other words, while what all networks have in common is that they offer a pool of reliable business partners and information, different networks offer different services. Second, in order to fully employ networks an entrepreneur does not need to be a member of each of them. The introduction of a friend is enough[39]. It is the diversification of output the different networks offer plus the manageable entry and exit costs, which allow individual entrepreneurs to fully exploit each network's comparative advantage[40]. This also explains why a great deal of Shanxi networks of entrepreneurs do not employ patron-client relations, let alone the Mafia-kind of relations, both of which are based on local monopolies and mutual dependency.

To employ a multi-layered system of networks instead of relying on bilateral personal relations offers other advantages. The pool of resources, reliable business partners, knowledge, and information is larger, while scale economies can be expected when a larger group of business partners subscribes to the same business practice. Monitoring costs are lower to the extent that not each contract needs to be monitored. Instead, reputation and the sanctioning mechanisms of networks serve as enforcement devices.

All in all, as it was with the case of choosing the right institution, the selection of individual business partners and networks does also reflect neither random choice nor blind imitation. Once again past performance is taken as a predictor of future behaviour, which as Institutional Economics has shown is useful in situations of high uncertainty[41]. Evolutionary economics claims that such devices need to promise an economic value, otherwise they would not be selected. This can, but must not, mean that rational actors carefully weighting the (expected) returns and costs “choose” them. As a matter of fact, the emergence of business routines cannot be rationally chosen as they reflect *tacit knowledge* whose usefulness is left unscrutinised. The analysis of routines, therefore, depends on a thorough knowledge about Chinese business practices and the employment of cognitve sciences, such as social psychology or sociology. Whether intended or not, the *instrumentality* of revived, transferred or newly established institutions is decisive in the long run. The selection process at work will facilitate the imitation of those devices which contribute to economic development (or welfare) while those institutions which cannot contribute (or contribute less) will be dismissed (or forgotten). The instrumentality of institutions here

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47; Hwang Kwang-Kuo, "Modernization of the Chinese Family Business", in Henry S.R. Kao, Sinha Durganand, Ng Sek-Hong (eds.), *Effective Organisations and Social Values* (London: Sage 1994), pp. 37-62. Hong Liu, "Old Linkages, New Networks: The Globalization of Overseas Chinese Voluntary Associations and its Implications", *The China Quarterly*, No. 155 (September 1998), pp. 582 - 610. Kwok Leung, "Negotiation and Reward Allocations Across Cultures", in P.C. Early and M. Erez (eds.), *New Perspectives on International Industrial/Organizational Psychology* (San Francisco: New Lexington Press, 1997), pp. 640-675.

[39] Michael Harris Bond, *Beyond the Chinese Face* (Oxford: Oxford University Press, 1991); Peter M. Blaug, "Interpersonal Choice and Networks in China", *Social Forces* Vol. 69, 4 (June 1991) pp. 1037-1062.

[40] See also Thomas Menkhoff, “Yinyong or How to Trust Trust: Chinese non-contractual business relations and social structure”, *Internationales Asienforum* 23 (1992) pp. 262-288.

[41] Barbara Krug, “On Custom in the Economy”, 1999; Robert Frank, Passion within Reason, 1988.

refers to *accountability and predictability* in business relations, and not to *efficiency* which would be the selection criteria for choosing production factors. Those institutions, which promise more predictable business relations or help to find "accountable" business partners (individuals or local government) will be preferred.

So far the descriptive analysis of Shanxi entrepreneurship. It leaves one wondering whether and to which extent the findings can be seen as representative for the whole of China. To deal with this question in a systematic way asks for a theoretical framework that employs two sets of assumption

1. We may assume that Chinese entrepreneurs, i.e. individual agents, respond to the business environment in a systematic way: Trying to make the best out of it causes them to move towards those activities that promise positive returns (profit) while avoiding those which prove to be costly. They will do so unilaterally or, if this should be too expansive or impossible, they will join forces with others. If a common denominator for the business environment can be found then the common feature of Chinese entrepreneurs can be traced. An example would be entrepreneurship itself. Once the reforms allowed them to do so, a great number of Chinese started their own business. When they realised that the needed capital exceeded their personal savings or knowledge they looked for others with whom they could pool resources.
2. We may assume additionally that there is heterogeneity in China to the effect that Chinese entrepreneurs face different sets of alternatives from which they select devices with which they expect to help to overcome the problems as defined by the situational constraints (see below) An example would be that in the South of China the (extended) family is known or remembered as the natural pool of resources, an alternative that Shanxi entrepreneurs do not see. Subsequently, family firms will emerge in the South while Shanxi or other places will be dominated by firms in which collective actors (other firms or state agencies) claim property rights[42].

While the first assumption is straightforward and well supported by many field studies[43], the second assumption is intriguing.

THE SITUATIONAL CONSTRAINT

It certainly can be claimed that, indeed, the Chinese entrepreneurs have something in common, which distinguishes them from entrepreneurs in Japan, Europe or Australia. The distinguishing feature is the situation they find themselves in, namely the reform process, which aims at the transformation of the economy. In an economic analysis the situation works as constraint in the form of transaction costs.

[42] Alternatively it can also be argued that the observed behaviour is a result of lengthy evolution, whereby a powerful selection mechanism wipes out such entrepreneurial activity that does not conform to contemporary situational constraints. This assumption is analysed in Barbara Krug and Laszlo Polos, "The Strawberry growth underneath the Nettle: The Emergence of Entrepreneurs in China", Erasmus University Management Report 2000 forthcoming.

[43] See Jonathan Unger and Anita Chan "Inheritors of the boom" 1999 and the field studies listed therein.

Uncertainty

The Chinese economy [45]can be best characterised by two features: Higher then normal level of uncertainty and weak institutions. Uncertainty may come from the environment, but may also be generated internally by technology. Environmental uncertainties reflect the (at least partly) unpredictable behaviour of business partners, ignorance, opportunism, bankruptcy, and sudden major re-organisations. Subsequently, demand seems serendipitous, supply is accidental. In these circumstances an entrepreneur faces the following problems:

1. S/he faces a low general level of expertise in the society at large. There is nobody to imitate, no procedure to copy, expertise cannot be easily learned with the help of formal or informal education, and neither can expertise be bought. In short, it is the newness of the organisational form of the firm that poses the challenge for entrepreneurs.
2. There is no collective memory about what can go wrong as there is no past experience on which to rely upon

3. There is no general knowledge about (excess) demand, price- or income elasticity of demand, let alone systematic research that would help an entrepreneur to calculate the risk of his venture.

4. There is no routine of business practice upon which an economic agent can rely. The effect of this high level of uncertainty is then that each individual entrepreneur faces a high variety of responses to each of his actions.

Notwithstanding the need to acquire (foreign) capital or other resources, to organise, manage and create business practices - or institutions – is crucial[46] in the situation of uncertainty. In the long run the value of each resource, may that be land, Western machinery, the Internet, or a skilled workforce depends on the ability to innovatively design the business relations with each business partner (and the

[45] Richard Whitley, “Eastern Asian Enterprise Structure and the Comparative Analysis of Forms of Business Organisation”, in P.N. Ghauri and S.B. Prasad (eds.) *International Management* (London: Dryden Press, 1995) pp. 191-212. Richard Whitley, J. Henderson, L. Czaban, G. and Lengyel, “Trust and Contractual Relations in an Emerging Capitalist Economy: The Changing Trading Relationships of Ten Large Hungarian Enterprises”, *Organisation Studies* 17, (1996) pp. 397-420; Victor Nee, “The Role of the State in Making a Market Economy”, *Journal of Institutional and Theoretical Economics* 156, 1 (2000) pp. 64-88. For a more general discussion see James D.Thompson, *Organisations in Action*.(McGraw-Hill New York, 1967); Bart Nooteboom, H. Berger and N.G. Noorderhaven, “Effects of Trust and Governance on Relational Risk”, *Academy of Management Journal* 40, 1 (1997) pp. 308-332; Arthur L. Stinchcombe, “Social Structure of Organisations”, in James G. March (ed.) *Handbook of Organisations* (Chicago: Rand McNally, 1965) pp. 142-193.

[46] Walter W. Powell, “Neither Market Nor Hierarchy: Network Forms of Organisation”, *Research in Organisational Behaviour* 12 (1990) pp. 295-336; Stephen Pratten, “The Nature of Transaction Cost Economics”, *Journal of Economic Issues* 31,3 (1997) pp. 781-803; Eirik Furubotn and Rudolf Richter. *Institutions and Economic Theory. The Contribution of the New Institutional Economic.* (Ann Arbor:: University of Michigan Press, 1997); Oliver Williamson, “The Evolving Science of Organisation”, *Journal of Institutional and Theoretical Economics* 149 (1993) pp. 36-63. For China see Louis Putterman, “The Role of Ownership and Property Rights” 1995; Jean C. Oi, “The Role of the Local State in China's Transitional Economy”, 1995; Victor Nee and Sijin Su, “Institutional Change and Economic Growth in China”, *Journal of Asian Studies* 40 (1990) pp. 3-25; Qian Yingyi and C. Xu, “Why China’s Economic

government). Private property rights cum standard contracts are of limited help only since both rely on the assumption that all future outcomes can be captured and transacted in present-day contracts. This is already difficult in a world of well-established business practices, and more so in a world of high uncertainty. In the long run the value of each resource depends on the ability to innovatively design the business relations with each business partner (and the government).

Weak economic institutions

The usual way economies and societies deal with behavioural uncertainty, might this be caused by natural or moral hazard, by external shocks, value changes, or innovation is to create institutions and/or organisations for the purpose of "streamlining" behaviour. In (Western) market economies business practices, for example, depend on contracts, private property rights, laws, the notion of liability and compensation as well as the consensus that innovation should be rewarded. In short: "Institutional environments that provide general purpose safeguards relieve the need for added transaction-specific support. Accordingly, transactions that are viable in an institutional environment that provides strong safeguards may be nonviable in institutional environments that are weak, because it is not cost-effective for parties to craft transaction-specific governance in the latter circumstances[47]". Subsequently, the weaker the institution, the greater the variety of possible responses and the higher the uncertainty with respect to expected outcomes. As uncertainty translates into risk for which an appropriate premium needs to be calculated, economic agents have a strong incentive to search for (institutional) solutions which are more advantageous for at least some of them (with the loser being compensated). While changing the overall frame of institutions might be outside the control of individual agents and rather depend on the functioning of the political market, the governance of individual transactions (private exchange) is not. It is worth mentioning that the problem of China and her entrepreneurs is not that there are still socialist institutions working; it is rather that both the remains of the socialist past and the newly introduced market mechanism are weak[48].

Weakness in this case refers to the ability of institutions to shape behaviour. Modern organisation theory[49] shows that in order to function institutions must offer a "code" whose violation is connected to a specific sanctioning mechanism that does not tolerate observed code violations. Institutions are effective if the costs of code violations work as a deterrent. The less economic agents violate the code and/or the less codes get violated the higher the level of regularity and predictability in the business environment. In China, however, as in most emerging market economies, these codes, which might be business practices, expectations or laws work as occasional “blueprints” only. They are rarely sanctioned effectively enough. Weak economic institutions, in other words, do not contribute much to

Reforms Differ: The M-Form Hierarchy and Entry? Expansion of the Non-State Sector” *Economics of Transition* 1,2 (1993) pp. 135-170.

[47] Oliver Williamson, “The Evolving Science of Organizations” 1993, p.476

[48] Victor Nee “ The Role of the State, 2000; Yingyi Qian, “The process of China’s Market Transition”, 2000).

[49] Glenn R.Carroll and Michael T. Hannan, *The Demography of Corporations and Industries.* (Princeton: Princeton University Press, 2000).

the problem of reducing high uncertainty. On the contrary, if, as it is the case, such institutional weaknesses lead to the (oligopolistic) competition between a few producers of institutions, such as the Communist Party, local government or strong social network then the costs for "acquiring" a predictable and accountable business environment can increase rapidly. In this case bribing oneself into a useful business network is the cost one has to pay for securing a relatively more predictable business environment[50].

Both situational constraints, weak institutions and uncertainty, can help to explain why *searching for devices that shape individual behaviour offers high returns in China*. In other words, to invest in social capital, i.e. networks, trust, reputation or business practices, offers higher returns at the beginning of entrepreneurship than to invest in capital goods around a core business. Moreover, under uncertainty and weak political institutions, flexibility that allows the quick change of location, production, and even the closing of firms can be paramount to success. This is so for basically two reasons: one is the ability to circumvent the confiscation risk if a firm gets too big, too influential or in the way of another well-protected firm. Another reason is that a successful entrepreneur needs to quickly exploit market opportunities about which s/he might learn via the network. Thus, while a company in the West which switches name, line of production, or location would be judged as unreliable, and subsequently mistrusted, a Chinese firm can change its identity without much cost as long as the entrepreneurs and the network behind the firm remain stable and reliable. In short, theory would then expect that (successful) *Chinese firms reveal a weak organisational identity supplemented by entrepreneurs and networks with a reputation for reliability and predictability* – and this is indeed what the empirical study in Shanxi showed.

Conclusion:The Spatial Dimension of Entrepreneurship

So far it was shown that entrepeneurship in China can be modelled by the assuming a specific behavioural patter shared by all would-be entrepeneurs: High levels of uncertainty and weak institutions make it advantageous to invest in social capital and to establish firms with a weak organizational identity in order to swiftly shift production to new business opportunities. The Shanxi data set when compared to the results of empirical research elsewhere suggests, that indeed, this kind of behaviour can be found across China.

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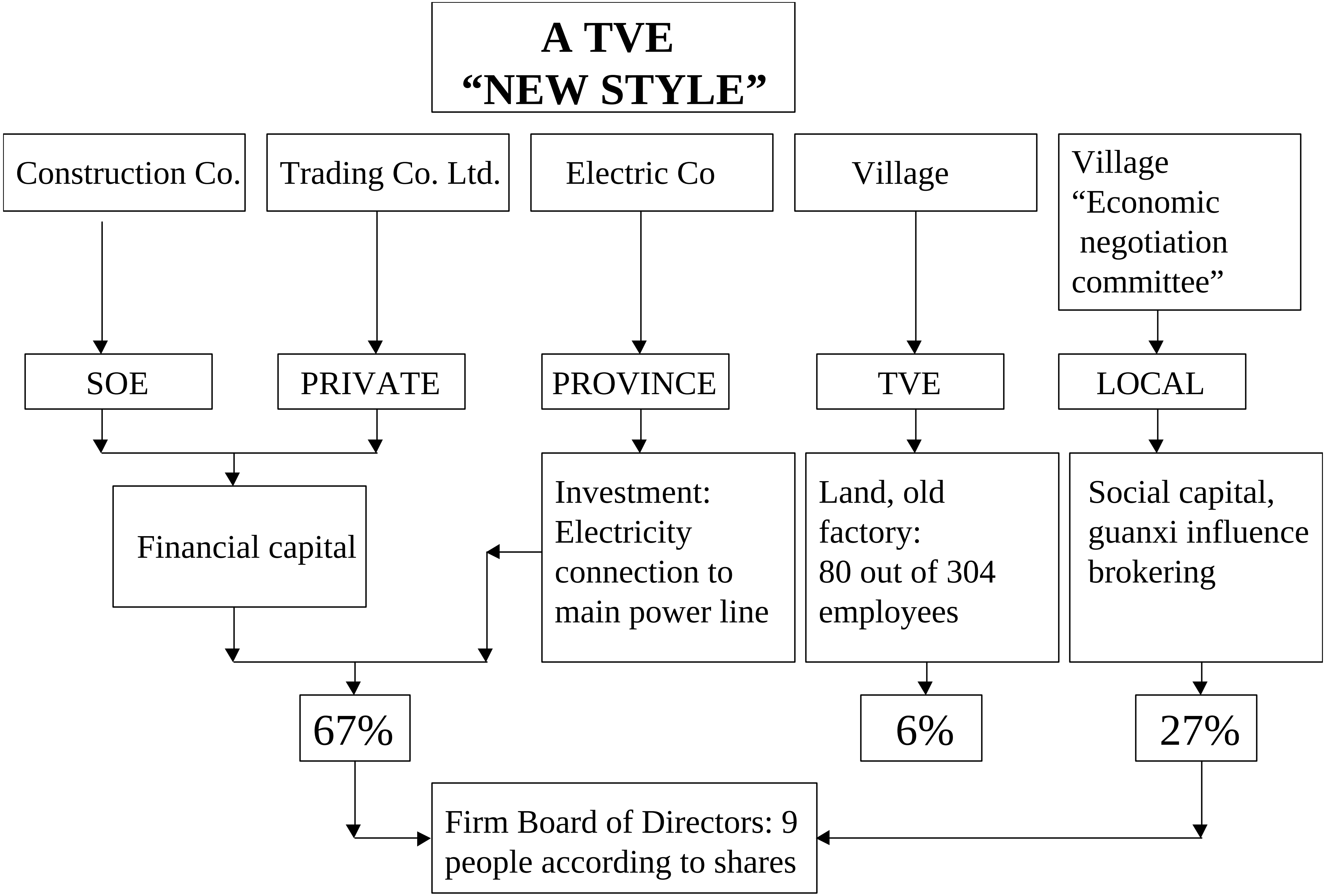
[50] Diego Gambetta, D. *The Sicilian Mafia: The Business of Protection.* (Cambridge, MA: Harvard University Press, 1993); A. Smart, "Gifts, Bribes, and Guanxi: A Reconsideration of Bourdieu's Social Capital". *Cultural Anthropology* 8 (1993) pp. 388-408. Hans D. Flap, "Patronage: an Institution in its Own Right", in Michael. Hechter, Karl .D. Opp, and Rainer. Wipler (eds.) *Social Institutions: Their Emergence, Maintenance, and Effect,* (New York: Aldine de Gruyter, 1990) pp. 225-243.

That leaves the question how to model the heterogeneity within China, which might cause different forms of entrepeneurship and forms of firms. One way to do so is to start with the assumption that all three/four factors, namely the situational constraint, the remembered economic and social institutions as well as the behavioural patterns and the collective memory reveal a *spatial dimension*. In short, different forms of firms will emerge in response to different situational constraint, different institutions remembered, different collective memories and differences in the speed and scope by which business practices can be established. To find out the geographical boundaries of these factors asks then for comparative studies where one or two of these factors are varied in a systematic way. One could, for example assume that the level of uncertainty and weak institutions is higher in the hinterland than in the coastal cities. Subsequently, different forms of entrepreneurship might develop even within the group of potential entrepeneurs, which remember the same set of institutional devices and share the same collective memory. In this case the development of firms would be "situation driven", implicitly suggesting that once China will have developed an integrated domestic market, firms will converge to one form. In contrast to this, other studies could start in a location where the situational constraint is known to be the same focusing on differences in the institutional past. To the extent that remembered economic institutions and hijacked social organizations offer the blueprint for entrepeneurship, a special kind of path dependency could be confirmed. In this case different forms of firms can be expected, irrespective that all firms face the same business environment. Finally, the collective memory and the shaping of behavioural patterns orchestrated by networks will lead to different forms of entrepeneurship even if both the situational constraint and the set of institutional devices were the same. In this case internal migration might offer a useful starting point for an analysis. If, for example, a special Shanxi- or Wenzhou way of doing things should survive within communities form these places in the coastal cities, then forms of firms will emerge in a surrounding that otherwise would have suggested other forms[51]. In the final analysis it will be the interplay of all three factors, which must lead to a diversity of entrepeneurship, and one that can only be analysed with the help of comparative studies.

[51] One useful field study for this research agenda is Laurence J.C. Ma and Biao Xiang, " Native Place, Migration and the Emergence of Peasant enclaves in Beijing", *The China Quarterly* 155 (1998) pp. 546-581.

Table I : **Firms: Number, age, and sector**

Interviewed in:	1993	1996	1997	1999	Total	Percent
Firms:						
Total	12	37	28	27	104	
Per cent	11.5	35.6	27	26	100	
Year of registration						
Before 1982	1	14	5	0	20	19.2
1983 - 1991	7	16	13	9	45	43.2
1992 - 1999	4	7	10	18	39	37.6
Average age of firm at the time	4	18	11 ¾	5 ½	10	
Interviewed						
Sector:						
Primary sector	2	14	3	8	27	26.0
- Coal and -processing	1	7	2	1	11	
- Food processing	1	5	--	5	11	
Manufacturing	--	14	7	4	25	24.0
Service	10	9	18	15	52	50.0
- Old service	3	6	8	9	26	
- New service	7	3	10	6	26	
Ownership registration:						
SOE	1	18	10	3	32	30.7
TVE	--	5	4	--	9	8.6
Collective	6	2	4	4	16	15.4
Gufen	--	3	4	7	14	13.5
Private	4	6	6	13	29	27.8
Joint venture	1	3	--	--	4	3.8



The first 3 shareholders nominate 6, the village 1 and the village government's "Economic negotiation committee" 2 members to the board of directors.

DEVELOPMENT OF A TYPICAL CHINESE PRIVATE COMPANY

YEAR	1986	1989	1991	1992 TO 1999
ACTIVITY	Mr. Wang starts cloth trade	Starts a shop for household appliances	Representative for Robert Bosch, car electronic car repair	Plus hotels, catering firm, recreational facilities, plus construction company in Australia
INPUT	5,000 RMB savings		Recruitment of a railway engineer as manager. Recruitment of Technicians	Access to bank loans 70 mln. Shares for 99 employees

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