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UNIVERSITY OF KENT

EMERGING FORMS OF BUSINESS VENTURE UNDER MARKET SOCIALISM IN CHINA: A COMPARATIVE STUDY OF FOUR CASES

THESIS SUBMITTED TO THE FACULTY OF SOCIAL SCIENCES AS CANDIDACY FOR THE DEGREE OF DOCTOR OF PHILOSPHY

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CONTENTS

ABBREVIATIONS

ACEDZD	Administration Council of Economic Development Zone of Dalian
ACFTU	The All China Federation of Trade Union
AICSA	The Administration and Inspection Committee of State Assets
CIIDEA	China International Intellectuals Development and Exchange
CMC	The Central Military Commission of the People's Republic of China
COE	Collective-Owned Enterprise
CPC	Communist Party of China
CTIEC	China Textiles Import & Export Corporation, Liaoning Branch
DSF	Dalian Sunfed Fashion
DFTECB	Dalian Foreign Trade & Economic Cooperation Bureau
EDZ	Economic Development Zone
FCAB	Foreign Currency Administration Bureau
FDI	Foreign Direct Investment
FIE	Foreign Invested Enterprise
FJV	Foreign Joint-Venture
FTZ	Free Trade Zone
GCS	Group Company System
GDP	Gross Domestic Productivity
HR	Human Resource
IPO	Initial Public Offerings
ISO	International Standards Organisation
IUEC	International Unemployment and Employment Committee
LGIEC	Liaoning Garments Import and Export Corp.
LTG	Liaoning Times Group
LU	The Labour Union
MES	Modern Enterprise System
MFTEC	The Ministry of Foreign Trade and Economy Committee
MIS	Management Information System
MNCs	Multi-National Corporations
MOFERT	The Ministry of Foreign Economic Relations and Trade
NDRU	The Bureau of Economic Operations under the National
NPC	The National People's Congress
NTB	The National Tax Bureau
OECD	The Organisation of Economic Co-operation and Development
POE	Privately-Owned Enterprise
PRC	People's Republic of China
QMS	Quality Management System
SLAC	Shenyang Liming Anna Company
SMF	The State Ministry of Finance
SOB	State-Owned Bank
SOE	State-Owned Enterprise
TGIEI	Times Garments Import and Export Incorporation
TRQ	Tariff Rate Quota
TVE	Township and Villageship Enterprise
USSR	Union of Soviet Socialist Republics
VAT	Value Added Tax
WTO	World Trade Organisation

ILLUSTRATIONS

ABSTRACT

The purpose of this thesis is to explore the distinctive characteristics of emerging forms of business enterprise under market socialism and identify how rapid environmental and institutional changes in economic reforms are impacting upon them; particularly in shaping their management models. Some general patterns in the development of business ventures are identified to outline the dynamics of organizational change and management under market socialism in China.

In chapter one, we review trends and characteristics in the development of market socialism in China and examine the general environment within which organizations operate: the economic and political systems. A summary account for the formation of market socialism is presented in this chapter. The impact of these for changing management processes is discussed in chapter two. The focus of this chapter is upon management practices under the two periods of 'state' and 'market' socialism. The evolution of enterprise management in China is examined in this historical context because this legacy has shaped many of the present features of management in present-day China. These first two chapters provide the background for our empirical research into four different types of enterprise management as these are emerging in China. These are (1) changing forms of state ownership; (2) collective-owned enterprises; (3) privately-owned business ventures; and (4) foreign joint-ventures. The methodology used for the empirical research is outlined in chapter three. Chapters four, five, six and seven present empirical data collected in the four case study organizations. These are analyzed by reference to the McKinsey 7-S framework. In chapter four, the case study of a state-owned enterprise - '*Liaoning Times Group*' is illustrated and analyzed; a collectively-owned enterprise - '*Shenyang Liming Anna Clothing*' is discussed in chapter five; '*Dalian Dali Cashmere Product Company*' – a privately-owned enterprise is investigated in chapter six; and '*Dalian Sunfed Fashion Clothing*' – a foreign joint-venture in chapter seven. In chapter eight, we compare the differences and similarities between the four cases studies and identify emerging trends in management practices as they are evolving under the continuing development of market socialism in China.

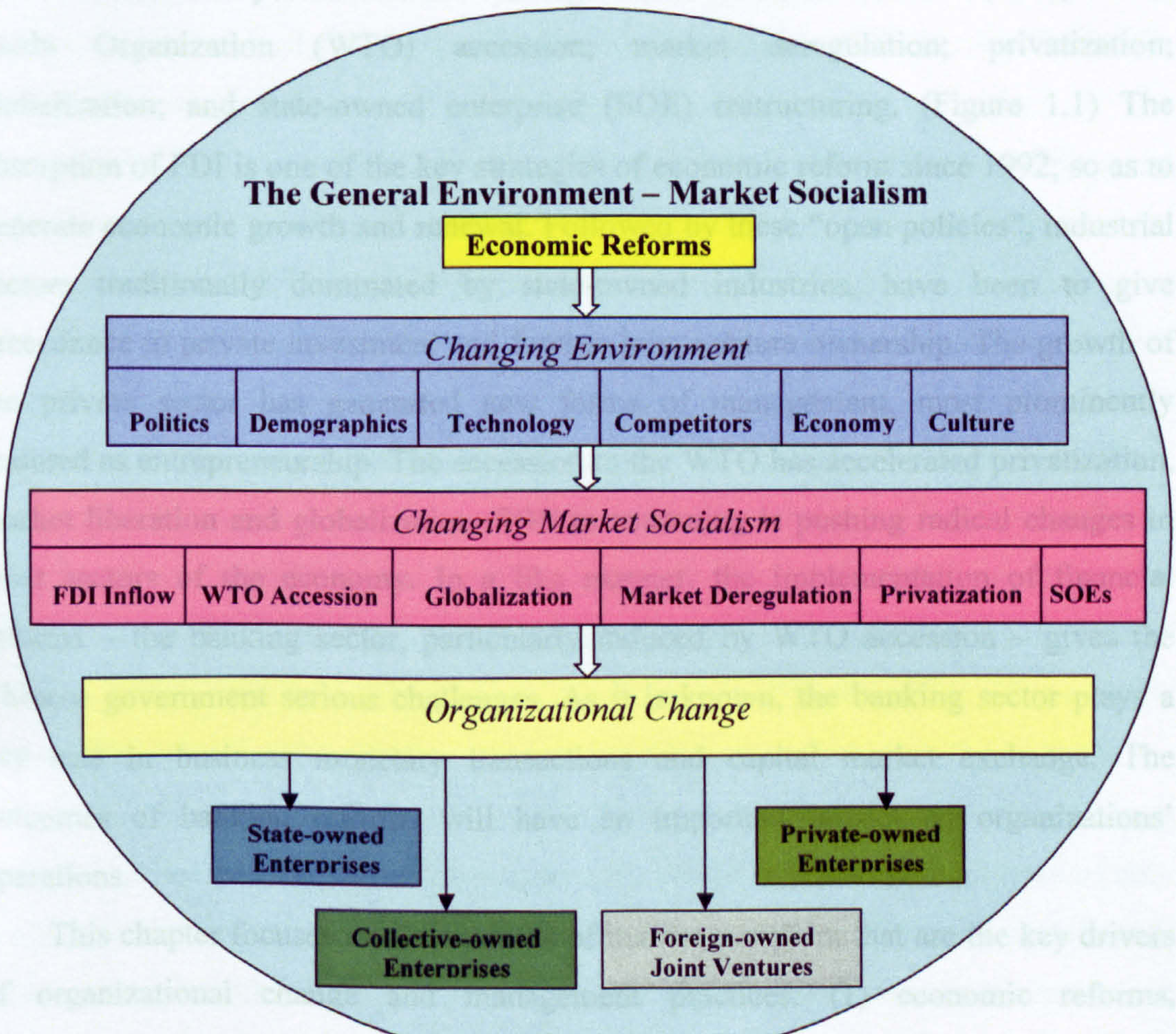
CHAPTER ONE:

Chinese Market Socialism: A Summary Account

Introduction

The aim of this chapter is to introduce the main features of market socialism and the general environment within which organizations operate: the economic and political systems. The focus is on economic reforms which allow for different forms of business organization to emerge. These changes under the emerging market socialist economy are the background to forms of enterprise management and emerging forms of business venture. The relation between these environmental forces and organizational change can be illustrated in Figure 1.1

Figure 1.1 Environmental Forces Impacting Organizations



The business environment, *sometimes called the macro-environment, includes the external factors that usually affect all or most organizations.*[1] As depicted in Figure 1.1, the business environment in China includes the economic system of market socialism; the socialist political system; demographics (age, gender, race, ethic origin and education level of the population); cultural background (values, beliefs, language, behavior, and religious influences), and technology (innovation and change). All of these aspects of the general environment have consequences for managing organizations. China's economic reforms over two decades have generated a rapidly changing environment which has encouraged the emergence of new forms of business venture.

Likewise, under these economic reforms, the drivers of organizational evolution can be examined by reference to – foreign direct investment inflow (FDI); World Trade Organization (WTO) accession; market deregulation; privatization; globalization; and state-owned enterprise (SOE) restructuring. (Figure 1.1) The absorption of FDI is one of the key strategies of economic reform since 1992, so as to generate economic growth and renewal. Followed by these "open policies", industrial sectors traditionally dominated by state-owned industries, have been to give precedence to private investment and foreign joint venture ownership. The growth of the private sector has generated new forms of management, most prominently featured as entrepreneurship. The accession to the WTO has accelerated privatization, market liberation and globalization. SOE restructuring is pushing radical changes in most sectors of the economy. In a like manner, the implementation of financial reforms – the banking sector, particularly induced by WTO accession – gives the Chinese government serious challenges. As it is known, the banking sector plays a key role in business monetary transactions and capital market exchange. The outcomes of banking reforms will have an important impact on organizations' operations.

This chapter focuses on four aspects of market socialism that are the key drivers of organizational change and management practices: (1) economic reforms, (2) FDI injection, (3) WTO impact and (4) globalization. Conclusions are then drawn on the implications of these changes on the economic environment for enterprise practices and management.

[1] Alder, P. S. and Kwon, S. (2002), 'Social capital: prospects for a new concept', *Academy of Management Review*, 27 (1), January 2002, pp. 17-40.

1.1 The Concept of Market socialism

Originally "Market Socialism" was an attempt by a Soviet-style economy to introduce market elements into its socialist economic system in order to address the inefficiencies of its economy. "*It was first attempted during the 1920's in the Soviet Union as the New Economic Policy, but abandoned. Later it was attempted in Hungary (where it was nicknamed "goulash socialism"), Czechoslovakia and Yugoslavia in the 1970's and 1980's. Modern Vietnam and Laos can also be described as market socialist systems. The Soviet Union attempted to introduce market socialist systems with its perestroika reforms under Michael Gorbachev prior to the collapse of the USSR (Union of Soviet Socialist Republics) in 1991.*"[2] It is also the system introduced in the People's Republic of China by Deng Xiaoping in the late 1970's and has evolved into what some economists, outside of China, would argue is modern Chinese capitalism.

Socialism and capitalism, as two social regimes under different political and economic systems, coexist and challenge each other. The core differences between the two social systems as far as the relations of production are concerned, is in the nature of ownership and control. Like the capitalist society, socialism is also a complex industrial system systematically geared to the accumulation of wealth. Under capitalism, the means of production and economic surplus are privately owned, while in the socialist societies, the ownership and economic surplus are legally transferred to government; namely to the people of the whole country that own them. The distribution of this 'publicly-owned' surplus is subject to claims by all sectors of socialist society and is a deliberate political process, "the transition of politically defined objectives", although they are expressed in economic terms. (Davis and Scase, 1985)[3] As Marx and Engels (1969) originally defined it, under capitalism, producers create the economic surplus which becomes the personal wealth and property of non-producers; that means the capitalists exploit the proletarian. Whereas socialism is characterized by public ownership of the means of production; workers are masters or owners of the enterprises, so there is no exploitation. The distribution and deployment of social resources and economic surplus are conducted and determined by a

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[2] http://encyclopedia.thefreedictionary.com/Socialism%20with%20Chinese%20characteristics (accessed 5th May 2004)

[3] Davis, H. and Scase, R. (1985), *Western capitalism and state socialism: an introduction*, Basil Blackwell, London.

centralized planning system of government rather than the market. Pierson (1995)[4] has stated the core principles of market socialism;

"At its simplest, market socialism describes an economic and political system which combines the principles of social ownership of the economy with the continuing allocation of commodities (including labor) through the mechanism of markets. For market socialists, it is not markets but capitalist markets, that is, markets which inscribe the social and economic power of private capital, that are objectionable. They offer an alternative model in which markets are combined with varying forms of the social ownership of capital. Amongst its supporters, the market is recommended not only as a way of attaining greater economic efficiency under socialism, but also as a way of securing greater individual liberty or a more equal value of liberty, of increasing democracy and of enhancing social justice."

Socialism in China initially adopted the Marxist theory and the Soviet model when it was established in 1949. Through its own practices over decades, the Communist Party of China (CPC) has gradually developed its own socialist model and radically redefined many of the terms and concepts of Marxist theory from the Chinese point of view, to justify its economic policies. The Communist Party of China has proceeded from China's realities and integrated the fundamental tenets of Marxism with these concrete realities, developing new ways of building socialism in China. It has argued that socialism is not incompatible with economic policies such as markets, free trade, or anything else that appears to work. In current Chinese Communist thinking, China is in the primary stage of socialism, and this redefinition allows the People's Republic of China (PRC) to justify the existence of an economic market. China's transition from planning towards a market system has many surprising features. The communist regime remains intact. Reforms have meant a gradual erosion of state economic control rather than a quick retreat from planning. Reforms began with no clear objectives other than a determination to improve performance. Even, Deng Xiaoping's dictum – 'seek truth from facts and just do whatever seems to work' (a guiding principle for reforms), presents a false image and a great deal of uncertainty. The goal of creating a "*socialist market economy with Chinese characteristics*" is itself an outcome of the reform process that has emerged well into the second decade of transition.

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[4] Pierson, C. (1995), *Socialism after communism: the new market socialism*, The Pennsylvania State University Press, University Park Pennsylvania, USA, pp84-85.

China's hybrid economic system is a mixture of political economy with both socialist and capitalist characteristics.[5] It is not simply a socialist economy like the old Soviet model or Stalin economy, nor does it imitate western capitalism; it has hybridized both features. To understand this, it is necessary to grasp some knowledge of how the administration is structured and how power and control are wielded by the Communist Party.

1.2 The Evolution of Economic Reforms in China

The essential content of China's reforms is the transformation from a planned economy to a market-oriented economy under the regime of socialism. Initially the intention of economic reform at the early phase only focused on adjustments of economic policies to improving China's economic performance. Until the middle 1980s, the objective of market-orientation appeared to be clarified, but how to achieve it remained equivocal and controversial. Many policies were implemented as experiments, and often resulted in political conflicts. In accordance with the notion of Wu Jinglian (a famous Chinese economist and a leading participant in CPC's economic reforms' planning and policies since 1995), the evolution of economic reforms in China can be systematically clarified in three phases over the past half century. These can be described as follows:

First Phase: Administrative Decentralization 1958 -1978

Since New China was established in 1949, after 3 years of economic recovery from the distortion of civil wars, the Communist Party of China proposed the general route of socialist construction and reformation for the transition to socialism. This general route requested: (Mao, 1953)[6]

'Firstly, during a quite long period, it was to gradually realize the national socialist industrialization, constantly expand socialist economic forces, in order to construct the lagging agriculture country to be an advanced industrial country. Secondly, it was to gradually realize the State' socialist reconstruction in agriculture, handicraft and industry.'

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[5] Lichtenstein, P. M. (1992), 'The political economy of left and right during China's decade of reform', *International Journal of Social Economics*, 19(10), December 1992, 1992, pp. 164-180.
[6] Mao, Ze-dong (1953), *The anthology of Mao Zedong: the general route of Communist Party in the transition of socialism*, Vol. 5, The People Press, Beijing, p89.

The essence of this general route was to reconstruct the institutions from privatized production resources to a socialist-owned regime, in the aim of rapid increasing productivity. In line with this general route, the State implemented the first *Five Year Plan* (1953-1957). The principle task was to rapidly industrialize through the construction of 694 major industrial enterprises[7]. This built the initial solid foundation for socialist industrial construction. The annual average industrial and agricultural GDP growth in these five years (1953-1957) was 10.9% (Ren & Ren, 1993)[8]. In this period, the centralization of administration appeared to be an effective means of allocating and distributing resources to where it was most needed for the country's reconstruction.

At the end of 1957, Mao Zedong launched the 'Great Leap Forward' in order to push the speed of industrialization. The reforms in 1958 were supposed to decentralize administration and give autonomy to enterprises and employees, as well as to local governments. Liu Shaoqi and Shun Zhifang were the main representatives for this proposition. However, Mao always advocated the 'spiritual incentive' and opposed the 'material incentive' for people, as he regarded this as the distinctive difference between capitalism and socialism. Therefore, giving autonomy to enterprises and employees was a contradiction to Mao's main ideology, as the empowerment would inevitably involve material incentive for enterprise management. It was criticized as 'Yugoslavian Revisionism' and 'Capitalist Individualism' that should be abandoned. Decentralization focused only on local government, which was all about the distribution of authority from the central administration. This decentralization of authority was basically in terms of seven aspects: 'planning', 'enterprise jurisdiction', 'resources allocation', 'administration of approval', 'investment and loans on construction projects', 'finance and taxation', and 'labour management'. (Wu, 2003)[9] With the prerequisite of a planned economy regime remaining unchanged, the decentralization of authority in layers of hierarchy to local governments formed the institutional infrastructure for the 'Great Leap Forward'.

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[7] Li, Fu-chun, (2004), 'The report of the first five year plan about developing national economy', cited from Peng et al (2004), *Studies on theory and practice of economic development in China*, China People University Press, Beijing, pp6.

[8] Ren, Da-fang and Ren, An-tai (1993), *Century ups and downs – the evolutionary path of modern China national commerce and industry*, China Broadcast and Television Publication Co., Beijing, pp335-336.

[9] Wu, Jing-lian (2003), *Contemporary China's Economic Reforms*, Shanghai Yuandong Press., Shanghai.

Under this institutional support, different levels of local governments fully utilized the authority of deploying resources to launch basic construction projects, to employ labour and to freely use peasants' material assets, in order to complete Mao's unrealized and impossible missions, such as '*Double steel production in one year*' '*Exceed Britain in three years and overtop America in ten years*' etc. (Bo, 1993)[10] The inevitable consequence was failure. The negative effects appeared in many aspects of the economy, such as a reduction in production, large losses in industrial and commercial enterprises, serious scarcities in the supply of subsistence consumer products, and a slump of the whole economy. Over 15-30 million people died from starvation and famine between 1959-1961 (Ashton et al, 1984).[11]

In 1962, the Communist Party remedied the chaos caused by decentralization, and returned authority back to the centralized government administration. This allocated and deployed resources by executive commands from the Central Committee of the Party. However, decentralization allowed for the growth of local market relations. For instance, the creation of township-village enterprises (TVEs) was the outcome of this period of decentralization. The local governors utilized the power they were granted from administrative decentralization to support funding for their own regional enterprises' development, in order to pursue local benefits and achieve target performance. (Qian, 2003) [12] TVEs were cooperative agreements between local governments and enterprises, which represented mutual benefits for both. It was argued by Boisot and Child (1996)[13] that at this time, it was more a network than a market economy in so far as it was built on a tight web of interpersonal obligations based on trust rather than on atomized competitive relations. It later proved that the emergence of TVEs became a major contributor to rapid growth in GDP in China for the later development of a market-oriented economy. By

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[10] Bo, Yi-bo (1993), *The retrospect of several important decisions and events*, CPC Central Party School Publisher, Beijing, pp679-702.
[11] Ashton, B., Hill, K., Piazza, A. and Zeitz, R. (1984) 'Famine in China, 1958 – 1961', *Population and Development Review*, 10 (4), June 1984, pp122-178.
[12] Qian, Ying-yi (2003), *Contemporary economics and China economic reforms*, China People University Press, Beijing.
[13] Boisot, M. and Child, J. (1996), 'From fiefs to clans: explaining China's emerging economic order', *Administrative Science Quarterly*, 41 (4), Dec1996, pp600-628.

1991 these enterprises were producing almost 60% of the total output in the countryside, as measured in market terms. (Gabriel, 1998)[14]

Second Phase: Incremental Reforms 1979 – 1993

After the Communist Party had failed in reforming the State-owned economic sector and faced a standstill in the growth of the state economy, the main force of reform began to focus on the non-state economic sectors to provide opportunities for growth. It was called the 'Incremental Reforms Strategy' (Wu, 2003).

The creation of this incremental reforms strategy was initiated in 1976 after the collapse of the "Gang of Four". When political power returned to the right-wing of the Communist Party, the concept of state-owned enterprises' reform was advocated by Shun Zhifang in 1957 and became promoted by the Party at this stage. In 1979, Xue Muqiao published his works - "*A study of the problems in China's socialist economy*". This had a big impact on ideas of reform at this time. He argued "*the economic reform needed to solve two problems – one was reform of administrative institutions in the state-owned enterprises (including collective enterprises); the other was reforms of the state administration in order to make it adequate for large social production.*" (Xue, 1979)[15]

With the influence of these ideas, experiments on expending autonomy to state-owned enterprises were implemented in Si Chuang province. In 1978 to 1979, there were over 100 state-owned enterprises being adopted as the 'experimental units' in this province, which achieved significant improvement in performance as a result. Then these experiments were expanded nationwide. By the end of 1979, 4200 state-owned enterprises were being reformed. By 1980, this had increased to 6600 units and their productivity accounted for 60% of total budgeted national industrial productivity, and 70% of total national industrial and commercial profitability (Wu, 2003).[16] However, this positive effect didn't last for long; the limitation of these reforms appeared. The operation of these enterprises with their new autonomy did not trade according to the rules of market competition, nor were they led by the market pricing

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[14] Gabriel, S. J. (1998), 'Technological determinism & socialism with Chinese characteristics: pulling the cart without watching the road?', *Satya Gabriel's Online Papers: China's Essay Series* http://www.satya.us (accessed 12th January 2004), October, 1998.

[15] Xue, Mu-qiao (1979), *The study on the problems in China's socialist economy*, The People Press, Beijing, p185.

[16] 'CPC Congress Bulletin of the Eleven Central Committee the Third Plenary' (22nd December 1978), The People Press, Beijing, (1982), cited from Wu, Jing-Lian. (2003), p57.

system that reflected the scarcity of commercial commodities. Therefore, such exertion of power and autonomy by these enterprises would not be propitious to the effective deployment of economic resources.

An important turning point in economic reform took place in September 1980. Headed by Deng Xiao Ping, the Communist Party introduced policies that allowed peasants to contract land for farming on the basis of individual/family responsibility. This replaced the model of the 'peoples communes'.[17] The TVEs, on the basis of collective ownership, began to prosper after this change. Since then, China has launched a series of reform strategies and policies that distinguished it from Soviet Russia and Eastern Europe with their focus on state-owned economic sectors. China abandoned attempts to reform the state-economy and transferred its focus to non-state sectors, where the market-oriented enterprises were embedded. Since then, their growth has driven the development of the whole economy.

Generally speaking, the success of reforms in the rural non-state economic sectors encouraged the Communist Party take further steps in other sectors to promote the growth of the non-rural, non-state economy. An increasing number of "mixed-ownership" enterprises emerged along the coastal areas, including foreign-joint ventures, and these became the main force for China's economic growth. The performance of this incremental strategy can be illustrated in three aspects:

(1) Promoting Measures For The Growth of The Non-State Economy

Whether the existence and further development of the non-state economy should be permitted has been a politically sensitive issue in China. The doctrines of socialism in Mao's stage, such as '*more communes and larger the better'; 'the task of communists is to vanish capitalism.*' (Mao, 1953)[18], still shapes people's thinking. This changed with the legitimation of land being contracted to individuals and families. Also the growth of TVEs opened up the possibilities of a new form of socialism. Because the non-state-owned enterprises were market-oriented, not planned, their emergence and prosperity gradually formed regional markets in which market

[17] The Communist Party of China (CPC), 'Anthology of important literatures since the third plenary congress' (1982) The People Press, Beijing, p507. The people commune is the regime of communal society, which all the people work in the unit of communal village and equally share the gain and food. All the property, particularly the land and productive tools belong to the commune. The peasant do not own any piece of land. The new paradigm – contracted responsibility breaks this situation, and allows the peasant to contract the piece of land based on the unit of family or individual and responsible for the loss and gain with the commitment of fixed submission of annual gain.
[18] Mao, Ze-dong (1953), *The anthology of Mao Zedong: two talks about the agriculture communal corporation*, Vol. 6, The People Press, Beijing, p298.

forces started playing an increasingly important role in deploying economic resources. By the middle of the 1980s, production in the non-state sectors accounted for one-third of total national production. In retail industry, its growth was even faster. (See Table 1.2 & 1.3)

Table 1.2 The Percentage of Economic Components in Total Industrial Production of China (%)

YEAR	1978	1980	1985	1990
State-owned	77.6	76.0	64.9	54.6
Collective-owned	22.4	23.5	32.1	35.6
Others*	0.0	0.5	3.0	9.8

*Notes: Others included private-owned and foreign-invested joint ventures.

Sources: 'China Statistics Year Book' (Selected from varying years)

Table 1.3 The Percentage of Economic Components in Retail Commercial Sales of China (%)

YEAR	1978	1980	1985	1990
State-owned	54.6	51.4	40.4	39.6
Collective-owned	43.3	44.6	37.2	31.7
Others*	2.1	4.0	22.4	28.7

*Notes: Others included private-owned and foreign-invested joint ventures.

Sources: 'China Statistics Year Book' (Selected from varying years)

(2) Developing Liberal Economic Policies to Establish Trading Links Between Regions and the International Market.

The market infrastructure was weak due to over 30 years of planned economy and the extent to which market forces had been almost extinguished. However, the reform leaders of the Party adopted an "Open" strategy using the world market and foreign direct investment (FDI) to rapidly reform the domestic market in some regions. These selected regions (particularly along costal areas with geographical advantage) were connected to international markets through tailored regulatory environments. Competitive forces were then injected to facilitate the future development of domestic markets. This forced enterprises to participate in market forces of competition and enterprise managers had to gain market economy skills. Market mechanisms reinforced the imperativeness to improve quality and cost of products in order to gain competitive advantages for survival. Within this atmosphere of relatively free markets, achieving greater enterprise autonomy and improving the quality of management became essential issues. Participating in import and export trading also impacted upon domestic pricing systems.

(3) Establishing Experimental Areas for Regional Development.

The methodology of regional development was adopted as an effective way to create small 'regions" of free market economy along the costal areas.[19] This was to test the new reform policies and to examine the outcomes, and see how effective the new system of market economy could operate. These regions were mapped out as 'economic development zones' (EDZs). How these experimental economic zones operated are elaborated in section 5 of this chapter. Their existence has shaped the characteristics of Chinese market socialism.

The *'Dual-Track System'*

The 'dual-track approach' was created to allow the two paradigms – planned economy and market-oriented economy to coexist. It created a "track" of the market economy to allow for the purchase of raw materials and sales of products for non-state enterprises, outside the unified state planning system. Such a dualistic system was particularly embodied in the pricing system and in ownership institutions. (Opper, 2001)[20] This is a distinctive feature of the Chinese socialist market system. Until the middle of 80s, the non-state economy accounted for 30% of total industrial outputs (table 1.2). They could not survive if there was no free market exchange. In January 1985, the State Price Bureau and Material Assets Bureau officially issued "the legal notice for permission on opening industrial production materials and self-sell products" (Wu, 2003)[21].

[19] The costal areas have their natural geographical advantages with the great convenience in transportation, communication and market infrastructures. In history, these geographical advantages always lead the advance development compared to the interior lands.

[20] Opper, S. (2001), 'Dual-track ownership reforms: lessons from structural change in China, 1978-1997', *Post-communist Economies,* 13 (2), Jun2001, pp. 205-227.

[21] Wu, Jing-lian (2003), *Contemporary China's Economic Reforms*, Shanghai Yuandong Press., Shanghai, p65.

Since then the 'dual-track economic system' has been formally in operation. This approach has fostered the basic market environment for the non-state economy's growth and prosperity. It has matched the general strategy as the institution to promote the formation of a dominant market-oriented economy. Gradually prices in the domestic market matched prices in international markets as the share of the non-state economy increasingly grew. At the beginning of 1990s, planned commodity prices no longer dominated the domestic commodity circle. A countervailing tendency has also existed where trade and investment barriers between provinces grew, inhibiting inter-provincial competition. This potential balkanization could be observed at times during the late 1980s and early 1990s as the dual-track pricing system gradually phased out price controls (Young, 2000; Xu and Voon, 2003)[22] (See Table 1.4). Most economists (Qian, Roland and Xu, 2006; Morphy, Shelfer and Vishny, 2000)[23] agree this dualistic approach has had more advantages for the transition of China's economy. The problems and challenges for the State-enterprises operating under this 'dual-track economy' are elaborated in section 6 of this chapter and in chapter 2.

Table 1.4 Percentage of Transactions at Market Prices (By Transaction Volume)

	Retail commodities			Agricultural commodities			Producer goods		
Year	Market	State guided	State fixed	Market	State Guided	State Fixed	Market	State guided	State Fixed
1978	0%	3%	97%	6%	2%	93%	0%	0%	100%
1985	34%	19%	47%	40%	23%	37%	13%	23%	64%
1991	69%	10%	21%	58%	20%	22%	46%	18%	36%
1995	89%	2%	9%	79%	4%	17%	78%	6%	16%
1999	95%	1%	4%	83%	7%	9%	86%	4%	10%
2001	96%	1%	3%	94%	3%	3%	88%	3%	10%
2003	96.1%	1.3%	2.6%	96.5%	1.6%	1.9%	87.3%	2.7%	10.0%

Source: National Reform and Development Commission and Price Yearbooks

Third Stage: The Growth of Reforms Since 1994

The Theory of Integral Reforms

[22] Young, A. (2000), 'The razor's edge: distortions and incremental reform in the People's Republic of China', *Quarterly Journal of Economics*, 115(4), Nov2000, pp1091-1135.
Xu, Xin-peng and Voon, J. P. (2003), 'Regional integration in China', *Economics Letters*, 79 (1), Apr2003, pp35-42.
[23] Qian, Ying-yi, Roland, G. and Xu, Cheng-gang (2006), 'Coordination and experimentation in M-form and U-form organisations', *Journal of Political Economy*, 114 (2), Ap2006, pp366-402.
Morphy, K. and Shelfer, A. and Vishny, R. (1992), 'The transition to a market economy: pitfalls of partial reform', *Quarterly Journal of Economics*, 107 (3), pp. 889-906.

Starting in the middle of the 1980s, the reforms in an all-round-way were pushed forward by Deng Xiao Ping. The theory of 'reforms in an all-round-way' was generated amid the process of designing reform plans for systems of price, taxation and finance. The designers realized that reforms were needed in all aspects of the economic system. The market economy should be a "totality" requiring every aspect of the economy in harmony. The only paradigm that could replace the command economy was the market-oriented economy as it was the only mechanism available for effective resources deployment and distribution. A market economy is an organic system that is comprised of three main systems: (1) those independent enterprises with self-operating and self-responsibility for loss and profit; (2) a competitive market system; and (3) a macro-control system through spontaneous market adjustments. These three systems are integrated and so reforms should be exerted in these three aspects synchronously as a whole. (Wu, 1985)[24]

The Measures and Executory Schemes for 'Reforms in All-Round-Way'

In November 1993, the 14th Plenary Session of the Communist Party Central Committee decided how to build a socialist commodity market system'. This consisted of the following elements[25]:

(1) Reform of Finance and Taxation

The old revenue-sharing system was replaced by the implementation of a unified 'Tax-sharing system' and 'VAT' for central and local governments based on their administrative authority. A system of taxation was established to meet the needs of the market economy, in order to facilitate fair market competition, particularly national taxation laws.

(2) Reforms of Finance and Banking

A unified, open, fairly competitive and strictly managed financial system was established. The national banks remained as the mainstay, while other types of financial agencies were allowed to coexist. Concrete reforms were as follows:

a) The establishment of a 'Central Banking System', to execute currency policy under the administration of the central government.

b) National banks were to be set up to operate as professional commercial banks and provide various business and financial services.

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[24] Wu, Jing-lian (1985), *Economic mechanisms and coordinated reforms, anthology of Wu Jinglian*, Shanxi People Press, Tai Yuan.

[25] These are summarized and referenced from the literatures achieves on the official websites www.chinatoday.com & www.china.org.cn and www.china-un.org (accessed 26th September 2004)

c) The setting up of specialist merchant banks for imports and exports, agriculture, etc. These were made responsible for providing low-interests loans for government-assigned projects.

(3) The Setting-up of A System of Foreign Exchange Administration

The government determined two steps for the reform of the foreign exchange system. The first step was to eliminate the double standards of foreign exchange rate between domestic enterprises and foreign enterprises; to realize the merger of dual-tracks of exchange rate, so that the currency of Renminbi (RMB) could be partially convertible. The second step depending on the actual situation at the time, was to abolish control over capital flows and to realize RMB currency as fully convertible currency.

(4) The Reform of State-own Enterprises

This proposed the "further conversion of mechanisms of operation in State-owned enterprises, establishing them as suitable modern co-operations with manifest efficiencies to meet the increasing demands of the market economy."

(5) Establishing a New System of Social Security

This created an institutional system that comprised social insurance, welfare, medical insurance, retirement system, etc.

Since 1994, state-owned and controlled enterprises are no longer the determining force of the economy, and the rapid growth and emergence of private enterprises has taken precedence in the evolution of market socialism. Table 1.5-A, demonstrates the rapid growth of the private-owned sectors of which GDP share has increased from 33.8% in 1990 to 47% in 2001; accounting for almost half of total GDP. Such mixed ownership and control under state planning is one of the distinctive characteristics of Chinese state socialism.

Table1.5-B, illustrates the main indicators of four types of enterprise as emergent economic components in China in 2004. Privately-owned enterprises make up 57.70% of the total number of enterprises and 31.63% of gross industrial output by comparison to 12.88% and 32.66% for state-owned enterprises. Privately-owned and foreign-invested enterprises comprising the private economy create the majority profits and sales revenue, which together account for 66.25% of total sales revenue and 54.94% of total profits. These figures demonstrate that the private economy has become the mainstream in Chinese market socialism and the state sector has lost its dominate role.

Table 1.5-A The Percentage of Economic Components in China's GDP Share (%)

YEAR	STATE-OWNED	COLLECTIVE-OWNED	PRIVATE-OWNED*
1990	47.7	18.5	33.8
1995	42.1	20.2	37.7
1996	40.4	21.3	38.3
1997	38.4	22.1	39.5
1998	38.9	19.3	41.9
1999	37.4	18.4	44.2
2000	37.3	16.5	46.2
2001	37.9	14.6	47.5

*Private-owned in this table means the all the privately-owned enterprises. In other words, all non-state and non-collective-owned. But it excludes foreign-owned enterprises.

Source: China Statistic Yearbook (selected from various years).

Table 1.5-B The Percentage of Different Economic Components in China for 2004

(Unit: RMB Hundred Million Yuan and Percentage)

Main Indicators / *Four Types of Enterprises*	**Number of Enterprises**	**Gross Industrial Output Value**	**Total Assets**	**Total Sales Revenue**	**Total Profits**
State-Owned and State-Holding	35597 (12.88%)	70228.99 (32.66%)	109708.25 (46.72%)	56234.54 (28.43%)	5453.10 (41.36%)
Collective-Owned	24189 (8.75%)	10763.76 (5.01%)	7473.12 (3.18%)	10532.40 (5.32%)	489.04 (3.71%)
Privately-Owned	119357 (57.70%)	68013.45 (31.63%)	62042.37 (26.42%)	66301.87 (33.52%)	3557.24 (26.98%)
Foreign-Invested	57165 (20.68%)	65995.21 (30.70%)	55601.79 (23.68%)	64736.34 (32.73%)	3686.64 (27.96%)
National Total (% Total)	***276,474 (100.00)***	***215,001 (100.00)***	***234,826 (100.00)***	***197,805 (100.00)***	***13,186 (100.00)***

Source: China Economy and Trade Yearbook 2005, pp566-572.

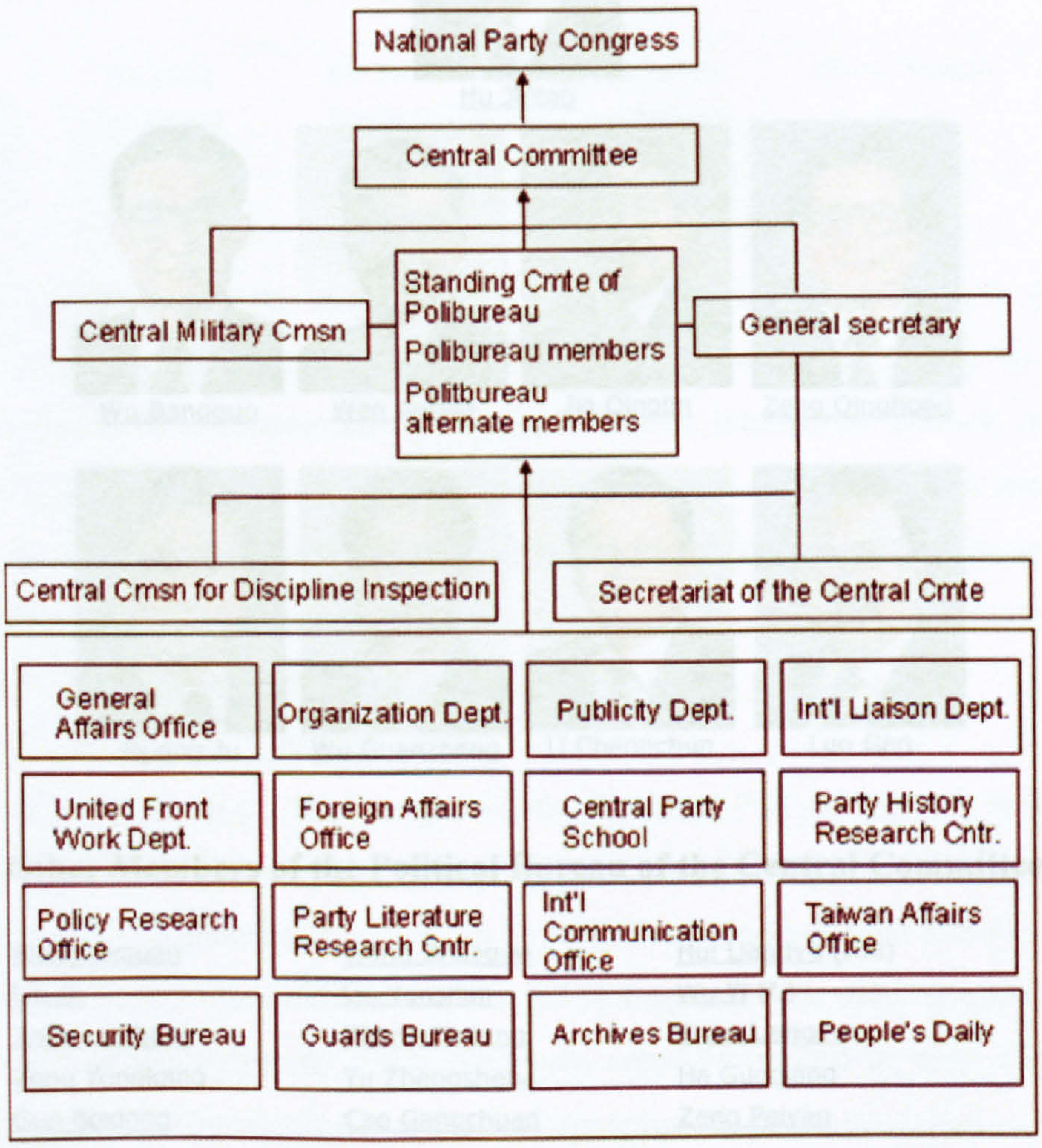
1.3 Government Institutions in the Transformation to Market Socialism

3.1 Administrative Structure of Communist Party of China (CPC)

The Communist Party of China (CPC) is the only political party in the country. The CPC has both central and local organizations. At the top is the Central Committee. When it is not in session, the Political Bureau and its Standing

Committees exercise the power of the Central Committee. Both the Political Bureau and its Standing Committees are elected by the plenary session of the Central Committee. (Chart 1.6)

Chart 1.6 Chart of the Central Organisations of the Communist Party of China[26]



[26] Source: Adapted from http://www.china.org.cn/english/features/state_structure/64735.htm (accessed 20th April 2003)

Standing Committee of the Political Bureau of

The CPC Central Committee as in 2007[27]

Hu Jintao

Wu Bangguo

Wen Jiabao

Jia Qinglin

Zeng Qinghong

Huang Ju

Wu Guanzheng

Li Changchun

Luo Gan

Other Members of the Political Bureau of the Central Committee

Wang Lequan	Wang Zhaoguo	Hui Liangyu (Hui)
Liu Qi	Liu Yunshan	Wu Yi (f.)
Zhang Lichang	Zhang Dejiang	Chen Liangyu
Zhou Yongkang	Yu Zhengsheng	He Guoqiang
Guo Boxiong	Cao Gangchuan	Zeng Peiyan

Alternate Member of the Political Bureau of the Central Committee

Wang Gang

Members of the Secretariat of the Central Committee:

Zeng Qinghong	Liu Yunshan	Zhou Yongkang	He Guoqiang
Wang Gang	Xu Caihou	He Yong	

Military Commission of the CPC Central Committee:

[27] http://app1.chinadaily.com.cn/highlights/party16/structure2.html (accessed 20 January 2007)

Chairman: Jiang Zemin
Vice-Chairmen: Hu Jintao, Guo Boxiong, Cao Gangchuan
Members:

Xu Caihou   Liang Guanglie   Liao Xilong   Li Jinai

CPC Central Commission for Discipline Inspection:

Secretary: Wu Guanzheng
Deputy Secretaries:

He Yong   Xia Zanzhong   Li Zhilun   Zhang Shutian
Liu Xirong   Zhang Huixin   Liu Fengyan

The Communist Party is a unified entity organized according to its program, constitution and principles of democratic socialism. Its Constitution stipulates that any Chinese worker, farmer, member of the armed forces, intellectual and any advanced element of other social strata who has reached the age of 18 and who accepts the program and constitution of the Party and is willing to join and work in one of the Party organizations, and carry out the Party's decisions and pay membership dues regularly, may apply for membership.

The National Party Congress

The Party's organ of supreme power, the National Party Congress, is held once every five years, and is convened by the Central Committee. Its functions and powers are to hear and examine the report of the Central Committee; to hear and examine the report of the Central Commission for Discipline Inspection; to discuss and decide on major issues of the Party; to revise the Party constitution and to elect the Central Committee and the Central Commission for Discipline Inspection.

The Central Committee

This is elected by the National Party Congress. When the National Party Congress is not in session, the Central Committee leads all the work of the Party and represents the CPC outside the Party. It is elected for a term of five years.

The Political Bureau, Its Standing Committee and the General Secretary

They are all elected by the plenary session of the Central Committee. When the plenum of the Central Committee is not in session, the Political Bureau and its Standing Committee exercise the functions and powers of the Central Committee. The Secretariat of the Central Committee is the administrative body of the Political Bureau and its Standing Committee. The general secretary of the Central Committee is responsible for calling sessions of both the Political Bureau and its Standing Committee, and is in charge of the work of the Secretariat of the Central Committee. Members of the Central Military Commission of the CPC are determined by the Central Committee.

Under the Central Committee of the CPC are such offices and departments as the General Affairs Office, the Organization Department, the Publicity Department, the International Liaison Department, the United Front Work Department and the Policy Research Office.

Local organisations of the CPC include congresses of various provinces, autonomous regions, municipalities directly under the Central Government, cities with districts, autonomous prefectures, counties and cities without districts as well as districts of cities. The committees elected by the congresses listed above serve a term of five years. Grassroots organizations of the Party, where there are more than three full members of the Party, are set up in enterprises, rural villages, organizations, schools, research institutes, neighbourhoods, the People's Liberation Army, companies and other basic units.

Discipline inspection commissions are also set up at various levels of the CPC. Their major tasks are to maintain CPC's constitution and other inner Party rules and regulations, assist Party committees to strengthen the Party style, examine the implementation of the lines, policies, principles and decisions of the Party. The Central Commission for Discipline Inspection works under the Party Central Committee. The local discipline inspection commissions work under the dual leadership of the Party committees at the same level and the discipline inspection commissions at the next higher level. The term of office of discipline inspection commissions is the same as that of the Party committees. *The People's Daily* is the paper of the CPC Central Committee while *Seeking Truth* is the Party's magazine.

The Central Military Commission of the People's Republic of China (CMC) is the highest state military organ with the responsibility of commanding the entire armed forces in the country. Led by a chairman and consisting of vice chairmen and members, the Commission is elected for a term of five years and can stand for reelection.

The presidency of the People's Republic of China, as the head of the state, is an independent organ of the state which, as an office of state power itself does not decide on state affairs, but exercises its power according to decisions of the National People's Congress and its Standing Committee.

The current president is Hu Jin Tao, who was newly elected in 2003. Jiang Ze Ming was the previous president and now is the chairman of Military Committee. The Premier is Wen Jia Bao, who replaced the previous Zhu Rongjin. The President exercises the power of the head of the state, according to decisions of the National People's Congress and its Standing Committee. In foreign affairs, the President represents the People's Republic of China and enjoys the highest right of representation of the state. In terms of procedural, ceremonial and symbolic significance, the presidency is the highest position of the state. In essence, however, the presidency does not decide any state affairs but acts according to decisions of the NPC and its Standing Committee. According to the Constitution, the President of the People's Republic of China exercises both domestic functions and powers and those in foreign affairs.

Mass organizations are an important component of the political institutions of China. Despite the fact that they are non-governmental organizations, the All-China Federation of Trade Unions, the Communist Youth League of China and the All-China Women's Federation exercise, to a fairly large extent, some of the functions of the government. As a result, the tasks, the organizational setup and posts of leaders of some mass organizations are decided by organs of the central authorities. For the same reason, these organizations receive appropriations from the state treasury for funding.

There are two major ideologies that compete with each other within the Communist Party. One is the "state economy" approach, which emphasizes the need to maintain state control over economic activity. (Aoki and Jin 1997)[28] The other is the "market economy" approach which argues the state should develop the economy through encouraging market forces. (Wolf, 1988)[29] This is by the state supporting enterprises associations, financial agencies, agriculture unions and other activities to encourage marketing functions in the economy. The present Chinese government favors this latter approach.

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[28] Aoki, M. and Jin, Y. (1997), *The functions of government in Asian Crisis*, China Economics Press, Beijing.
[29] Wolf, C. (1988), *Market and Government – trade-off two imperfect options*, China Development Press, Beijing, pp55-57.

In the 1980s, state-sponsored reforms were only intended to make the existing central planning system more flexible and efficient by decentralizing the administrative system and by making state-own enterprises more efficient. It meant the prohibition and restriction of private economy and free market, but promoting the mainstream of public ownership. The all-round shift toward market economic reforms took place in 1992, after Deng Xiao Ping clarified the concept of the market economy to be the cardinal plank of government policy and to replace the state-planned, socialist economy. Deng Xiaoping (1992)[30] said:

"From the very outset there are different opinions concerning the establishment of special economic zones, fearing whether this meant practicing capitalism. Shenzhen's construction achievements have answered those having worries of one kind or another, the special zone is "socialist", not "capitalist" in nature. Judged from the situation in Shenzhen, public ownership is the mainstay, foreign investment accounts for only one-fourth. Take that part of foreign capital for example, we can benefit from taxation and labor service! Don't be afraid of the establishment of more Sino-foreign cooperative enterprises, Sino-foreign joint ventures and solely foreign-owned businesses. We need not be afraid so long as we are clear-headed. We have advantages, large and medium-sized State-owned enterprises and township enterprises, more importantly; we have the political power in our own hands."

Xiaoping also said also about the Shenzhen economic zone;

"The "four small dragons" (Hong Kong, Taiwan, Singapore and South Korea) in Asia have developed very rapidly, so has your development. Guangdong should strive to catch up with the "four small dragons" in Asia. In a 20-years' time... ... not only should we develop the economy, we should also create a good social order and a good social mood. We should surpass them in material development and cultural and ethical progress. This and this alone can be regarded as socialism with Chinese characteristics. Singaporean social order is good, because the country is under strict control; we should learn from its experiences and should exercise better management of society."

Deng's 1992 speech confirmed the political direction of economic reforms, the relevant supporting policies and the removal of several state constraints in the economic sphere. FDI and private enterprises began to grow rapidly, and a market

[30] http://app1.chinadaily.com.cn/highlights/party16/leaders/dengtour.htm (accessed 8th October 2004)

system based on hybrid forms of ownership emerged with the government's approval. At the same time, the government retained ownership over its four heavy and vital industries; the State security industry; natural resources monopoly; public service and communal products sector; and high-technology.[31] As the progress of market reforms would not take place by itself, it has been sponsored by the government. The accession to membership of the World Trade Organization has further urged and spurred the progress of both economic and political reforms in China. However, political reform is a major challenge for the Chinese government, as there are inherited traditions from China's command political economy as well as from historical feudalism, which still influences the ways of people's thinking.

1.4 Some Characteristics of the Chinese Economy

China has been the largest laboratory for extraordinary economic revolution for over two decades. The ultimate goal of reform is to improve the efficiency of the utilization of resources to generate economic growth and increase the wealth of the nation. A complete centralized planning socialist economy[32] in the past displayed serious inefficiencies in utilizing and distributing resources, which resulted in low productivity. The reforms launched in the early 70s for step-by-step economic improvement were initiated in the agriculture sector. In terms of outcome, the past 25 years of reform has witnessed sustained, rapid economic growth, with the average annual growth rate of GDP in the 1979-2005 period reaching 10.2 percent in 2005 and the total GDP volume exceeding 18 trillion RMB. (Table 1.7)[33] Along with rapid economic development, China's impoverished population (population with daily living cost less than one US dollar) has decreased by 147 million, accounting for 84.5 percent of the total volume of reduction in the poverty-stricken population of the East Asian region. China's impoverished population has also decreased to around 30 million (Dong et al, 2003).[34] Poverty has always been a difficult problem plaguing various countries around the world; it has seriously affected the stability and

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[31] 'The determinations on key issues of the State-own enterprise reform and development' (1999) *CPC 15th National Congress of Central Committee*. www.chinadaily.com.cn (accessed 30th September 2004)
[32] Originally it was imitated from Marx theory and Soviet Model in 1949.
[33] *China Statistics Yearbook 2006*, compiled by National Bureau of Statistics of China, China Statistics Press, Beijing, p27.
[34] Dong, P. et al (2003), *China economic analysis and prospect in 2003*, Economy and Sciences Publications, Beijing, p12.

sustainable development of the world economy.[35] As a developing socialist country with a large population and territory, China has enjoyed sustained, rapid economic development, providing constantly improving living standards for its people, thus making important contributions to the sustainable development and prosperity of humankind. These achievements may be the envy of those countries implementing a 'Big Bang' strategy as in Central and Eastern Europe.

Table 1.7 Statistics of GDP of China from 1990 to 2005

Year	Annual GDP (unit: RMB hundred million)	GDP Growth rate (%)
1990	18667.8	3.8
1991	21781.5	9.2
1992	26923.5	14.2
1993	35333.9	13.4
1994	48197.9	13.1
1995	60793.7	10.9
1996	71176.6	10.0
1997	78973.0	9.3
1998	84402.3	7.8
1999	89677.1	7.6
2000	99214.6	8.4
2001	109655.2	8.3
2002	120332.7	9.1
2003	135822.8	10.0
2004	159878.3	10.1
2005	183084.8	10.2

Source: China Statistics Yearbook 2006, p57.

1. 4.1 China's Economic Development Model

The vigorous, sustained and rapid growth of China's economy has become a flash point in world economic development and has received close attention from the international community. The UN "World Economic Situation and Prospects for 2003" stated that China has become the "locomotive" for Asian economic growth (Joshua, 2004).[36] This may not be very precise but it nevertheless indicates that China is making ever-greater contributions to the world economy. These stunning achievements in economic development are appealing to other countries that now recognize China's economic development model. The Foreign Policy Centre of UK

[35] http://www.unchina.org/about_china/html/poverty.shtml (accessed 3rd October, 2004)
[36] Joshua, R. (2004), *Report of The Beijing Consensus*, The Foreign Policy Centre, UK.

(2004)[37] states;

"China has begun to remake the whole landscape of international development, economics, society, and by extension, politics. The Beijing Consensus replaces the widely discredited Washington consensus, and shows how countries develop their way of life and political choices."

In contrast with Russia and other ex-socialist countries which experienced collapses in economic reforms, China is a distinctive model of success. Christopher Marsh, director of Asian studies at Baylor University, has observed;

"The Chinese are actively studying 'what went wrong' in Russia and other countries in Eastern Europe, hoping to devise policies that can continue to promote economic growth and a gradual deepening of pluralism, without resulting in a violent or sudden collapse of the current system. Ideas such as contrasting a 'controlled' as opposed to an 'uncontrolled' transition permeate the scholarly research in China on post-Soviet Russian politics."

Yet the Chinese model of controlled reforms may prove to be more beneficial, over the long run, for creating states and societies that are both more open and stable than the "creative destruction" that marked Boris Yeltsin's Russia.[38]

1.4.2 Debates of the 'China Model'

The Chinese development model, known as 'Chinese Market Socialism', is still reviewed as controversial. There are still many challenges ahead. Some western economists (Dorn, 2001; Dorn, 2004; Nove,1989; Stiglitz 1998)[39] argue against market socialism, arguing that markets must be based on voluntary exchange. According to them, socialism destroys the spontaneous nature of markets and substitutes government control for individual responsibility. Market socialism, even with 'Chinese characteristics', is an unnatural and artificial system which, like the Yugoslav experiment with workers' management, is destined to fail.

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37 http://www.un.org/esa/research.htm (accessed 5th October 2004)

38 http://www.inthenationalinterest.com/Articles/Vol3Issue6RealistPFV.html (accessed 7th October 2004)

39 Dorn, J. A. (2001), 'Creating Real Capital Markets in China', *CATO Journal*, 21 (1), Spring/Summer2001, pp65-75.

Dorn, J. A. (2004), 'Creating a constitutional order of freedom in emerging market economies', Economic Affairs, 24 (3), Sep2004, pp58-63.

Nove, A. (1989), 'The limits of full economic accountability', *Problems of Economics*, 32 (3), Jul1989, p25-35.

Stiglitz, J. E. (1998), *Whither Socialism?* The MIT Press, London.

But the reality is quiet the reverse. China's model seems to be prosperous instead of falling into failure or chaos. The consequence of reform experiments over two decades has strongly rebutted such claims. However, the Communist Party of China faces new challenges. For example, the needs to diversify the ownership of state-owned enterprises, and to consummate laws in many fields of business activity are not easy tasks to complete due to the weak infrastructure of the market. There is also the demand for the banking sector to act as an open capital market in order to embrace the forces of globalization. The control from government and demands of the free market economy are in friction. How to balance these conflicts is a challenge to the Chinese government. Incomplete legal systems are obstacles to bold movements of reforms. No experience of such reforms in other countries can be learned for reference, as China is developing and creating an explicitly new model by itself. Since the adoption of globalization in late 1996, the Party has recognized that economic globalization is a double-edged sword for China. The Asian financial crisis in 1997-1998 revealed the effect of this double-edged sword of globalization; that is, the challenges it presents as well as the opportunities. For example, the international market gives Chinese firms more business opportunities to enlarge their sales and expand their market, but it also means greater competition and a more complex environment to handle. It is just like a double-edged sword; it can beat your enemy while it might also hurt yourself if you don't use it properly.

1.4.3 Summary of Characteristics of Chinese Market Socialism

In line with the advocacy of the Communist Party[40], the Chinese characteristics of market socialism can be summarized as follows:

(1) The essence of socialism is to liberate and develop productive forces, eliminate exploitation and polarization, and finally achieve common prosperity. To reach this goal, it is committed to adhere to socialist principles, which retains a dominant position for public ownership and system of distribution. However, it also incorporates the need for markets and private ownership. This redefinition permits features of capitalism to co-exist within a regime of state socialist control.

(2) China is at the primary stage of socialism and will remain so for a long period of time, because of the nature of Chinese society and its present stage of development.

[40] http://www.politicalaffairs.net/article/view/36/1/1/ (accessed 8th October, 2004)

China has a large population and disparities in the level of development in different regions. The productive forces are also far from developed.

(3) China's economic system combines the basic socialist system and market-oriented economy. In the process of exploring socialism, the full development of a commodity market economy is a phase that cannot be surpassed during socialist economic development. This is a breakthrough from traditional thinking that a planned economy equals socialism and market economy equals capitalism. Besides, it is believed there is no fundamental contradiction between socialism and a market economy. A market economy is indispensable to the allocation of resources in socialized production. Combining socialism with the market economy is an innovation of Marxist theory in socialist economy. This significant innovation is a distinctive feature of the 'China Model', which generates a hybrid market structure encompassing both public and private ownership.

(4) China is still in the process of building 'rules of the game' for a market-oriented economy. It means the market legal framework is incomplete. The coexistence of the planned economy and the market economy means the government stills greatly interferes in market exchanges and transactions and political factors influence the direction of economy. Though economic reforms have allowed enterprises to independently operate in the market place, production materials, land, investment, funds and loans are still controlled by either central or local governments and are allocated by the way of government administration.

(5) Regional imbalances in economic developments have been generated from the implementation of government policies. Coastal economic clusters have not been caused by the spontaneous tendency of business clustering, but artificially engendered by government policies for 'economic zones for foreign investment'. Foreign investments are forced to operate in these tailored zones as part of experiments in the market-economy. As the market economy matures, these zones will disappear. However, they are still operated at the current stage of market socialism and represent a distinctive characteristic.

(6) The Communist Party of China emphasizes the need to build a socialist spiritual civilization (socialist cultural and ideological progress). Socialist spiritual civilization is a significant feature of socialist society. It is seen as an important goal and guarantee of modernization in China. The Party believes that socialism with Chinese characteristics can only be built on both material and cultural and ideological

grounds. Economic development offers the material basis for spiritual development while in return, cultural and ideological progress provides the ideological motive force and intellectual support. Since Mao's time, the construction of spiritual motivation other than material stimulation has been stressed as the main task of civilization. This tradition has never changed under the market economy and although the material incentive has been proposed, spiritual civilization is still the prior emphasis in Chinese society. It can be regarded as a cultural characteristic of Chinese market socialism.

So far a socialist market economy in the primary stage has been established. The public sector of the economy, as a dominant economic component, has contracted and the reform of state-owned enterprises steadily advanced. Non-public sectors of the economy such as the self-employed and private-owned economy including foreign-owned economy have rapidly developed. Market systems are being built and the state continues to improve its macro-control mechanism. The reform of finance, banking sectors, housing and governmental structures is proceeding.

1.5 Foreign Direct Investment (FDI) and Economic Development

China's open door policy towards foreign direct investment was initiated as part of the overall reform and open door policy launched by Deng Xiaoping in 1978.[41] From a general overview of China's market conditions for the past ten years (1992 – 2002), it was elaborated as a basic and featured development of the Chinese economy. The present methods of driving China economic growth are to attract FDI and issue national bonds (for government spending), as well as to encouraging export growth. What does the Chinese government do to attract FDI? What kind of foreign policy does the Chinese government implement to promote FDI, while seeking to protect its national industry from the severe impact of FDI inflows? How does this Open policy fit into a socialist market economy? Basically, foreign policies are exerted under the principle of gradualism and only have been implemented in tailored Special Economic Zones which are sometimes also called Economic Development Zones (EDZs). These are experimental areas for foreign investment. These offer preferential tax and administrative treatment to foreign firms locating there. Also, for the first time

[41] The turning point was the 11th general assembly of the central committee of the Chinese communist party in which the legacy of Cultural Revolution was officially repudiated and a resolution was adapted to the effect that emphasis would be placed on the modernization of socialism in the policies to start in 1979.

in modern Chinese history, wholly-owned foreign enterprises are permitted in EDZs. The regulations and constraints over FDI disclose the role of the regulatory environment over foreign investment, which is an important feature of the governance of market socialism.

1.5.1 Foreign Direct Investment (FDI) in China

FDI has been a major and fast-growing contributor to mainland economy in recent years.[42] Foreign trade and FDI not only attract capital and managerial skills, but also provide jobs, diversifies the economy and facilitates technology transfer. They also provide access to global market information, global production and global distribution networks that link the mainland more closely with the external economies that China needs to penetrate. WTO membership also makes China more attractive to foreign investors because they compete on equal terms with Chinese firms.

As shown in Table 1.8, FDI into China gradually increased in volume from 1979 to 1991. However, in this period, foreign enterprises in Economic Development Zones had tight restrictions. They were permitted to operate only within the geographical area designated as Economic Development Zones. Naturally their businesses were confined to 'passing trades', in which they bring in intermediate inputs from overseas, process them and export the final products to other countries. Although they were given preferential treatment for imports and exports, foreign enterprises were not allowed to transfer the foreign exchanges they earned to the source country directly unless this was approved by the National Tax Bureau (NTB) and Foreign Currency Administration Bureau (FCAB). We may call this the first phase in China's open door policy towards FDI (Branstetter and Feenstra, 2002).[43]

[42] This point has been stated in the chapter 2, 2.1.1 FDI in China.
[43] Branstetter, L.G. and Feenstra, R.C. (2002) 'Tade and Foreign Direct Investment in China: a political economy approach', *Journal of International Economics*, 58 (2), pp335-358.

Table 1.8 FDI Stock from 1979 – 1991

Unit: US$100 Million

Year	No. Of Projects	Contractual Value[44]	Realized Value[45]
1979-1982	920	49.58	17.69
1983	638	19.17	9.16
1984	2,166	28.75	14.19
1985	3,073	63.33	19.56
1986	1,498	33.30	22.44
1987	2,233	37.09	23.14
1988	5,945	52.97	31.94
1989	5,779	56.00	33.93
1990	7,273	65.96	34.87
1991	12,978	119.77	43.66
Total	**42,503**	**525.92**	**250.58**

Source: China Statistics Yearbook 2000

The second phase corresponds to the period between 1992 and 2005, when the decision to join WTO was made by the government. A series of deregulations on FDI were introduced in this period. There was a surge in FDI as can be seen in *Table 1.9*; the trend of FDI inflows has overtly grown year by year from 2002 to 2005.

1.5.2 What Do FDI Statistics Tell Us?

Since the latter half of 1999, most economies in Asia that were hit hard by the financial crisis have recovered. As a result, they are now more able to invest in China, and Asia is China's number one source of Foreign Direct Investment. [46] (*Table 1.10*) Japan, Korea, and Singapore, accounted 25.26% of total FDI inflow in China. In addition there is a regional FDI inflow of 37.61% from Taiwan, Hong Kong and Macao of China.

[44] Contractual value means the value of contracts between foreign invested companies and Chinese companies/governments signed for investment intention.

[45] Realized value means the value of foreign investments has been actually implemented and arrived according to the contracts.

[46] Statistics of FDI are sourced from MFTEC (http://www.tdctrade.com/econforum/boc/boc030101.htm accessed 12th October, 2004)

Table 1.9 FDI Stock from 1992 – 2005

Unit: US$100 million

Year	No. of Projects	Contractual Value	Realized value
1992	48,764	581.24	110.08
1993	83,437	1114.36	275.15
1994	47,549	826.80	337.67
1995	37,011	912.82	375.21
1996	24,556	732.76	417.26
1997	21,001	510.03	452.57
1998	19,799	521.02	454.63
1999	16,918	412.23	403.19
2000	22,347	711.30	593.56
2001	26,140	719.76	496.72
2002	34,171	847.51	550.11
2003	41,081	1,169.01	561.40
2004	43,664	1,565.88	640.72
2005	44,001	1,925.93	638.05
Total	**510,439**	**12,415.49**	**6,306.32**

Source: China Statistics Yearbook 1998, 2003, 2006[47]

[47] *China Statistics Yearbook 1998, 2003 and 2006*, National Bureau of Statistics of China, China Statistics Press, Beijing.

Table 1.10 China's Top-15 FDI Sources by Countries or Regions in 2005

Unit: USD$ million

Countries/Regions	Foreign Direct Investment	Share%
1. Hong Kong, China	17948.79	32.61
2. Virgin Islands	9021.67	16.39
3. Japan	6529.77	11.86
4. Republic of Korea	5168.34	9.40
5. United States	3061.23	5.56
6. Singapore	2204.32	4.00
7. Taiwan, China	2151.71	3.90
8. Cayman Islands	1947.54	3.54
9. Germany	1530.04	2.78
10. Samoan	1351.87	2.46
11. Netherlands	1043.58	1.90
12. United Kingdom	964.75	1.75
13. Mauritius	907.77	1.65
14. France	615.06	1.11
15. Macao, China	600.46	1.09
Total	**55046.90**	**100**

Source: China Statistics Yearbook 2006, p753-755.

As the *table 1.11 below shows*, developing countries have recorded a fluctuating increase of FDI by contrast to a gradual decline in developed countries. China's FDI has reached USD53.51bn in 2003; up 14.14% and overtaking the USA as the largest recipient of FDI. China, after joining the WTO in 2000, has accelerated its open door policy. During its first year as a member, China's investment environment has proved to be more attractive in a volatile global environment. All these factors have helped to push FDI inflows to reach USD53.51bn in 2003, or more than 9% of the global total.[48]

Table 1.11 FDI Inflows and Global Share

Unit: USD$ billion and percentage

	1990	1995	1999	2000	2001	2003
China	3.49 (1.67%)	37.52 (11.33%)	40.32 (3.75%)	40.71 (2.93%)	46.88 (6.38%)	53.51 (9.56%)
USA	48.42 (23.21%)	58.77 (17.75%)	294.98 (27.44%)	314.01 (28.34%)	124.43 (16.93%)	29.77 (5.32%)
Developed countries	171.11 (82.01%)	203.46 (61.46%)	829.82 (77.19%)	1107.99 (79.83%)	503.14 (68.44%)	366.57 (65.51%)
Developing Countries	36.90 (17.69%)	113.34 (34.23%)	222.01 (20.65%)	237.89 (17.14%)	204.80 (27.86%)	172.03 (30.74%)
World	208.65	331.07	1075.05	1387.95	735.15	559.58

Source: National Bureau of Statistics of China, 'World Statistical Data 2001, 2002, 2004'

Table 1.12 reveals that foreign investment has gone into the manufacturing sector with approximately 70.95% of the total share; real estate accounts for 9.81%.

What is the favorable mode of market entry for foreign firms? Table 1.13 illustrates the largest amount of FDI value (429.61 million US$) is in the form of wholly-owned foreign enterprises which account for 67% of total FDI. The second largest (146.14 million US$) is in the form of joint-venture enterprises with 23% of total FDI.

[48] In late October 2003, United Nations Conference on Trade and Development (UNCTAD) released its annual forecast, providing an overview of global FDI flows. This point is one of their findings.

Table 1.12 Foreign Direct Investment by Sector in China in 2004

Unit: USD 100 million

Sector	Number of Projects (unit)	Share%	Contracted Value[49]	Share%	Realized Value[50]	Share%
Agriculture, Forestry, Animal Husbandry and Fishing	11.30	2.59%	3270.96	2.13%	1114.34	1.84%
Mining	2.79	0.64%	1155.81	0.75%	538	0.89%
Manufacturing	303.86	69.60%	109735.76	71.50%	43017.24	70.95%
Production and Distribution of Electricity, Gas and Water	4.55	1.04%	3960.49	2.58%	1136.24	1.87%
Construction	4.11	0.94%	1768.89	1.15%	771.58	1.27%
Transport, Storage and Post	6.38	1.46%	2372.9	1.55%	1272.85	2.10%
Information Transmission, Computer Services and Software	16.22	3.71%	2021.37	1.32%	916.09	1.51%
Wholesale and Retail Trade	17.00	3.89%	2500.53	1.63%	739.59	1.22%
Hotel and Restaurants	11.74	2.69%	2168.87	1.41%	840.94	1.39%
Financial Institutions	0.43	0.10%	575.41	0.38%	252.48	0.42%
Real Estate	17.67	4.05%	13488.02	8.79%	5950.15	9.81%
Leasing and Business Services	26.61	6.09%	6742.48	4.39%	2824.23	4.66%
Scientific Research, Technical Service and Geologic Prospecting	6.29	1.44%	1006.41	0.66%	293.84	0.49%
Management of Water Conservancy, Environment and Public Facilities	1.64	0.38%	822.09	0.54%	229.11	0.38%
Services to Households and Other Services	2.51	0.58%	542.51	0.35%	157.95	0.26%
Education	0.59	0.14%	172.74	0.11%	38.41	0.06%
Total	**436.64**	**100%**	**153478.95**	**100%**	**60629.98**	**100%**

Source: China External Economic Statistical Yearbook, compiled by Department of Trade and External Economic Relations Statistics, National Bureau of Statistics, People's Republic of China, China Statistics Press, Beijing, p124.

[49] Contractual value means the value of contracts between foreign invested companies and Chinese companies/governments signed for investment intention.

[50] Realized value means the value of foreign investments has been actually implemented and arrived according to the contracts.

Table 1.13 Amount of Foreign Investment by Type in 2005

Unit: USD$100 Million

TYPE	Number of Projects	Contracted Value[51]	Realized Value[52]
Foreign Direct Investments (Sub-total)	**44001**	**1890.65**	**603.25**
Joint Venture Enterprises	10408	324.42	146.14
Wholly-Owned Foreign Enterprises	32308	1459.09	429.61
Total	**44001**	**1925.93**	**638.05**

Source: China Statistics Yearbook 2006, p752.

1.5.3 Foreign Investment Laws

There are three basic laws, which have an impact on foreign forms investing in China; the Chinese-foreign joint ventures Law; the Chinese-foreign co-operative enterprise Law; and the Foreign-funded enterprise law. Foreign investment limited liability companies, have to act according The Company Law, which is specially tailored for them. The fundamental legislation covering foreign investment in China is the "Law on Chinese-Foreign Equity Joint Ventures" (promulgated in 1979, amended 1990). It was followed by the "Law on Chinese-Foreign Contractual Joint Ventures" (1988). The "Law on Foreign Capital Enterprises" (1986) deals with enterprises established in China by foreign investors, exclusively with their own capital.[53] The laws are usually quite general and leave a lot of freedom for interpretation. There are also about 150 detailed regulations and provisions applying to foreign investment. The legal framework for FDI is in a process of change. As the market economy is still in the process of becoming mature, the constraints and limitations placed on FDI will be gradually removed in accordance with this situation changing.

In terms of industrial policy, the law maintains the guidelines for foreign investors,[54] in which industries are classified into three groups: foreign capital

[51] Contractual value means the value of contracts between foreign invested companies and Chinese companies/governments signed for investment intention.

[52] Realized value means the value of foreign investments has been actually implemented and arrived according to the contracts.

[53] The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) Website, the section of Foreign Laws and Regulations (http://www1.moftec.gov.cn/moftec_en/law_en_index.html, accessed on 14th October 2004).

[54] This guideline was effectuated on April 1st, 2002.

encouraged industries, foreign capital restricted industries, and foreign capital prohibited industries. The first type of industries enjoy additional incentives beyond those that already are accorded to foreign investors, which include conservation of material and energy, technology-intensive investments such as agricultural and environmental technology; projects that improve product quality and raw-material efficiency; development of energy, communications, and essential raw materials; products in short supply and urgent need domestically; export-oriented industries; substitutes for imports (which save hard currency); and projects in Central and Western regions in the inland. A revised version of the catalogue (1997)[55] specifies 18 industries as "restricted foreign investment industries", which means that the Chinese partners usually have to be the holding parties or play "leading roles" in any joint venture. Wholly-owned foreign enterprises often are not allowed in these industries. Restricted projects include industries that already are fairly well established in China; sectors that are open on an experimental basis; exploration of rare and valuable mineral resources; as well as industries subject to overall State planning, such as grains, pharmaceutical, wholesale and retail, financial services and broadcasting. Furthermore, for political, economic, or national-security reasons, foreign capital is not permitted into traditional indigenous industries, such as electricity and gas, and education and broadcasting, and those that are dangerous to state security, environmentally damaging, or involve products made with national-proprietary technology (Schlevogt, 2000b).[56]

There are two modes of entry for foreign affiliated enterprises in China: wholly-owned subsidiary and joint venture. The joint venture (JV) mode can be broken into several sub-modes based on the percentage ownership of the equity: foreign majority-owned joint venture, equally-owned joint venture and foreign minority-owned joint venture. These two entry modes can be realized by Multi-National Corporations (MNCs) through acquisition of an existing enterprise or setting up a new enterprise in the Economic Development Zones of China (Sun, 1999).[57] However, foreign enterprises are not confined to Economic Development Zones and their dividends are made completely transferable. But the earnings need to be defined as net income after

[55] Such catalogue can be obtained from the local governments of Economic Development Zones.
[56] Schlevogt, K. A. (2000b), 'Doing business in China, part II: investing and managing in China – how to dance with the dragon', *Thunderbird International Business Review*, 42 (2), March/April 2000, pp201-226.
[57] Sun, Hai-shun (1999), 'Entry modes of multinational corporations into China's market: a socioeconomic analysis', *International Journal of Social Economics*, 26 (5), 1999, pp642-659.

all the tax clearances by the National Tax Bureau and Foreign Currency Administration Council before it is allowed to be transferred to the foreign exchanges to the home country.

The imperfect laws applying to FDI development in China is a result of its recent economic development. China, as a socialist market country, has no available model of how to develop a successful socialist market economy. Deng Xiaoping has described the situation of China's open door policy, like "*For the reform of Chinese economy, we have to grope the stones by our hands in this river in order to cross it.*" "*Whatever black or white cat, the one who is able to catch the rat is the best cat.*" These words simply describe the direction of China's Open Door Policy. Although it has no available model to adopt, the trial of creating this new model and gathering experience through a gradual "opening-up" of the market is the method of the Chinese government. It is the reason for setting up the Economic Development Zones in China, which are then used as experimental areas for new policies and developing models.

1.5.4 Functions of EDZs in China

China's Economy and Technology Development Zones (ETDZs) have played an essential role in FDI development. "These years,[58] developed countries have started to move their knowledge-intensive manufacturing with high technique content to developing countries. Economic development zones have become the hottest spots for the individual transfer, both within China and the world at large." said Zhang Yansheng, a famous economist in China.[59] In accordance with the data of 2002 from The Ministry of Foreign Economic Relations and Trade (MOFERT), a total of 43 Economic Development Zones has reported faster growth in foreign investment and foreign trade than the national average. The ETDZs are the home to 736 foreign funded enterprises whose contractual foreign investment totaled 6.18 billion U.S. dollars during the first half of 2002, an increase of 34 percent compared with the same period in the previous year, and accounting for about 18 percent of the country's total. Realized foreign investment in the ETDZs reached 2.86 billion U.S. dollars in 2002.[60]

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[58] These years mean the time range from 1992 to 2002, when is the period for the fastest development in growth of FDI and China's economy since the implementation of reform.
[59] Cited from www.peopledaily.com (accessed 15th June, 2004)
[60] Statistics source: National Bureau of Statistics of China (http://www.stats.gov.cn/tjsj/ndsj/ accessed 2nd November 2004)

In the classification of Economic Development Zones' functions, these can be specified as five types; 'Free Trade Zone' (FTZ), 'Bonded Zone' (BZ), 'Export Processing Zone' (EPZ), 'Economic and Technologic Development Zone' (ETDZ) and 'High Technology Zone' (HTZ). Preferential treatment in these various zones includes significant reductions in national and local taxes. The preferential profit tax rates in ETDZs (15%) and in coastal open cities (25%) compare favorably with the national rate of 33%.[61] There also are exemptions on import and export duties, land fees, and priority treatment in the provision of basic infrastructure services and supplies. A refund of up to 40% of the income tax paid on the foreigner's share of profits is available, if it is reinvested directly for at least five years.[62] Under the guiding policy of encouraging exports, a refund of VAT (17%) on domestic purchased materials is given back to the Foreign-Invested Enterprises when the final products are exported.

1.5.5 Restrictions Over FDI

Reform policies have significantly improved the business environment during the past decade. Many entry barriers for FDI have been removed. For instance, regulations and policies that limited foreign firms to joint ventures (JV), were abolished in 2005. Policy changes covering price discrimination, foreign trade, exchange rates, entry barriers, internal markets and financial systems, have allowed for an increased role for substantial foreign investment. But still some constraints and limitations remain in the regulatory business environment. To a certain extent, for example, the state-controlled banking sector still limits the free movement of capital.

Companies must adjust to difficulties in coping with the changing regulatory environment. This is particularly apt for small firms. Take, for example, the change of regulations in the taxation system in foreign investment zones. Foreign companies who enjoyed the benefits of tax refund did not pay deposits to local national tax departments for years, but such benefits changed in 1999. All foreign companies had to place advance deposits before export taxes could be refunded. Small firms immediately suffered from this change as they didn't have the sufficient funds to tie up in deposits for three month. In 2000, this three month period for refunds was

[61] EIU. (1999), *Country fact sheet China*, 5th May, London, Economist Intelligence Unit.
[62] Cheng, F. (1998), *Tax incentives for foreign investment*, Speech presented by Deputy Director General, State Administration of Taxation of China.

extended to six months. But the application process was often delayed for more than six months due to unpredictable bureaucratic administrative systems. Even now, many foreign firms still encounter difficulties in dealing with governmental bureaucracy and business relationships. (Keillor et al, 2001; Schlevogt, 2000a)[63] How to handle regulatory constraints is a major concern for foreign firms in shaping their strategies for developing the Chinese market.

1.6 China's WTO Accession

China's accession to the World Trade Organization (WTO) is an important stage for market liberation and deregulation. It can be seen as a strong impulse to the progress of the market-oriented system. In addition, it has allowed China to step into another major phase of globalization.

1.6.1 Nature of WTO

The role of WTO is to enforce trade agreements. The predecessor of WTO was an association called General Agreement on Tariffs and Trade (GATT), which was formed in 1947 by 23 countries to negotiate reductions in trade restrictions and work toward common procedures for handling imports and exports. By 1995, 117 countries were participating. GATT's most important activity was sponsoring rounds, named for the place in which each began, such as the Tokyo Round and Uruguay Round. These negotiating rounds led to a number of multilateral reductions in tariffs and non-tariff barriers for its members. The reductions of tariffs are not the same percentage for all the member countries. The amount of reduction depended on countries' different tariff levels before negotiations and their bargaining strengths. The GATT had inherent weaknesses, such as a cumbersome closure, 'most-favored-nation' as well as no-assuring compliance with agreements. Therefore, the WTO was formally established in 1995 to replace GATT and deal with its shortcomings. (Daniels and Radebaugh, 2001)[64]

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[63] Keillor, B., Davila, V. and Hult, G. T. (2001), 'Marketing entry strategies and influencing factors', *Marketing Management Journal,* 11 (2), Fall 2001, pp1-11.
Schlevogt, K. A. (2000a), 'Doing business in China, part I: the business environment in China – getting to know the next century's superpower', *Thunderbird International Business Review,* 42(1), Jan/Feb2000, pp85-111.
[64] Daniels, J.D. & Radebaugh, L.H. (2001), *International Business: Environments and Operations*, 9th ed. Prentice Hall. New Jersey.

The WTO now has more than 130 members, who subscribe as a free trade system contained in two sets of trade agreements. The first set of trade agreements are called multilateral agreements, that include among other things, the General Agreement on Tariffs and Trade 1994, (GATT 1994), the Agreement on Trade-Related Investment Measures (TRIMs), the General Agreement on Trade in Services (GATS), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) and many other agreements. A member must accept all of these agreements as a complete whole. The second set of trade agreements is called plural-lateral agreements, to which members may adhere on a voluntary basis. These agreements include, for example, the Agreement on Government Procurement (AGP) and Agreement on Trade in Civil Aircraft (TCA). China has conducted negotiations on these two simultaneous fronts and engaged in regular talks with WTO members on a bilateral basis. It was during such bilateral negotiations that China and the U.S. agreed to trade concessions and accession conditions in November 1999. China concluded a similar agreement with the EU in May, 2000 (Hung, 2001).[65] China officially became a member of World Trade Organization (WTO) at the end of 2001. By 2005, over fifty developed and developing countries have recognized the status of the market economy of China. China has become the third largest trading country in the world that increasingly exerts influence in the world economy.[66] Between 2006 to 2010, China will be committed to the total openness of WTO membership, after the transition period (2001-2005). It will be a huge challenge for the competitiveness of Chinese enterprises.

1.6.2 Reasons For China Joining WTO

Demand of Reform Policy

The demand for economic growth and improvement had become a major force in China after the death of Mao. The people's living standards needed to be improved and the political status of the country in the world stage needed to be upgraded and strengthened. These goals of a country's development have to be closely linked to its

[65] Hung, T. W. (2001), 'The impact of WTO treaties on investment in China', *Harvard Asia Quarterly*, California, 25 (2), Jun2001, pp27-50.
[66] *China Statistics Year Book for foreign economic trading and corporation (2005)* compiled by the Committee of China International Trading Promotion and Propaganda, China Business Press, Beijing.

economic development. As Deng Xiaoping stated in the early of 1990s[67], "*Economic growth and development is the only strong and true theoretical guide for China.*" "*To seek for a sustainable economic development under a stable environment is the essential prerequisite for reform.*" Deng's concept has become the principle of China's economic policies. Since China first began to open up to the outside world in1979, it has become increasingly dependant on world trade. Total trade in 1979 was worth just over US$ 29 billion. By 2000, this had risen to US$ 474 billion – an increase of 16 times in just 20 years.[68] The position of WTO membership was compatible with China self-selected policy of rapid economic reform, which is why there was an opportunity for WTO agreement in 1999.

Security of World Trading Partners

China therefore needs certainty in trade and investment; it cannot afford to see its export figures and investments fluctuate in reflection of whims of other countries' relationships with it. WTO membership gives China recourse to WTO sanctions against countries that do this. With the trading treaties with other countries, China also enjoys the equal opportunities of investment and trade in its partners' countries, which efficiently and internationally promote China participation in the world market.

1.6.3 The Impact of WTO

Many economists have acknowledged that the influence of the WTO entry on changing the Chinese market has been positive because of the ways globalization and liberalization have contributed to China's economic transition. It is transforming the market conditions significantly, of which the following are the more important aspects.

Liberation and Deregulation of Market Place

(1) Import and Export trading

Thanks to China' accession of WTO in 1999, tariffs and non-tariffs barriers are being phased out gradually within 5 – 10 years (2005 – 2010). The Chinese government has lowered tariffs throughout the entire period of open policy. After WTO, China is committed to lower tariffs to meet the accession's conditions. In accordance with the announcement from the Chinese Foreign Ministry in 2005, China has lowered its average tariffs to 10.1 percent from 14 percent in 2001, and abolished

[67] Deng, Xiaping (1993), *The Anthology of DengXiaping: the talk in the national congress of China Communist Party (23rd September, 1985)*, Vol. 3, p143, The People Press, Beijing.
[68] 'Xinhua FM spokesman: China seriously fulfills WTO commitments', *Xinhua Newspaper*, 18th September 2002. http://www.stats.gov.cn/english/ (accessed 8th November, 2004)

424 non-tariff measures and granted tariff rate quotas. For example, the tariff rates on automobile have been reduced from over 100% in 1998 to 25% in 2005; for air-conditioners, from 40% in 1998 to 20% in 2005; for motorcycles from 60% in 1998 to 40% in 2005 and for computers from 25% in 1998 to 0% by 2005.[69]

In addition to trade liberation concerns, deregulation of the legal environment has taken place. The constraints and limitations on the business environment is being reduced, which is part of the commitment from the Chinese government for being a member of WTO. Particularly in the banking sector, the difficulty of handling foreign currency has become a manifest obstacle for both foreign and domestic firms.

The obvious improvement from the first stage of China's preparation to WTO accession was the system of customs. A significant reform of structural change for the customs system was started in 1999, in order to improve the efficiency of working procedures of export and import by combining three originally independent and individually administrative departments. Thus, the Commodity Inspection, Hygiene Inspection, and Animal and Plant Inspection were cooperated into a single bureau. This reform was successfully accomplished by 2002 and speeded up international trade flows, simplified by the documentations of trade transparency. IT control systems have been put in place to replace traditional paper documentation of trading processes.

As The Economic Survey of China has pointed out (OECD, 2005)[70]: "*The sole-ownership socialist economy had been successfully transformed to a freer socialist market with diversified forms of ownership. The momentum towards a more open business environment has continued this decade with membership of the World Trade Organisation resulting in the standardisation of a large number of its laws and regulations and the prospect of further tariff reductions. Further changes have been made to the constitution in 2004, stressing the role of the non-state sector in supporting economic activity in the county and protecting private property from arbitrary seizure. In 2005, regulations that prevented privately-owned companies entering a number of sectors of the economy, such as infrastructure, public utilities and financial services are abolished.*"

(2) Domestic Market

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[69] *China Statistics Year Book for Foreign Economic Trading and Co-operation (2005)*, compiled by the Committee of China International Trading Promotion and Propaganda, China Business Press, Beijing, p453-454.

[70] OECD, *Economic Survey of China in 2005*, chapter 2, 16th September 2005.

For the last two decades, China has had important policies to attract FDI, such as beneficial tax policies, economic zones' policies, export promotion policies for foreign invested enterprises, etc. These policies have given foreign-invested joint ventures special treatment in areas such as profit taxes policy and intermediate-inputs import tariff remission. At the same time, important incentives for foreign-invested joint ventures to export their production have been also developed. However, China has imposed legal and de-facto restrictions to limit foreign access to domestic markets. Indeed, many of the benefits just mentioned are conditional on export performance. Free Trade Zones (FTZs) are mainly located in Economic Development Zones (EDZs) where they have easy access to foreign markets. Meanwhile, domestic firms like state-owned enterprises (SOEs) and collective-owned enterprises (COEs) enjoy several protectionist measures but do not share many of the benefits directed at foreign firms. Native firms sell mainly in protected local markets and face some increasing competition from state-owned enterprises and collective-owned enterprises has taken place. To sustain its commitment to full employment and high production the government has directed increasing amounts of credit to state-owned enterprises. A smooth opening of domestic markets has been taking place, but the biggest step has yet to be implemented: the removal of special protective policies for domestic firms in general and state-owned firms in particular. However, all the removal of non-tariffs barriers is not an easy task to be completed due to China's dual-tracks economic structure. The integration process of China into WTO has advanced in many aspects but several additional elements are required before it can be considered to be a full member of WTO, such as banking and the capital market while the media industry is still restricted and tightly controlled for foreign companies.

"China's leaders have repeatedly reaffirmed that the long-range objectives of trade reform are a more open trade regime and membership in the World Trade Organization (WTO). A prerequisite of the latter is "national treatment" for Foreign-invested Enterprises (FIEs); that is, they are not subject to legal requirements that do not also apply to domestic firms. To this end, the Chinese have begun to take a number of steps to reduce, and ultimately eliminate the differences between the present export and domestic trade regimes. Some of these changes have been mentioned above: tax breaks on investment goods for FIEs are being phased out, and other aspects of tax treatment are becoming more unified. There are also plans to reduce the scope of tax exemptions for all entities, foreign and domestic. If

implemented, these reforms will tend to unify the trade regimes, and the resulting system will be more open than the present dual regime."(Naughton, 1996) [71]

It is often reported that tariff liberation is accompanied by the liberation of FDI. The opening of access of domestic markets to foreign production introduces competition in markets. This affects significantly the competitive position of native firms if foreign firms have more advanced technologies. (Claro, 2002)[72] A larger competitive market will emerge domestically. More competitors will come into the Chinese market and more domestic and joint venture companies will expand their markets to overseas. For the latter trend, domestic firms have to face the serious test of whether they are competent to compete in the international market. More private-owned enterprises will emerge in the marketplace. WTO obligations make it easier for entrepreneurs to develop and grow in accordance with less constraints and requirements.

(3) Improvements in the Enforcement of the Legal System

While the service and commodity markets are opening in a careful and planned way, China has clarified and revised relevant laws and regulations, which are now basically in accordance with WTO rules and China's WTO commitments. A reporting and consulting system has been set up to make its work more transparent. However, it still remains a raising challenge for the present legal system. Albeit China had been preparing for the WTO for some time, and now the membership has become a reality, reshaping its legal environment in order to satisfy the requirements of the WTO involves big modifications. To date, China has repealed legislation regarding price controls on over 128 categories of goods. The State Council has examined all the administrative regulations passed prior to 2005, and has abolished 221 regulations. China has modified or is modifying laws, regulations, and rules governing areas such as foreign investment, customs, intellectual-property protection, foreign trade, foreign exchange, and insurance.[73] Great progress has been achieved, especially in the areas of foreign investment and intellectual-property protection. The Equity Joint Ventures Law, the Cooperative Joint Ventures Law, and the Wholly Foreign-Owned Enterprises Law as well as the rules for their implementation have been amended.

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[71] Naughton, B. (1996), 'China's Emergence and Prospects as a Trading Nation', *Brookings Papers on Economic Activity*, 14 (2), pp. 273-337.

[72] Claro, S. (2002), 'What to expect from China's entry into WTO', *Journal article of Tariff and FDI Liberation*, 27 (1), Jan2002, pp35-60.

[73] *China Statistics Year Book for foreign economic trading and corporation (2005)*, compiled by the Committee of China International Trading Promotion and Propaganda, China Business Press, Beijing,

Provisions on giving priority to purchasing in China, on foreign exchange balances, and on required ratios of exports to domestic sales have been removed. These changes and improvements in the legal environment, combined with access to China's domestic market make China attractive to FDI. (Zweig and Chen, 2007)[74]

Pressure on Reforming the Rural Infrastructure of the Agricultural Sector

About 65% of China's population lives in the countryside. In 2000, there were 499 million people working in the rural economy with about 355 million working in agriculture itself. And yet China's agricultural sector only generates 16% of the country's GDP – in sharp contrast to the 50% it generated 50 years ago. (Crook, 2002)[75] Nevertheless, China's WTO entry has helped in part to resolve issues related to protecting this sector. China's rural economic system has been guided by its mandatory grain-purchase system, with the production and cropping patterns determined and planned by the central government. Such system has been changed gradually to a market-driven mechanism since the open-policy exerted. After WTO entry, China has gradually engaged in free international trade of agricultural products, which means its agriculture is subject to global changes in prices, market accessibility, trade structure and trade rules concerning agricultural products.

The impact on the agricultural sector is the benefits from preferential treatment in free trade, especially in tariff reduction, enjoyed by all signatory countries to GATT. China can unconditionally obtain the most-favored-nation status with all WTO members. These give China a better opportunity to tap international agricultural resources and markets. It also accelerates its agriculture reforms and establish an agriculture macro-control system compatible with the market economy, thus enhancing the production of agricultural products and sharpening the competitive edge of China's farm products in the international market. (Zhu, 2006)[76]

The negative impact on the agricultural sector is the competition arising in the domestic market by the entry of foreign firms. As China has to open its domestic market and revoke all non-tariff restrictions on imported farm products, the government's protective policies on domestic farm products are being gradually

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[74] Zweig, D. and Chen, Zhi-min (2007), *China's reforms and international political economy*, Routledge, London.

[75] Crook, F. W. (2002), 'The WTO's impact on China's agricultural Sector', *Journal of China Business Review*, 29 (2), Mar/Apr.2002, p12.

[76] Zhu, Zhongli (2006), *The security of Chinese industries after WTO accession*, Shanghai Finance and Economy Press, Shanghai.

phased out. Foreign agricultural products at lower prices are set to pose great challenges to their Chinese counterparts. The flood of foreign farm products into China puts heavy pressure on the country's foreign exchange reserve, the financial source of imports.[77]

China's WTO tariff commitments varied according to product and were phased in by 2004. The average tariff rate on agricultural products fell to 15.8% percent in January 1st, 2002, according to the Tax Committee of the State Council. China has used tariff-rate quotas (TRQs) to protect domestic production of some agricultural commodities, including wheat, corn, rice, soybean oil, cotton, and sugar. According to the agreements with WTO, China must restrict domestic support to its farmers to 8.5% of the value of the specific crop. China maintains state import rights for some agricultural goods, including wheat, corn, rice, sugar, cotton, soybean oil, and tobacco. Foreign-invested enterprises in this sector has been able to distribute imported and domestically produced agricultural goods since 2003. Foreign majority ownership was allowed in 2004 with no geographic or quantitative restrictions, and wholly foreign-owned enterprises were permitted in 2005.

Trend of Globalization and High-Technology-Oriented Economy

Clearly WTO accession generates a new phase of globalisation and technological development in China. In consequence, such a trend is having significant effects on the state and economy, particularly on the cultural aspect. The development of technology has become the main concern of the state, thus rules and policies are pushed forward for its encouragement. A more market-oriented, more transparent and rules-based economy can facilitate further access to the world market. The integration of China into the world market has also required the adoption of leading edge technologies as a consequence of this access. Chinese firms are not only faced with domestic competition but also the rivalry from foreign firms with highly developed management skills and advanced technologies. On the one hand, it is a crucial threat to their survival; on the other hand, it is also a driver for improving their management skills as well as their competitiveness.

Employment's Opportunity or Threat?

[77] http://fpeng.peopledaily.com.cn/200003/30/print20000330O103.html (accessed 5th November, 2004)

A high rate of unemployment is currently a serious problem for the Chinese government. Will WTO membership solve this problem? The answer to this question varies and induces debates according to different measurements. In the labor market, the demand is much less than the supply. In accordance with the official statistics report for 89 major cities of China shows the work force seeking jobs is 2.53 million while there are 1.98 million vacancies. But the China International Intellectuals Development and Exchange Association (CIIDEA), has argued WTO accession can increase 12 million job vacancies per annum (Xiao, 2003)[78]. However, the Chinese government faces increasing problem of unemployment as economic reforms deepen (See Figure 1.14). The restructuring of state-owned enterprises has generated a large number of laid-off labourers. It endeavours to solve it by more actively embracing the globalization trend to attract foreign investment. However, this remedy does not always work as expected. The reality for the country's labour force is that the country's training and education system should be reformed and adapted for the changing environment. Only when the local workforce is trained up to international standards, can the country gain the benefit brought by globalization and avoid its negative side effect on employment.

Figure 1.14 The Status of Unemployment in China (1985-2005)

Year	1985	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Unemployment (10000 persons)	239	383	520	553	570	571	575	595	681	770	800	827	839
Unemployment Rate (%)	1.8	2.5	2.9	3.0	3.1	3.1	3.1	3.1	3.6	4.0	4.3	4.2	4.2

Source: China Statistics Yearbook 1998, 2003, 2006, p125.

1.6.4 The Relations between WTO and FDI

WTO membership has indeed promoted an increase in foreign direct investment (FDI), which rose from only US$ 3.49bn in 1990 to US$ 40.71bn in 2000, and to an all-time high of almost US$ 53.51bn in 2003 (Table 1.11). The WTO accession has therefore helped to reverse the fall in FDI that occurred in 1999. This decline had worried the government. FDI has played an important part in driving China's economic transformation in the past 20 years, accounting for as much as 17.3% of all

[78] Xiao, Z. (2003), *Economic Analysis and Future Perspectives for2003,* Economy and Sciences Publications, Beijing.

investment in China in 1994.[79] During the 1980s and 1990s FDI was attracted to China by generous tax incentives provided by the government, and by a seemingly infinite supply of cheap labor. The attraction of these benefits seemed to be fading by the late 1990s as investors realized that chaotic rules and poor infrastructure made it hard turn a profit in China. (Ma, 2003)[80] Entry into the WTO, has created a more rule-based system as well as opening up to FDI previously restricted areas of the economy. This seems to have revived foreign investor interest in China.

1.7 The Challenges Facing Market Socialism

China's transition is characterized by "gradualism" and 'a market growing outside of the regime'. Administrative decentralization and the expansion of managerial autonomy and incentives for state-owned enterprises, has introduced major market-based reforms in the economy since 1979. This gradualist transition has led to the extraordinary development of the non-state sectors, replacing the role of the state sector in industry at the core of the economy, and to the governance of the economy in large part by market forces.

The extraordinary reforms in China have injected huge rigour to the economy. At the same time, it is quite natural that some problems have emerged. Chairman Hu Jintao has admitted "China's economic infrastructure is weak, productivity is low and development is extremely unbalanced." This notwithstanding, China is still facing up to the painful challenges such as further privatization of state-owned enterprises, institutional restructuring in the banking sector, tax reforms, actions on property right protection and control of the growing economy. How successful China completes these challenges will determine its international status not only in Asia but also on the world economic stage. The unfinished reforms on state-owned enterprises and the restructuring of the banking sectors are core challenges for the Chinese government at present. However, they remain demanding tasks for the Communist Party of China, since these require the application of international standards and laws in banking systems.

1.7.1 The Reform of State-Owned Enterprises

[79] EIU (2004), *The Economy, Country Profile of China*, p32, Economic Intelligence Unit.
[80] Ma, Hong (2003), *China market development report: latest report compiled by Development and Research Centre of State Council*, (eds), China Development Press, Beijing.

The reasons for reform

The ultimate goal of China's reforms is to improve the efficiency of the utilization of resources. However, state-owned enterprises, as dominant forces in economy, have been operating with very low efficiency for a long time. Although the reforms of state-owned enterprises, began in 1978, injected greater operating autonomy to enterprises, their losses have increased due to institutional constraints (See table 1.15). The State Ministry of Finance and state-owned banks have extended loans to these loss-making sectors to keep them from bankruptcy. Such 'soft budget constraints' within the financial sector can have disastrous effects for the entire economy (Stiglitz, 1994).[81] Kornai (1992)[82] has pointed out that the major reason for the poor performance of state-owned enterprises is their 'soft budget constraints' as the slow reform of state-owned enterprises and the slow reform of state-owned banks are closely linked.

Table 1.15 The Status of Losses in SOEs (1978-1997)

Unit: % billion RMB

Year	Independent SOEs		Branches to Independent SOEs	
	Percentage of loss SOEs	Loss in total	Percentage of loss SOEs	Loss in total
1978	n.a.	42	23.9	44
1979	n.a.	36	23.4	37
1980	19.2	34	22.4	32
1981	22.9	46	27.7	42
1982	20.8	48	25.1	43
1983	12.8	32	14.6	29
1984	10.2	27	10.5	23
1985	9.6	32	9.6	27
1986	13.1	54	13.4	47
1987	13.0	61	12.8	51
1988	10.9	82	10.7	71
1989	16	180	15.9	128
1990	27.6	349	30.3	279
1991	25.8	367	28	300
1992	23.4	369	22.7	300
1993	30.3	453	29.8	290
1994	n.a.	483	n.a.	335
1995	n.a.	640	44.0	409
1996	n.a.	791	n.a.	530
1997	n.a.	741	n.a.	n.a.

Sources: 'China Finance Year Book' (1994) p438; 'China Statistics Year Book' (1996), p429; 'China Statistics Year Book' (1997), p439; Xinhua Daily: 'The National Statistics' Report on National

[81] Stiglitz, J. E. (1994), *Whither Socialism?* The MIT Press, London.

[82] Kornai, J. (1992), *The Socialist System*, Princeton University Press and Oxford University Press, UK.

Economy and Social Development 1997' (1998), 4th Mar 1998, daily report on China, 98-071. (Sited in Lardy, 1999, p42).[83]

As the figures in table 1.15 reveal, the losses of state-owned enterprises declines at the period of the beginning of reforms. But then the percentage losses increased and reached a summit in the middle of 90s. The transformation of state-owned enterprises and their structural readjustments have reached a crucial stage, filled with deeply rooted contradictions and emerging problems. The major contradiction between planned regime and the demand for independent-operations for a market-oriented economy is the routine cause for these problems. A considerable number of state-owned enterprises have not yet adapted to the demands of the market economy. They are not flexible in terms of structural change; weak in technological innovation; heavily in debt; carry social burdens; and have a large number of surplus employees and difficulties in production and business operations.

"*It is imperative to take practical and effective measures to solve these problems. This has a vital bearing not only on the success or failure of state-owned enterprises reform, but also on that of the overall economic restructuring of the country. Thus, a number of active measures need to be implemented in order to eliminate the barriers of further economic development, facilitate market competition, and promote technological progress so as to provide good management systems and a sound legal environment*", commented Gao, president of the Economic Reform Foundation in China (Wang, 2000)[84].

The History of Reform in State-Owned Enterprises

State-owned enterprises have experienced three stages of reform over the last 20 years. The first stage started with an experiment in 1980 by focusing on restructuring incentive systems for state firms and giving autonomy to managers to produce products for the market and outside the planning system (Hay, Morris, Liu and Yao, 1994)[85]. The second stage focused on the development of both products and markets, and property-rights reform. In contrast, the third stage was to corporatise state-owned

[83] Lardy, N. R. (1999), *China's Unfinished Economic Revolution*, China Development Press, Beijing, p42.
[84] Wang, Z.M. (2000), 'Economic Reform Foundation's President Shangquan Gao on organisational reform and sustainable business development', *Academy of Management Executive*, 14 (1), Feb 2000, p8.
[85] Hay, D., Morris, D., Liu, G. and Yao, S. (1994), *Economic Reform and Chinese State-Owned Manufacturing Enterprises 1980-87*, Clarendon Press, Oxford.

enterprises (Lin, 2001)[86] and create a diversified ownership structure in the industry by implementing a 2-R reform strategy – ***Retain*** state ownership structure in strategic sectors for large enterprises, and ***Retreat*** from state control of small and medium size firms that operate in highly competitive markets (Liu and Woo, 2001)[87].

At the third stage of reform, corporate governance and clarity of ownership were major issues in the reform of SOEs. Alongside it, some serious problems were in need of further solutions. Lack of clarity of property rights and ambiguity of ownership were caused by the lack of relevant laws. Secondly, there was often little change in state-owned enterprises management structures after corporatization. The State still had full control and the capacity for intervention. For instance, there was still one owner and no board of directors, which was directly administrated under government bureau before 2001. The directors/managers were actually more likely to be bureaucrats and not entrepreneurs, which were appointed by the administrative bureau. Such management staff was selected based on their rank in the state bureaucratic hierarchy. They often lacked management skills and incentives; they were often politically motivated. This situation leaded to inefficiency, low productivity and sometimes corruption. Although state-owned enterprises had produced an average 10% growth rate in the value of industrial output during the period 1978 -1998, this rate is considerably below the average for other sectors (Zhou, 2003)[88]. Provinces within China where the state controlled a large percentage of production were notorious for their shoddy goods, high pollution levels, and ever increasing losses. Shanxi, Guangzhou, Yunnan, Qinghai, Ningxia and Xinjang top the list of the least productive provinces with the state controlling 60-80% of the industry. Shanghai, directly controlled by Beijing, grew at an average of 6%, the lowest of all areas. Regions with less state control and more foreign investment reached 16.9%. While SOEs creating these problems were drastically over-staffed, they lacked the ability to reform and streamline their business structures. These were the main issues to be resolved in the third stage of reform.

After these three stages of reform, some improvements are evidenced in the state-owned enterprise sector. For example, a more diversified ownership structure in

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[86] Lin, C. (2001), 'Coporatization and corporate governance in China's economic transition', *Economics of Planning*, 34 (1), pp5-35.
[87] Liu, G. S. and Woo, W. T. (2001), 'How will ownership in China's industrial sector evolve with WTO accession?' *China Economic Review* 12 (1), pp. 137 – 161.
[88] Zhou, D.Y. (2003), *The SOE Reform in China*, Summer Semester 2003, Europe-University Viadrina, Germany, p8.

the industrial sector has emerged in the late 1990s: wholly state-owned firms (44% of total industrial sales in 1997), collective-owned firms (26% of sales), and mixed state- and private-owned firms (24% of sales, and wholly private-owned firms (6% of sales) (Liu and Garino, 2001)[89]. It is evidenced that state ownership has declined. The focus on enterprise autonomy, incentives, management and competition have created a more market-oriented economy. Many large size state-owned enterprises have achieved significant improvement in their performance on both domestic and international markets. For example, Haier, Changhong, Shanghai Haixin, Huali, and Shenzhen Mingda, TCL, and China Petrol, between 2001 and 2003. These state-owned corporations have made successful mergers and purchases overseas with billions of US dollars (Zhang, 2003)[90].

As Table 1.16 illustrates, the number of state-owned and state-holding enterprises have significantly declined by 57% (from 64737 in 1998 to 27477 in 2005); and the number of employed persons has reduced by 50%. In state-owned enterprises, gross industrial output value, total assets and the quality of management have considerably improved. These reveal how reforms have improved the efficiency of production and effectiveness of management in the state sector. Total profits in the state-owned enterprises have dramatically jumped by 12 times from RMB 525.14 million (US$63.50 million) in 1998 to RMB 6519.75 million (US$788.36 million) in 2005; whereas the total liabilities has also almost doubled in 2005 compared to 1998. This reflects the effect of profit-driven policies applied to state-owned enterprises, which has significantly pushed the profitability of enterprises in the short term, but has also generated side-effects and challenge for their long term competitiveness.

[89] Liu, G.S. & Garino, G. (2001), 'Privatization or Competition – a lesson learnt from the Chinese enterprise reform', *Economics of Planning*, 34, pp35-51.
[90] Zhang, Li (2003), *Make the strong stronger: 21st Century business overview*, Higher Education Publications, Beijing, p46.

Table 1.16 Main indicators of State-Owned and State-Holding Industrial Enterprises

Unit: RMB 100 million yuan

Year	Number of Enterprises (Unit)	Gross Industrial Output Value	Total Assets	Total Liabilities	Total Owners' Equities	Total Profits	Annual Average Employment (million persons)
1998	64737	33621.04	74916.27	35648.27	26759.22	525.14	37.47
1999	61301	35571.18	80471.69	49877.69	30566.88	997.86	33.94
2000	53489	40554.37	84014.94	51239.61	32714.81	2408.33	29.95
2001	46767	42408.49	87901.54	52025.60	35741.27	2388.56	26.75
2002	41125	45178.96	89094.60	52837.08	36139.17	2632.94	24.23
2003	34280	53407.90	94519.79	55990.53	38381.02	3836.20	21.62
2004	35597	70228.99	109708.25	62005.79	47479.25	5453.10	19.73
2005	27477	83749.92	117629.61	66653.58	50625.00	6519.75	18.74

Source: China Statistics Yearbook 2006, p526-528.

Although some state-owned enterprises have been corporatised, they are still not separate from political intervention and administrative responsibilities. They still undertake social responsibilities and staff welfare, which should be undertaken by the Government. Whether the social burden can be stripped out, also depends on a series of changes in the external environment and in government policies. If problems such as price inflation, poor industrial structure and an undeveloped labor market cannot be dispelled through policy reform, the transition of state-owned enterprises can only cause inflation, unemployment and other problems. (Otsuka et al, 1998)[91]

The reform plan initiated in 1993 has played a limited role in promoting labor mobility and market-oriented wages. Accordingly, it usually reflects on the slow progress of some state-owned enterprises in off-loading the burden of insurance for retirement and medical treatment.

1.7.2 Economic Disparities in Regions

The development of the market economy has been unbalanced, with most industries clustered in the east coastal regions, where most foreign companies have set up business. In 2004, the trend of disparities in regional development is becoming even greater by comparison with 2002. This could disadvantage the whole

[91] Otsuka, K., Liu, D. and Murakami, N. (1998), *Industrial Reform in China – past performances and future prospects*, Clarendon, Oxford.

development of the nation, and increase the disparity of income distribution. The existence of unbalanced development can be seen in Table 1.17.[92]

As table 1.17 illustrates, in 2002, exports in ten provinces account for 87.9% of the total export of the country. Cichuan, Xinjiang, Heilongjiang, inner-Mongolia and Shanxi have become the fastest growing provinces. The west of China and the inner-lands, especially in the extreme North and the mountain areas, have remained undeveloped or at a low development level. This is mainly caused by the undeveloped transportation system which isolates them from the outside world. Communications in these areas are often difficult, besides bureaucracy and language difficulties. Telecom services may also be of low reliability. Fax machines are often engaged, telephone calls may be routed to the wrong number and Chinese switchboard operators vary in their helpfulness, competence and knowledge of English to the extent that communication in English is rarely possible in less-developed areas. The poor condition of transportation has caused inefficient business support.

[92] *China's Economy and Trade Yearbook 2005*, Compiled by Committee of Inspection and Administration of State Assets, State Council, China Economy Press, Beijing, p65.

Table 1.17 Exports and Imports for 31 Provinces, Municipalities and Cities of China in 2002 and 2004

Unit: USD$ Hundred Million

Year	2002			2004		
Provinces	**Total of Imp. & Exp.**	Export	Import	**Total of Imp. & Exp.**	Export	Import
Beijing	**525.09**	126.15	398.94	**946.62**	205.75	740.87
Tianjing	**227.55**	115.73	111.82	**420.42**	208.62	211.80
Hebei	**66.66**	45.95	20.71	**135.26**	93.40	41.86
Shanxi	**23.12**	16.62	6.50	**53.82**	40.35	13.47
Inner-Mongolia	**24.41**	8.07	16.34	**37.23**	13.56	23.67
Liaoning	**217.39**	123.65	93.74	**344.37**	189.18	155.19
Jilin	**37.07**	17.68	19.39	**67.93**	17.15	50.78
Heilongjiang	**43.50**	19.87	23.63	**67.92**	36.82	31.10
Shanghai	**726.40**	320.46	405.94	**1600.19**	735.07	865.12
Jiangsu	**702.97**	384.71	318.26	**1708.57**	874.97	833.60
Zhejiang	**419.61**	294.16	125.64	**852.29**	581.59	270.70
Anhui	**41.81**	24.53	17.28	**72.12**	39.37	32.75
Fujian	**284.00**	173.73	111.27	**475.49**	293.96	181.53
Jiangxi	**16.95**	10.52	6.43	**35.29**	19.95	15.34
Shandong	**339.35**	211.09	128.26	**606.75**	358.54	248.21
Henan	**32.03**	21.19	10.84	**66.21**	41.76	24.45
Hunan	**39.53**	20.98	18.55	**54.34**	30.97	23.37
Hubei	**28.76**	17.95	10.81	**67.72**	33.82	33.90
Guangdong	**2211.06**	1184.65	1026.41	**3571.33**	1915.58	1655.75
Guangxi	**24.30**	15.07	9.23	**42.78**	23.86	18.92
Hainan	**18.67**	8.19	10.48	**34.02**	10.93	23.09
Sichuan	**44.69**	27.11	17.58	**38.57**	20.91	17.66
Chongqing	**17.94**	10.91	7.03	**68.72**	39.84	28.88
Guizhou	**6.91**	4.42	2.49	**15.14**	8.67	6.47
Yunnan	**22.26**	14.30	7.96	**37.51**	22.39	15.12
Tibet	**1.30**	0.81	0.49	**2**	1.30	0.70
Shanxi	**22.25**	13.77	8.48	**36.43**	23.97	12.46
Gansu	**8.77**	5.49	3.28	**17.73**	9.96	7.77
Qinghai	**1.97**	1.51	0.46	**5.76**	4.55	1.21
Ningxia	**4.43**	3.28	1.15	**9.08**	6.46	2.62
Xinjing	**26.92**	13.08	13.84	**56.36**	30.47	25.89

Source: *China's Economy and Trade Yearbook 2005*, Compiled by Committee of Inspection and Administration of State Assets, State Council, China Economy Press, Beijing, p65.

Table 1.18 Regional GDP Status 2004 – 2005 (%)[93]

	REGIONS	2004	2005
The Proportion of National GDP by Regions (%)	Eastern	55.4	55.6
	Central	18.9	18.8
	Western	17.1	16.9
	Northeastern	8.7	8.7

Notes: The Eastern region covers 10 cities and provinces – Beijing, Tianjin, Hebei, Shanghai, Zhejiang, Jiangsu, Shandong, Fujian, Guangdong and Hainan. The Central region comprises 6 provinces – Shanxi, An'hui, Jiangxi, Henan, Hubei and Hunan. The Western region includes 12 provinces –Inner-Mongolia, Qinghai, Ningxia, Xinjiang, Tibet, Gansu, Shanxi, Guangxi, Sichuan, Chongqing, Guizhou and Yunnan.

The figures in table 1.18 show large regional imbalances. The GDP in the eastern area is 55.6% in 2005; in the western regions it is only 16.9% and the gap is widening. The GDP percentage of the northestern region is less than one-half compared to the central and western regions.

Due to this unbalanced development, the macro economic controls cannot be applied to all areas. Robert Lawrence Kuhn, managing director of Citigroup and famous US investment expert, suggested that special consideration and policies should be given to enterprises in these areas as it is vital to raise people's income in the backward areas and to improve their living conditions and settle the imbalance in the nation's economic development. It will benefit China's economy in the long-term and stabilize growth. Special attention should be paid to economic development in rural areas, as this has a population of more than 900 million. It is favorable to spur the domestic demand as a whole since raising farmers' annual income can boost farmers' purchasing power.[94]

1.7.3 Paradoxes in Regulation and Deregulation

It is an imperative trend that China's regulatory environment will be deregulated and liberated eventually, when a sound market economy that is totally based on law is completed. Notwithstanding this, it still has a long way to go. China, when it decided to develop a market economy recognized it would have to confront the paradoxes of

[93] *China Statistics Yearbook 2006*, Compiled by National Bureau of Statistics of China, China Statistics Press, Beijing, p41. (Note: The statistics in 2004 is amended by the third China Economic Census on 8th March 2006.)

[94] An interview with Kuhn, R. L. by the reporter of People's Daily, 'Macro-control policies are favourable for the development of China's economy', *People's Daily*, 6th May, 2004. (http://english.people.com.cn/ accessed 18th December 2004)

regulation and deregulation. The process of liberation will be painful, as it will require changes in some essential routines embedded in the Chinese regime; particularly, the leaders of government. For instance, the reforms on state-owned enterprises will remove some potential benefits for bureaucrats and call for less control over the economy from government. It will require a more democratic society and political party. It won't be easy since state bureaucrats often use public enterprise funds for personal expenses and for their own benefits.

Deregulation is urgent in many aspects of the economy in order to achieve a complete market-oriented economy. In China, besides the highly regulated state sector, the limited areas for entry of outsiders and foreigners widely exist. Constraints in foreign currency exchange create obstacles for foreign firms' operations in China. The restricted foreign exchange capital market has hampered domestic enterprises from going to international capital markets. Such high regulations lead to the existence of the so-called 'informal economy', where a great number of firms operate "under cover"[95]. For example, since China has highly restricted the exchange of foreign currency, a black market has emerged to meet the market demand. This not only generates profiteering for speculators, but also leads to the corruption of banking staff who have control over foreign currency cash, because this business requires collaboration between them. There are more examples. The smuggling of foreign cars was prevalent 10 years ago when the import tax was over 150-200%. Smuggling had led to a wide range of corruption in the customs system, when officials were bribed for releasing cars and escaping customs duties. This problem is particularly acute in developing countries. As McKinsey (Farrell, 2004)[96] suggests "*governments must correct the root causes of informality – heavy tax burdens and complex regulatory schemes – and enforce the law more rigorously.*"

When the market is highly regulated, not only can it create an informal economy, but also it can promote the abuse of power of State officials. When government officials have too much power over controlling the rules and laws of the market, it won't be a fair and spontaneous competitive market. Instead artificial barriers discriminate and hamper economic development. For foreigners doing business in

[95] The hidden dangers mean unexposed illegal businesses existing informally in certain market segments that are high regulated, but such informal economy contains dangers and harms for the formal economy and become the counterpart for the formal laws, although the dangers are hidden apparently.

[96] Farrell, D. (2004), 'The Hidden Dangers of the Informal Economy', *McKinsey Quarterly*, No. 3, August 2004.

China, "networks" exist in the business world. This is often known as 'no relationship, no business.'(Zheng, 2006)[97] It cannot be denied that such a highly regulated environment has played a crucial role in forming such relationship networks. According to the OECD (2002)[98], the influence and function of relationships seems to get weaker as market deregulation deepens and a more formal market environment emerges.

1.8 Concluding Remarks

Given this outline of characteristics of market socialism in China, the objective of which is to understand the multitude of variables and dynamics (institutions, characteristics, society, political and economic systems) that shape this market. Since China is formally a socialist country, it has a unique development constituting of a hybrid model of capitalism and socialism, a coexistence of both planned and market-oriented economy. Furthermore, this hybrid market model is also mixed with its historical cultural rich inheritances (such as Confucianism, Taoism and Maoism, feudalism, etc.). This explains why many western theories and models, to a certain extent, become inapplicable to the Chinese context, as these were developed from a different market context. People and enterprises behave differently when they are in a regulated environment.

This chapter has reviewed key forces in the changing business environment in China. It has discussed how government politicians and policies are generating a socialist market economy with dynamic growth rates. Through decades of reform, a hybrid market structure has emerged, which encompasses both public ownership and private ownership, under a combined regime of both planned and market economy. By joining the WTO and continuously absorbing FDI, new opportunities and threats have been created which impact upon local business strategies and management. The inevitable trend of globalization and further market liberation, progress the development of the market economy to becoming more mature. Under this changing macro environment, the process of state sector restructuring is ongoing and it remains a dominant force in market competition. The characteristics of market socialism are

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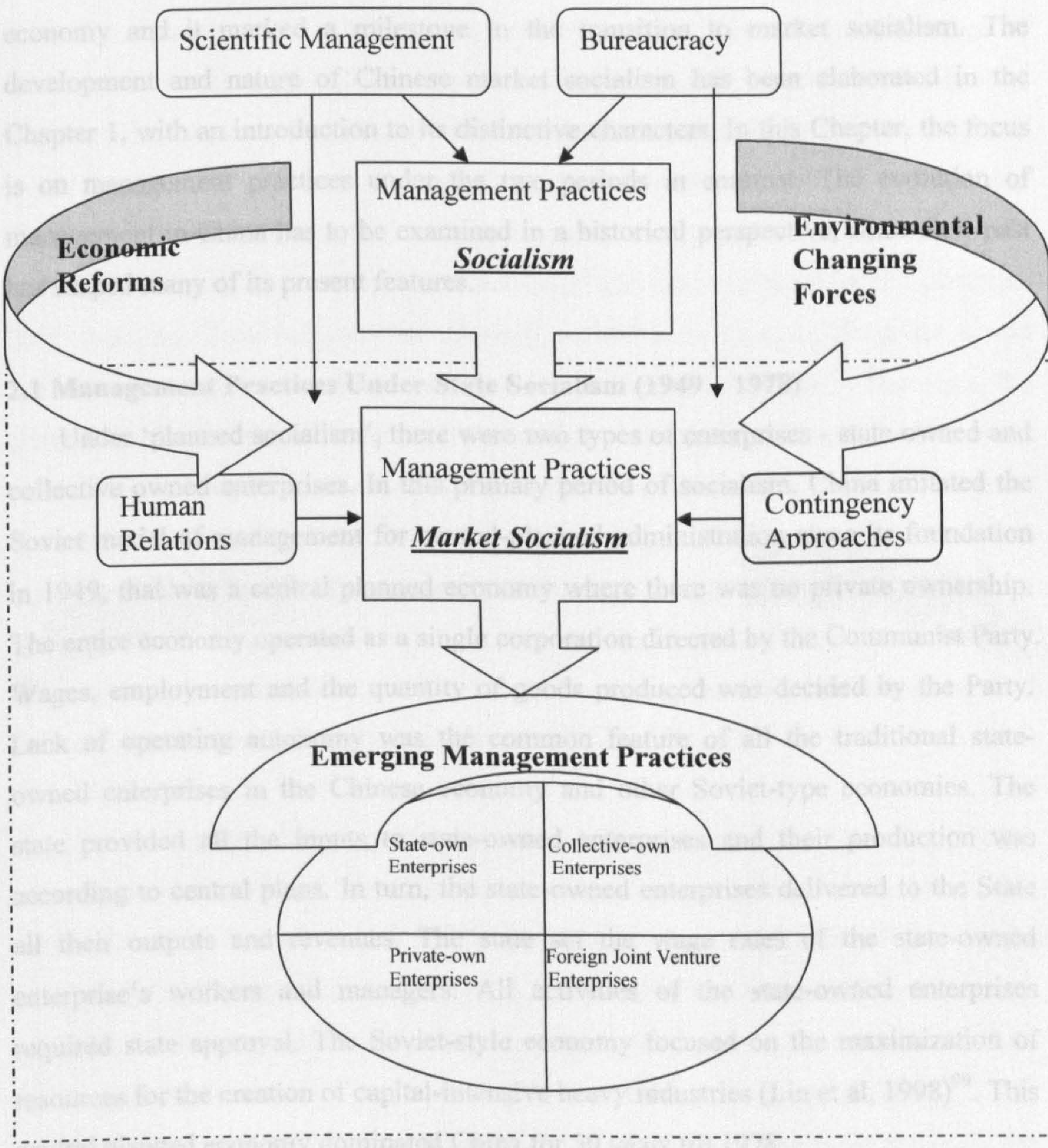
[97] Zheng, P. (2006), 'Success and failure in marketing strategies in China: a case study approach' *Working Paper Series,* No. 131, February 2007, Kent Business School, University of Kent.
[98] OECD (2002), 'An OECD perspective on regulatory reform in China' published as chapter 11 in *China in the World Economy: The Domestic Policy Challenges*, by Scott Jacobs, managing partner, Jacobs and Associates.

the influencing factors that shape Chinese management practices. Understanding these is essential to understanding the characteristics of Chinese enterprises and management structures and processes. The next chapter looks at the development of enterprise management practices. Economic transformations have led to the emergence of new business ventures that will be examined from both macro and micro environmental influences. The case studies introduced in the following chapters will illustrate how these are characterized by contrasting strategies and operational processes. However, before these are discussed, theories and practices of enterprises' management are reviewed by reference to their applicability to the conditions of Chinese market socialism.

CHAPTER TWO:

Emerging Forms of Business Venture under Chinese Market Socialism

Figure 2.1 A Framework for Analyzing the Emergence of Management Practices in China



Introduction

Management practices in China can be assessed from two distinctive phases in its transition – 'socialism' and 'market socialism'. Since the foundation of the People's Republic of China in 1949, highly central-planned socialism dominated in China for three decades. Amidst this phase, some administrative decentralization took place, although these didn't change the efficiency and productivity of Chinese economy significantly. However, it fostered the conditions for structural reforms in later stages of development. The turning point for the official advocacy of a market-oriented economy began in the 80's, headed by Deng Xiao Ping, chairman of the CPC (1978-1997). It was a breakthrough that marked the end of 30-years of planned economy and it marked a milestone in the transition to market socialism. The development and nature of Chinese market socialism has been elaborated in the Chapter 1, with an introduction to its distinctive characters. In this Chapter, the focus is on management practices under the two periods in contrast. The evolution of management in China has to be examined in a historical perspective, since their past has shaped many of its present features.

2.1 Management Practices Under State Socialism (1949 – 1978)

Under 'planned socialism', there were two types of enterprises - state owned and collective owned enterprises. In this primary period of socialism, China imitated the Soviet model of management for central-planned administration since its foundation in 1949; that was a central planned economy where there was no private ownership. The entire economy operated as a single corporation directed by the Communist Party. Wages, employment and the quantity of goods produced was decided by the Party. Lack of operating autonomy was the common feature of all the traditional state-owned enterprises in the Chinese economy and other Soviet-type economies. The state provided all the inputs to state-owned enterprises and their production was according to central plans. In turn, the state-owned enterprises delivered to the State all their outputs and revenues. The state set the wage rates of the state-owned enterprise's workers and managers. All activities of the state-owned enterprises required state approval. The Soviet-style economy focused on the maximization of resources for the creation of capital-intensive heavy industries (Lin et al, 1998)[99]. This central planned economy dominated China for 30 years till 1978.

The central planned economy was regarded as the instrument for the creation of socialism. It was embodied in state ownership, administrated by the enforcement of a powerful State machine. Marx Karl (1818-1883)[100] proposed this theory of socialism as an ideal supposition to replace capitalism. The leader and theorist of the early

[99] Lin, Justin, Yi. Fu, Cai, Fang and Li, Zhou (1998), 'Competition, policy burdens, and state-own enterprise reform' *American Economic Review*, 88 (2), May1998, pp. 422-428.
[100] Marx. K. (1938), *Capital: a critical analysis of capitalist production*, translated from the third German edition by Samuel Moore & Edward Aveling and edited by Frederick Engels, George Allen & Unwin, London.

Russian revolution, Lenin (1870-1924)[101] emphasized the importance of the state machine organizing economic activities within Marx's theory of socialism. He emphasized the power of the state machine as the means for realizing his ideal society, when the state would then whither away. Lenin claimed that at the first stage of communism – socialism – all the citizens became employees (and armed workers) of the state. The whole society would become an administrative unity; it would become a giant factory with fair pay and equal work. After the success of the October Revolution, Russia was the first country to establish a regime of a central planned economy, featured with the enforced authority and administration of the powerful State machine. They believed the aggregation and accumulation of capital would transform the national economy to an 'absolute unified associate trust'. Therefore, the proletarian should take ownership of all productive resources and then, in accordance with a general state plan, all economic activities should be administrated by a central committee of the national economy and its hierarchical subordinates within industrial bureaus. At the same time, the commodity market should be abolished. Following Lenin, Stalin exerted the power of the state machine to extreme limits. He personally characterized the two idiosyncrasies – "State Ownership" and "Central Command and Planned Administration" as the main features of socialism into the Russian textbook of political economy.

The Soviet-type economy was good at mobilizing resources for building priority industry sectors in China. However, the economy was very inefficient due to two main reasons: (i) low allocatable efficiency because of the deviation of the industrial structure from the pattern dictated by the comparative advantages of the economy; and (ii) low technical efficiency because managers had no means to motivate workers and to give them incentives for improving their performance (Lin et al, 1996)[102]. The later economic transition from a planned economy to a market-oriented economy has been attempting to overcome these two vital defects, by implementing reforms in administrative decentralization, autonomy decentralization, privatization, market competitive mechanisms and so forth. In consequence, these economic reforms have generated a managerial evolution in state and non-state sector firms.

[101] Lenin, V. I. (1870-1942), *Selected works in three volumes*, International Publisher, New York.
[102] Lin, Justin, Yi, Fu; Cai, Fang and Li, Zhou (1996), *The China miracle: development strategy and economic reform*, Chinese University Press, Hong Kong.

2.1.1 Ownership Under State Socialism

Under the soviet model, state ownership was embodied in two types of firm; state-own enterprises (SOEs) and collective-own enterprises (COEs). A large number of collective-owned enterprises were established during the 1950s. Taking 'agricultural cooperatives' as the stereotype, these 'Supply and Purchase Cooperatives' and 'Trust Cooperatives' were reconstructed as collective enterprises and integrated into the State's central control system. They were completely controlled by the central government in the central planning system, although there was some common ownership by employees. This was also the ownership form of the majority of small and medium size enterprises (Child, 1994; Liu, 1993; Tian, 1997; Opper, 2001)[103]. State-owned enterprises and collective-owned enterprises were the only legal forms of enterprise allowed to exist in this early socialist period. As mentioned in chapter 1, the emergence of township and villageship enterprises from agricultural cooperatives was a distinctive force for later creating a market economy. Many private enterprises grow out of cooperatives and township and villageship enterprises in the early stage of market socialism. (Bruton et al, 2000)[104] However, in the early stage of state socialism, they were an integral part of the state economy and under complete administrative control of the State.

2.1.2 Nationalization and Industrialization in China

Industrialization and nationalization were initiated in China 1949. At that time, industry in China accounted for only 10% of the total economy. After experiencing a long period of war turbulence, the GDP in 1949 was less than one-half of before the 2nd World War broke out in 1939, and heavy industry was only 30% of what it was in 1937. According to statistics of United Nations in 1947-1949, the development of industrialization in China was low, which steel production about 1/87 of that of the United States, 1/22 of Germany, 1/19 of Russia, 1/14 of Britain, and 1/6 of Japan. Its

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[103] Child, J. (1994), *Management in China during the era of reform*, Cambridge University Press, Cambridge.
Liu, Guo-gang (1993), 'On ownership structure under the market economic structure', *Foreign Broadcast Information Service*, 16 June 1993, p37.
Tian, Xiao-wen (1997), 'The rise of non-state-owned enterprises in China', *Communist Economies and Economic Transformation*, 9 (2), pp219-231.
Opper, S. (2001), 'Dual-track ownership reforms: lessons from structural change in China, 1978-1997', *Post-Communist Economies*, 13 (2), Jun2001, pp205-227.

[104] Bruton, G. D., Lan, Hai-lin and Lu, Yuan (2000), 'China's township and village enterprises: Kelon's competitive edge', *Academy of Management Executive*, 14 (1), Feb2000, pp19-30.

electric production was only 1/35 of the United States, 1/8 of Russia, 1/6 of Britain and Japan. Coal production was equal to 1/9 of the United States, 1/7 of Germany, ½ of Russia, 1/3 of Britain and Japan. (Peng et al, 2004)[105] This was the basis for the socialist reconstruction of industries in the newly-established communist state of China. In line with the Soviet model, the Communist Party focused on heavy industrialization as its main rationale for nationalization. Between 1949 -1956, capitalism, market institutions and the private sectors were abolished. The Stalin-style centrally planned economy was established.

2.1.3 The Nature of Enterprises

Enterprises under a planned economy do not have the same functions as market-oriented enterprises. They become adjuncts of the State administrative organs; all the properties, employees, finance, purchase and sales, productions and supply are decided by state administrative organs or committees. Their economic activities are planned and commanded by the Central Committee of the State. They are departments of the State and they exist as units of production within state bureaucracies, which are led by the Party.

As the traditional state economy was established in line with Lenin's 'State Syndicate Model' – in order to manage the whole society as a whole big factory – the economy was divided in two parts – rural areas and urban areas. The urban areas were organized as a single enterprise with all citizens being employees of the state. State-owned enterprises (Guo Ying Qiye) and collective-owned enterprises (Jiti Qiye) were simply the grass-root production units for the state administrative bureaucracy. The essential tasks for state-owned enterprises (SOEs) and collective-owned enterprises (COEs) were to officiate and to follow the commands and instructions from the higher authorities. They did not need to be creative or innovative. How much and how to produce, what to manufacture, where the raw materials were purchased from, and where the product was sold, were all decided by the planned command from administrative organs of the central government. Neither did the state-owned enterprises or collective-owned enterprises have their own incentives, nor were they possible to make any decisions on the distribution of resources in line with their own benefits and due to changes in the market environment. Nevertheless, they acted as

[105] Peng, G. & Huang W. and Guo, Y. (2004), *Studies on the theory and practice of economic development in China*, The People's University Press, Beijing, pp.257-258.

regulators of the social economy.

Under a state socialist regime that incorporated party, politics and the economy, state-owned enterprises acted not only as units of production, but also as organizations of the Party and State's political system. They had imposed on them a wide-range of social obligations and functions. During the Culture Revolution, these functions of state-owned enterprises were exerted to the extreme as they were regarded as 'the bulwark of proletarian rule'. The state utilized these enterprises as instruments to achieve its political and economic objectives, such as establishing a powerful military industry, and investing in the development of nuclear weapons. Employees in state-owned enterprises and collective-owned enterprises were treated and managed as members of the party and government. Moreover, the state-owned enterprises and collective-owned enterprises took all the responsibilities for employees, such as social security, welfare, medical care, housing and education, providing lifelong service – from the cradle to the grave - for employees (Ding et al, 2004)[106]. People management practices were characterized by centrally planned job allocations, relatively egalitarian reward systems and seniority-based pay awards (Schermerhorn and Nyaw, 1990)[107]. It was a system referred to as 'everyone eating out of one big pot'. This model of management system in state-owned enterprises and collective-owned enterprises was also known as three irons - 'iron rice bowl', 'iron chair' and 'iron wages', which was essentially transplanted from the Soviet-model (Ding and Warner, 2001; Child, 1995)[108]. Within this system, managers had no incentive to make decisions, and they tended to avoid responsibilities. Their career advancement was based on neither merit nor performance but through political favors.

With the 'iron rice bowl' system, from 1949 to the pre-reform time, there was no human resource function in Chinese firms, but only personnel management (renshi guanli). This undertook paper-work processing with recruitment based on a job-assignment plan organized by the state. Each employee had a dang'an (personal file)

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106 Ding, D. Z.; Ge, G. and Warner, M. (2004), 'Evolution of organizational governance and human resource management in China's township and village enterprises', *International Journal of Human Resource Management*, 15 (4), June/August 2004, pp. 836-852.

107 Schermerhorn, Jr. J. R. and Nyaw, M. K. (1990), 'Managerial leadership in Chinese industrial enterprises', *International Studies of Management and Organisation*, 20 (1/2), Spring/Summer 1990, pp. 9-21.

108 Ding, D. Z. and Warner, M. (2001), 'China's labour management system reforms: breaking the "Three Old irons" (1978-1999)', *Asia Pacific Journal of Management*, 18 (3), pp. 314-334.

Child, J. (1995), 'Change in the structure and prediction of earnings in Chinese state enterprises during the economic reforms', International Journal of Human Resource Management, 6 (1), p30.

that recorded birth, family, education and career. These data would be kept in his/her working unit and managed by the personnel departments of enterprises. There was little labor mobility between enterprises, because state-owned enterprises could impose stringent controls on the mobility of their staff by locking-up their dang'an (Yan and Warner, 2001)[109].

In order to understand how the industrial management or administration was carried out in state-owned enterprises and collective-owned enterprises, it is necessary to understand the structure of the planning system that is the Chinese bureaucratic hierarchy. The enterprises, as units of production, were managed through provincial and municipal administrative levels. Larger factories in the priority heavy industrial sectors normally had executive authority concentrated in the hands of their directors – the so-called 'one director management system'. (Child, 1998a) [110] This system contributed to substantial advances in heavy industrial output during the 1950s and the essentials of its planning and administrative structure remain in place today. It was, nevertheless, an imposed approach relying heavily upon bureaucratic top-down direction which did not fit happily with either the efficiency of management in socialist ownership or the demands of autonomy of enterprises.

2.1.4 Administrative Structure of Central Planning System

China's State Planning System is outlined in figure 2.2. (Campbell, 1987) [111] The management of state-owned enterprises and collective-owned enterprises was shared by the Central Government and different levels of local governments (e.g. levels of province or city). As Figure 2.2 shows, some state enterprises reported directly to central ministries others reporting to municipalities (Beijing, Shanghai and

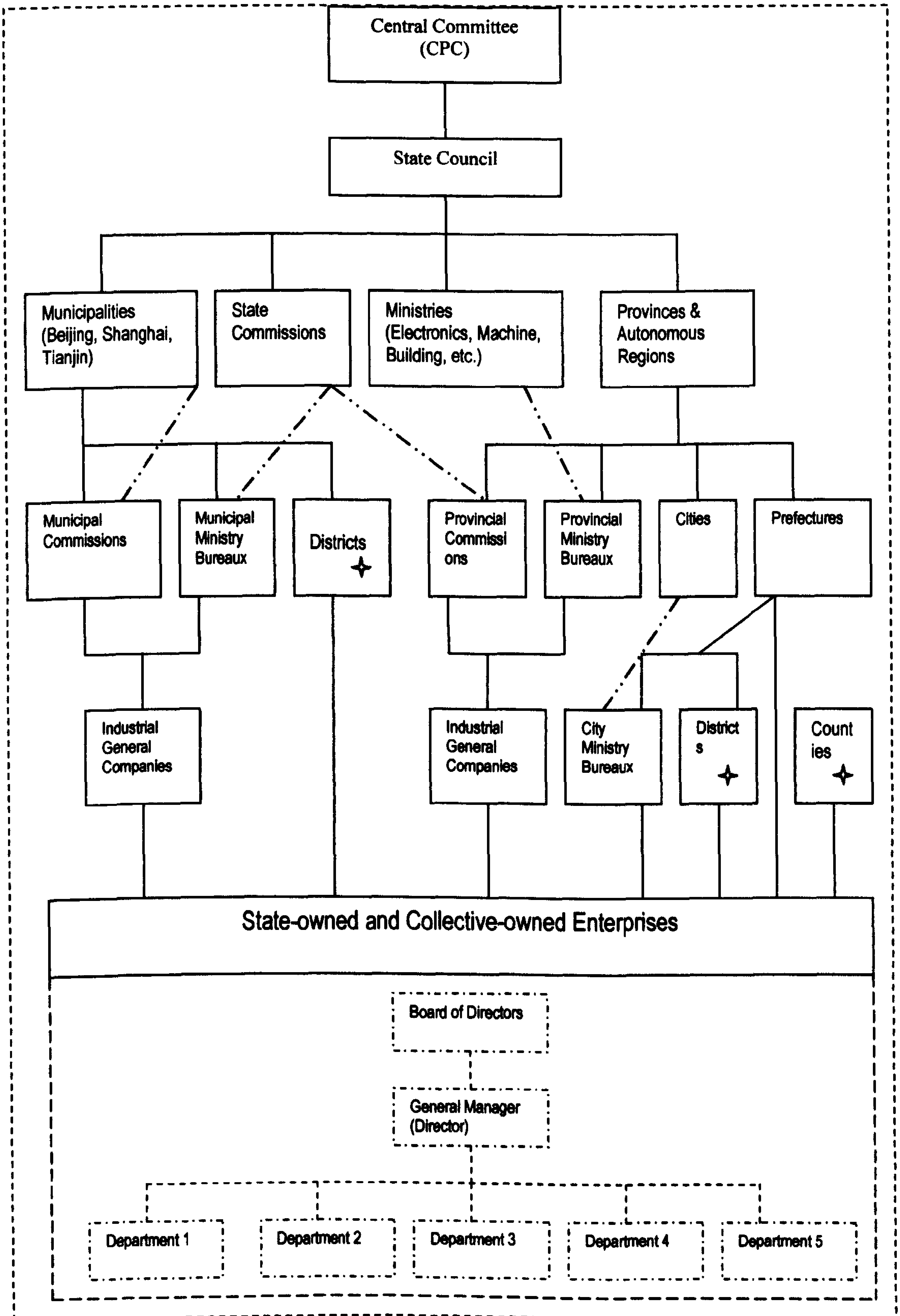
[109] Yan, D. and Warner, M. (2001), 'Sino-Foreign Joint Ventures' versus 'Wholly Foreign Owned Enterprises in the People's Republic of China', *Working Paper, The Judge Institute of Management Studies, Cambridge*, No. 11, Oct2001, p31.

[110] Child, J. (1998a), 'Management and organisations in China: key trends and issues', Chinese Management Centre CMC, School of Business, The University of Hong Kong, *Working Paper*: CMC1998-004-01, September, p25.

[111] Campbell, N. (1987), Enterprise Autonomy in the Beijing Municipality, in the book of 'Management Reforms in China', edited by Malcolm Warner, Frances Pinter (Publishers), Ltd. London, p55.
This framework from Campbell has been modified by adding more hierarchical structures on the top and the bottom, in order to illustrate these relations between hierarchy bureaucracies. On the top of the state council is the central committee led by CPC as the superior top, and down to the bottom – the enterprise's practices, where there are more management hierarchies within their own structure. The structure marked in line of dashes is hypothetical to represent a general imaginary for all SOEs and COEs, which shows the top of the enterprise management, known as the board of directors, however, commonly the general manager or director is responsible for reporting to the upper authorities.

Tianjin) or provincial authorities. The level of central government was made up of municipalities, provinces, ministries and state commissions, and directed and led by the Communist Party – the Central Party Committee. According to the subordinate relationships that state-owned enterprises and collective-owned enterprises were subject to, these enterprises were respectively operated by different levels of hierarchical bureaux. Then, at each level of hierarchy, the operation of state-owned enterprises and collective-owned enterprises was partitioned by a series of departments of local government.

Figure 2.2 China's State Planning System



Note: ✦It indicates that the majority of these are collective-owned enterprises.
Source: adopted and modified after Campbell (1987), p55.

The lower level of local government comprised of the branches of municipalities and the provinces. These bureaux supervised industrial companies, each of which, in turn, controlled the activities of a number of factories and research institutes. Most enterprises needed to report to two higher authorities, which in turn reported to two ultimate bodies – a Technical Ministry and a State Economic Commission. The Municipalities controlled district organizations which supervised smaller enterprises, which were normally organized as collectives. In the provinces the major cities were also divided into districts; some of these districts had ministry bureaux looking after state enterprises. Outside the cities the prefectures controlled state enterprises directly and collective enterprises through their country sub-divisions (Boisot and Child, 1988)[112].

In general, the decisions relating to investment and production were undertaken by the Planning Commission and Economic Commission; those relating to labor management such as recruitment and dismissal, assessment and reward, supervision and inspection for the key management stuff, were mainly undertaken by the Party's Labour department and by personnel departments in central or local government. Under the finance system of unifying revenue and expenditure, the State Fiscal Bureau was equivalent to the finance department of enterprises, managing cash flow, revenue and expenditure, as well as imposing duties, taxes and profits. The Labor Bureau substituted the labor market of a market economy through the means of labor allocation and deciding the policies of human resource management in aspects of recruitment, wages, bonuses and so on.

Due to the absence of markets, these enterprises did not have to consider prices or supply and demand factors. The main task of general managers was to cooperate with the bureaucrats of government organs. They needed to coordinate enterprise activities with government objectives, instead of satisfying the demands of the market. More importantly, they had to constantly negotiate with upper administrative authorities in order to gain access to resources, and to be given achievable rather than excessive production targets. The problematic relationship between state-owned enterprises and central government concerned many economists, who referred to the

[112] Boisot, M. and Child, J. (1988), 'The Iron Law of Fiefs: bureaucratic failure and the problem of governance in the Chinese economic reforms', *Administrative Science Quarterly*, 33 (4), Dec1988, pp. 507-527.

'soft budget constraint' (Kornai, 1980)[113]. In theory, the state should be only responsible for state-owned enterprise losses that arise from policy demands. However, it was always difficult to distinguish between policy-induced losses and the own operational losses of state-owned enterprises or collective-owned enterprises. The managers of state-owned enterprises would ascribe their losses to state's policy burdens, no matter whether the losses were due to their own managerial discretion. Consequently, in most cases, the state in practice was responsible for all the state-owned enterprises' losses. As such, the budget constraints of state-owned enterprises became soft (Naughton, 1994).[114]

Because the prices of inputs and outputs, taxation and capital, were all controlled by the government, enterprises could control their production costs through negotiations with the government. When enterprises encountered financial hardships, the government tended to help them get out of financial difficulty by giving them more preferential loans, fiscal appropriate funds, tax reductions, or permission to increase their prices. 'If such interventions become quite frequent, the norm of the enterprises would be built on the expectation of these interventions.' (Kornai, 1992)[115]

2.1.5 Administrative Decentralization in the Central Planning System

In the middle of 1950s, due to inefficiencies in resources allocation and low productivity, the state economy suffered. The Party and economists ascribed these to the central administration in which all decisions were controlled by the top bureaucratic organs that were removed from enterprise operational activities. It was argued if decision-making of enterprises was decentralized to local government; the performance of management would be improved. Therefore, economic reforms in administrative decentralization were initiated in the state sector by Mao in 1957. This was driving the 'Great Leap Forward' (1957-1960) and later the 'Culture Revolution' (1966-1976). These reasons consisted of the following:

(1) Decentralization of planning to local authorities

This facilitated the formation of local independent economic systems. Local governments decided production plans, the allocation of resource quotas and construction projects.

[113] Kornai, J. (1980), *Economics of shortage*, North-Holland, Holland.
[114] Naughton, B. (1994), 'What is distinctive about China's economic transition? State enterprise reform and overall system', *Journal of Comparative Economics*, 18 (3), Jun1994, pp. 470-491.
[115] Kornai, J. (1992), *The socialist system*, Princeton University Press and Oxford University Press, UK.

(2) Decentralization of enterprise governance to local authorities

Except for a minority of state enterprises, the majority of enterprises (88%) were decentralized to local government for administrative control. The GDP percentage of direct-administrative controlled enterprises was reduced from 39.7% in 1957 to 13.8% in 1958. (Zhou, 1984)[116]

(3) Decentralization of the distribution of supplies to local authorities

The supply of goods distributed by central government declined by 75%. Distribution was allocated to local authorities to which enterprises had to apply for resource allocation.

(4) Decentralization of the supervision of infrastructural construction projects, investments and loans to local authorities.

Investment and construction projects, with limitations, could be approved by local governments. Amounts that exceed certain limitations required plans to be submitted to the State Planning Commission for approval. Local state banks could determine the amount of loans according to local enterprise requests for production and construction.

(5) Decentralization of taxation to local authorities

To enhance and expand the fiscal capability of local governments, various taxes such as estate duty, stamp tax, culture entertainment tax, etc, were allocated to the revenues of local governments. Others were shared with central government.

(6) Decentralization of labor management

The recruitment of employees in all enterprises could be decided at the provincial and municipal levels without the approval of central government. This aspect of decentralization was implemented at the enterprise level, giving some autonomy of labor management to enterprises themselves.

2.1.6 Management Autonomy in State-Owned Enterprises and Collective-Owned Enterprises under State Socialism

After the reforms of administrative decentralization, local governments and collective communes obtained a higher degree of autonomy in terms of their

[116] Zhou, Tai-he (1984), *The reform of economic system in contemporary China*, China Social Sciences Press, Beijing.

capabilities to deploy resources. The operational autonomy extended to state-owned enterprises and collective-owned enterprises included:

(1) Production targets conveyed from the State Planning Commission through different hierarchical levels were reduced from twelve to four – those of production of key products, numbers of employees, wages budgets and retained profits.

(2) The reward system was changed from the old arrangement of "Enterprise Bonuses" to a new arrangement of "Full Amount of profit commission retained". Moreover, the portion of the bonus distribution could be determined by local authorities.

(3) The autonomy of personnel management was expanded. Except for key management staff and technicians, all other employees could be recruited and managed by the enterprise itself. The enterprises had the right to arrange the allocation of employees between jobs as long as this did not increase the total number of employees.

The state-owned enterprises and collective-owned enterprises could use retained profits for paying bonuses to workers, supporting welfare programs, and investing in capacity expansion. Enterprise managerial autonomy was gradually extended through replacing the profit-retention system by a contract-responsibility system in which state-owned enterprises and collective-owned enterprises agreed to deliver predetermined amounts of revenue to the state and retain the residuals. The positive effect from administrative decentralization reforms was to generate some early period of market relations in the gaps of local state protectionism. Such administrative decentralization in a central planned economy fostered the conditions for the emergence of a non-state sector – a market economy.

After the Cultural Revolution, the focus of reforms was to transform the 'autonomy of enterprise management'. But the market economy could not be established on the basis of monopoly state ownership. Since the adaptation of the market-oriented strategy in 1978, state-ownership monopoly has broken down and a non-state sector has emerged. Its growth has enforced the restructuring of state-own enterprises. The new pattern of the socialist market economy is gradually comprised of diversified ownership enterprises, which has led to a new phase of market-oriented socialism.

2.1.7 The Functions of Trade Unions Under Centralized Planned State Socialism

Up to 1927 there were close links between the Party and trade unions. Indeed the Party often played a major role in forming both unions and labour federations. By the mid-1930s, there was a clear shift to a peasant-based strategy of revolutionary change. The Chinese labour unions were not the crucial allies of the Communist Party in the lead up to the 1949 liberation. Unlike some East European societies, the Chinese unions were weak and shadowy organizations such that there was no coalescence of an independent tradition and power base. However, this has not prevented a tale of Party/union conflict in China. Though trade union leaders have never challenged Party control, they have at times tried to carve out a more independent role, resulting in fractional disputes. The All-China Federation of Trade Unions (ACFTU) built up a trade union bureaucracy replacing the remnants of the pre-Revolutionary craft-based unions with a system of industrial unions in 1957. During the period of the Great Leap Forward, there was a partial collapse of the trade union structure and many union cadres were sent to the factory floor. After this, trade unions remained weak organizations with ill-defined functions. (Littler and Lockett, 1983)[117]

Since the late 1970s, the institution of the Workers' Congress was an adjunct of the 'factory management committee' and comprised part of the dual structure of work-place democracy in the Chinese enterprises (Warner, 1995)[118]. After the Cultural Revolution, the state appeared anxious to revive work-place democracy under a unitary system in order to buttress enterprise autonomy. In place of the dual structure preceding the Cultural Revolution, the Workers' Congress was subsequently reactivated, but with no the factory management committees. In 1978, Deng Xiao Ping declared before a national conference of trade unions that 'democratic management should be put into effect and the system of workers' congresses should be established and perfected in all enterprises.' (Ng, 1983)[119]

Starting from Soviet Model, socialism in China has reflected the significance of political conflicts, which affected every aspect of social development and the state economy. The functions of enterprises and the socialist economy changed institutionally in the next phase of market economy transformation. The processes of

[117] Littler, C. R. and Lockett, M. (1983), 'The significance of trade unions in China', *Industrial Relations Journal,* 14 (4), Winter 1983, pp45-78.
[118] Warner, M. (1995), *The management of human resources in Chinese industry*, St. Martins Press, London.
[119] Ng Sek Hong (1983), 'One brand of workplace democracy: the Workers' Congress in Chinese enterprise', *The Journal of Industrial Relations*, 25 (2), p59.

evolution in the early phase of socialism reveal the routines for such market transformation, which are essential to understand the Chinese characteristics of management under market socialism in the next phase.

2.2 Management Practices under 'Market Socialism' (1979 –)

Since 1979, the Chinese Communist Party headed by Deng Xiaoping, who regained power from the 'Gang of Four' in 1976, officially launched reforms in the direction of a market economy. This was a break-through in the old totally-planned economy and endorsed the role of market functions under socialism. 1979 to 1993 marked the first phase of transition for the initial formation of a market economy in which management practices with diversified ownership forms emerged under a 'dual-track' economic system. This was consolidated after 1993, following the adoption of open-door policies, and foreign direct investment absorption.

Forms of ownership under a market-socialist economy can be discussed in two areas – the state owned and the non-state owned sectors. The state sector includes state-owned enterprises and collective-owned enterprises, while the non-state sector includes privately-owned enterprises (individual-owned enterprises and township and villageship enterprises) and foreign joint-ventures. These four types of ownership have evolved with economic reforms and are influenced by such forces as privatization, market deregulation, technology advancement, World Trade Organization accession, globalization and foreign direct investment injection. As Sheehan, Morris and Hassard (2000) [120] state:

"The economic reform process in China, with all its organizational implications, is multifaceted. Included is state-sponsored marketisation, state-sponsored ownership diversity, the infusion of foreign capital, and reform of state-owned enterprises."

Due to limited academic research, management theory is impoverished in China, particularly in the period of centrally-planned socialism. We can only trace the evolution of practices in the light of developments in China. These are now discussed; first, in state sector enterprises followed by an analysis of the features found in the non-state sector.

<u>2.2.1 Managerial Reforms in State-Owned Sector</u>

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[120] Sheehan, J.; Morris, J. and Hassard, J. (2000), 'Redundancies in Chinese state enterprises: a research report', *Journal of Industrial Relations*, 39 (3), July 2000, pp486-501.

Following administrative decentralization, the state-owned enterprises and collective-owned enterprises were managed by local governments and they were given a certain degree of operational autonomy. The contract-responsibility system was replaced a modern corporate system in which the state was entitled to a dividend on its shares in state-owned enterprises' assets. Having fulfilled their compulsory delivery obligations, state-owned enterprises were allowed to sell their above-quota outputs to markets at market-determined prices. The state-owned enterprises and collective-owned enterprises were also permitted to purchase inputs from markets to increase production or to expand production capacity.

Before 1999 when a considerable number of state-owned enterprises had not yet been reformed to the market economy, they were inflexible in structure and governance; weak in technological innovation; heavily in debt; had overcommitted social burdens; overstaffed; low productivity and lacked managerial skills in business operations (Lardy, 1998; Wu, 2003)[121]. Boisot identified four characteristics of state-owned enterprise management in 1987: (1) enterprise performance was hard to define and measure; (2) definitions of responsibility were vague; (3) rewards for good performance were low; (4) and a cost centre mentality prevailed. The organizational culture that prevailed within state-owned enterprises was inward-looking and non-performance oriented. These problems within state-owned enterprises reflected the challenges the state sector must overcome in the transformation of market economy. The traditional state-owned enterprises were the heritage of particularistic 'feudal' relations rather than universalistic 'market' which reforms had to change (Boisot, 1987; Boisot and Child, 1988)[122].

The managerial evolution in state own enterprises from the transition of a command economy to a market-socialist economy had gone through the birth pangs of coping with rapid and severe fundamental changes. When the reforms started in 1979, most state-owned enterprises were profitable. Taxes and revenues from state-owned enterprises and collective-owned enterprises were the government's main

[121] Lardy, N. R. (1999), *China's unfinished economic revolution*, China Development Press, Beijing.
Wu, Jing-lian (2003) *Contemporary China's economic reforms*, Shanghai Yuandong Press, Shanghai.

[122] Boisot, M. H. (1987), 'Industrial feudalism and enterprise reform: could the Chinese use some more bureaucracy?' *In Management Reforms in China*, (eds), edited by Malcolm Warner, Francis Pinter, London.
Boisot, M. H. and Child, J. (1988), 'The Iron Law of Fiefs: Bureaucratic Failure and the Problem of Governance in the Chinese Economic Reforms', *Administrative Science Quarterly*, 33 (4), Dec1988, pp507-527.

sources of fiscal income. However, in spite of a significant increase in productivity, the profitability of the state-owned enterprises had declined substantially since the market-oriented forms started. In the late 90s, more than 40 percent of state-owned enterprises were operating at a loss despite large amounts of implicit subsidies from low interest loans and other state policy protections. The decline in profitability of state-owned enterprises was partly attributable to the dissipation of their monopoly rent. However, increases in wages and other worker fringe benefits were other important reasons. The average annual growth rate of the state-owned enterprise wage fund in the state sector was 16 percent in 1978-1996, while the average annual growth rate of output in the same period was 7.6 percent (Lin et al, 1998)[123].

Prior to economic reforms, managers of state-owned enterprises in China were rewarded primarily on their success in meeting physical output targets set by the government. There was basically no autonomy in firms with respect to many economic activities. The state specified detailed directives for all the state-owned enterprises and collective-owned enterprises to follow, and the exercise of performance evaluation was nearly non-existent, or at least, extremely unimportant (Boisot, 1987)[124]. Since the beginning of reforms, enterprises have increasingly been given more decision-making power concerning production, supply, marketing, financing, pricing, personnel, wages and bonus (Zhou, 1988)[125]. Such changes were reported to be triggered by the demands of managers in state-owned enterprises and collective-owned enterprises for increased autonomy. Equally, the government was also convinced that more delegation of power to the enterprise level would increase operational efficiency (Wu, 2003)[126].

With reforms, rewards were instead based much more heavily on the firms' tax payments and accounting profits. While the tax rate on firms remained high by Western standards, in practice more than three-quarters of retained profits went to firms' managers and workers. The link between accounting profits and employee compensation might if anything have been stronger than in Western firms (Gordon &

[123] Lin, Justin; Yi, Fu; Cai, Fang and Li, Zhou (1996), *The China miracle: development strategy and economic reform*, Chinese University Press, Hong Kong.
[124] Boisot, M. H. (1987), 'Industrial feudalism and enterprise reform: could the Chinese use some more bureaucracy?' *In Management Reforms in China*, edited by Malcolm Warner, Francis Pinter, London.
[125] Zhou, Zhong-hui (1988), 'Chinese accounting systems and practices', *Accounting, Organisations & Society*, 13 (2), Mar1988, pp207-224.
[126] Wu, Jing-lian (2003), *Contemporary China's economic reforms*, Shanghai Yuandong Press, Shanghai.

Lienesch, 1991)[127]. However, Gordon and Lienesch suggest that due to the large difference between accounting prices and market prices, the amount of tax evasion increased quickly during the period as market prices grew with inflation while official prices remained relatively constant.

The resulting loss in tax revenue led the government in 1986-1987 to shift to a contract responsibility system in which each firm signed a contract with the government, typically for three to five years, agreeing to minimum tax payments during each year of the contract. It was also designed as a performance evaluation system of the enterprise, in order to minimize the loss of control brought about by autonomy decentralization (Liu, 1995)[128]. The functions of the contract responsibility system was to achieve three objectives (Xie and Lin, 1992)[129]

- Assure a stable growth in government income
- Change government's control over enterprises from direct to indirect intervention; and
- Create an environment for the emergence of entrepreneurs

The main objective of the system is to encourage entrepreneurialism and stimulate people's inventive to work by specifying certain targets to be achieved and linking their achievements to their reward systems. Basically, this is similar to the budgetary evaluation system in a modern firm (Liu, 1995). Under this system, the Government contracts the enterprise out to be a contractor, which may be an individual, a group of individuals or an entire enterprise. Normally the contractor will be the chief executive officer of the enterprise (Tang et al, 1994)[130]. The contractor commits to fulfilling various targets or production indexes, of which a profit target is normally the major one. A base amount of profit has to be ascertained as a reference for setting the profit targets in each year within the contract period. The contractor may also be rewarded or penalized by means of pecuniary remuneration. Targets and remuneration are negotiated between the government and the contractor for each

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[127] Gordon, R.H. and Lienesch, W. (1991), 'Chinese enterprise behaviour under the reforms', *American Economic Review*, 81 (2), May 1991, pp. 202-207.
[128] Liu, K. C. (1995), 'State control and performance evaluation – the case of state own enterprise in China', *International Journal of Public Sector Management*, 8 (6), Sep1995, pp39-50.
[129] Xie, Q. H. and Lin, Y. F. (1992), *The theory and practice of state assets management*, Economic Science Press, China.
[130] Tang, Y. W.; Chow, L. and Cooper, B. J. (1994), *Accounting and finance in China: a review of current practice*, Longman, Hong Kong.

enterprise, so that the terms of contracts are always different from each other (Li et al, 1993)[131].

The contract responsibility system emerged at a time when there was virtually no system of performance evaluation for state-owned enterprises. It has played a role of introducing the concept of performance evaluation during the course of managerial evolution in China. The system normally works best in profitable enterprises. Those enterprises which are suffering losses are incapable of taking out a contract with the government, because it is difficult for them to guarantee future profits. Moreover, after the government gives the partial right of control and recourse of surplus to the contractor, the boundaries of property rights in state-owned enterprises and collective-owned enterprises becomes even more ambiguous. In subsequence, it exaggerates the conflicts between the contractors of enterprises and the government in the extent to which the tort to the state benefits is susceptibly occurred (Wu, 2003)[132]. Therefore, in late 1993 the contract responsibility system was abandoned by the Chinese government, but the payroll still remained linked to profitability. Total income of employees increased or decreased with the ups and downs of their company's profits.

Generally speaking, the effects of autonomy decentralization and profit retention have been very limited due to the untouched infrastructural administrative institution of the state ownership system. These measurements have improved state enterprise efficiency, particularly in aspects of motivation and decision making, as well as in information transparency. The reduced degree of government direct intervention in the daily operations of enterprises has facilitated the efficiency and effectiveness of enterprise management. However, it can not solve the in-depth structural problems of State-owned Enterprises, such as "soft budgets", multi-objectives, and conflicts of interests. Another negative effect of these reforms is "insider control" (Masahiko and Hyung-Ki, 1995)[133]. As a certain degree of autonomy is decentralized to enterprises, that is de facto to top management. This inevitably leads to a loss of control by the Party over the managers of State-owned Enterprises. The only way to inhibit "insider control" is the administrative intervention from the supervisory bureau of the

[131] Li, W. W.; Yang, J. L.; Chen, Y. and Wang, S. Q. (1993), 'The relationship between the government and state enterprises in China – a study of the contract responsibility system', Institute of national Economy, *Shanghai Academy of Social Science, Working Paper*, No. 12, January 1993.
[132] Wu, Jing-lian (2003), *Contemporary China's economic reforms*, Shanghai Yuandong Press, Shanghai.
[133] Masahiko, Aoki and Hyung-Ki, Kim (1995), *Corporate governance* in transitional economies: insider control and the role of banks, (eds), World Bank, Washington DC.

government. However, this would then mark a return to the shortcomings of the centralized administration system. Enterprise directors are under the supervision of the party committee of the enterprise, but the division of responsibility is vague between them, which often results in inefficient governance. Corruption is frequent when supervision is weak and irresponsible. Under such conditions, some directors with the power of autonomy in management can transfer state capital to personal accounts, causing the losses of state-own assets. Such corruption has been described as 'rent seeking activities' (Wu, 1993)[134]. Steinfeld (1998)[135] has drawn attention to two main causes for rent-seeking behavior in China – one is by agencies having to seek new roles for themselves in the transition from central planning, and the other is by the absence of formal institutions and governance that are essentially required for a functioning market economy.

In November 1993, the Communist Party 14th Delegates Congress determined several key answers to the construction of a socialist market economy which stressed the necessity for enterprise reforms in institutional innovation. It proposed the new system of 'modern corporate institution' to replace the old 'autonomy decentralization and profit retention'. 'The Corporation Law' was implemented in 1st July 1994, and in consequence, a range of 100 state-owned enterprises was selected for the experiment of reforms in institutional corporatization. Until 1997, the party further clarified the need of reforms in corporatization by extending this to medium size state-owned enterprises. One of the primary aims was to reduce government interference in the running of large state-owned enterprises and to encourage them to behave in a more entrepreneurial fashion, enabling them to become internationally competitive firms structured along the same lines as Western corporations with Boards of Directors accountable to shareholders rather than being subject to the political authority of the Communist Party (Sheedhan, Morris, and Hassard, 2000)[136]. In 1999, some emphasis on corporate governance and multiple-investor structure were proposed. Corporatization of state enterprises includes the following processes:

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[134] Wu, Jing-lian (1993), *The theory of 'rent seeking activities' and some negative effect of China's economy*, 2nd ed. China Finance and Economy Press, Beijing.
[135] Steinfeld, E. S. (1998), *Forging reform in China: the fate of state-owned industry*, Cambridge University Press, Cambridge.
[136] Sheehan, J.; Morris, J. and Hassard, J. (2000), 'Redundancies in Chinese State Enterprises: A research Report', *Journal of Industrial Relations*, 39 (3), July 2000, pp. 486-501.

- To achieve the divorce of government administration and enterprise management. Under the command economy, the Chinese government collapsed the role of governance and role of ownership into one body.
- To restructure state monopoly enterprises into competitive modern corporations.

  Under the planned economy, to achieve the economies of scale, there was usually one monopoly enterprise in each industry. Under the market economy, to create competition in the industrial environment, the state has reorganized and restructured state enterprises to create more competitors to break down these monopolies. Take the petroleum industry as an example. Prior to the reforms, the state set up two bureaux – 'Petroleum Industry Bureau' and Petroleum Chemistry Bureau' to manage all the petrol businesses nationwide. After the reforms, these two bureaux were gradually reorganized into three competitive commercial companies – SINOPEC, CNPC and CNOOC. Their business operations are under state supervision, but they do not have the administrative functions of government organs.
- Listing on domestic and international security and stock markets through the reorganization of assets.

  To improve their performance and management, the core assets are stripped from the original state enterprises, and reorganized for initial public offerings (IPO) and listings. The non-core assets, bad debt and redundant staff are retained in the original enterprises, so that the newly-created enterprises can possess the feasibility of IPO and listing with the prerequisite of a good record of performance and quality assets. Normally acquisitions and mergers are often employed by state-owned enterprises to gain strategic growth, IPO and stock market listing.
- Establish a system of independent directors in state owned enterprises.

  The independence is the key for the function of this system. They should be independent business partners, independent of the major shareholders, which are not holding a large percent of shares of the company and are not the representative of any main shareholders' interests. In accordance with the investigation of the Organization for Economic Co-operation and Development (OECD) in 1999, the independent directors in public listed companies accounted for 62% in America, 34% in Britain and 29% in France. China has initiated this system as a compulsory requirement for all public companies in 2001.

As Sheehan, Morris and Hassard (2000)[137] point out *"reforms in this way is intended to make those large corporations subject to a greater degree of market discipline, while avoiding the still very politically sensitive step of privatizing any of the 'commanding heights' of Chinese heavy industry."* But although the Party leadership is keen to stress that this is not a programme of privatization for the largest state-owned enterprises, the modern enterprise system (MES) and the group company system (GCS) reforms are very much concerned with questions of ownership and property rights, suggesting that Chinese leaders have at least 'internalized the logic' of West European-style privatization strategies (Steinfeld, 1998)[138]. Furthermore, since 1995, the reform and restructuring of small to medium sized state-owned enterprises (also called 'grasp large and release small'- zhua da fang xiao) was launched. This allows individuals and private enterprises to buy out small size state-owned enterprises as they are regarded as non-strategic enterprises in the state's economic planning. Some actions as selling-off of enterprise housing to workers, and the sale of shares to individual investors, bring the programme closer to at least partial privatization than the central government seems willing to admit (Zhang, 2000)[139].

Haier is a successful large collective-owned multinational corporation with a state-owned background. It is a good example of the outcome of managerial evolution in the state sector. Haier began as the Qingdao Refrigerator Factory, originally an importer of refrigerator production technologies from Germany. From modest beginnings, the company has grown and expanded into a prospering Chinese multinational corporation whose brand name has been becoming more recognizable in the world community over the last decade. Haier now manufactures a wide range of household electrical appliances in 86 categories with 13,000 specifications, and is now an exporter of these products to more than 160 countries. Haier's global sales in 2002 totaled RMB 71.1 billion (US$ 8.6 billion).[140] The development of Haier

[137] Sheehan, J.; Morris, J. and Hassard, J. (2000), 'Redundancies in Chinese State Enterprises: A research Report', *Journal of Industrial Relations*, Vol. 39, No. 3 July 2000, pp. 486-501.

[138] Steinfeld, E. S. (1998), *Forging Reform in China: The Fate of State-owned Industry*, Cambridge University Press, Cambridge, p34.

[139] Zhang, Xing-quan (2000), 'Housing reform and the new governance of housing in urban China', *International Journal of Public Sector Management*, 13 (6), 2000, pp. 519-525.

[140] Background information for Haier Group available at: www.haier.com (accessed 6th December 2004)

company reflects its success in its managerial evolution. Haier's success can be attributed to its prompt response to environmental changes and its implementation of managerial reforms. The first opportunity to Haier was from autonomy decentralization and the introduction of market mechanisms. As one of the outcomes of this transformational opportunity, Zhang Huimin was appointed as the CEO. His leadership and managerial talent guaranteed the first step of Haier' success. The second opportunity was spurred by Deng Xiao Ping' speech in 1992, which confirmed the direction of market development policy. This inspired Zhang Huimin to form a growth strategy for market competition. To gain the economies of scale, he planned to build Haier to be a giant in household electrical appliances industry with investment of 80 million RMB (US$ 9.7 million). But Haier could not get this large amount of loan through the State banks. As a solution, supported by the government, Haier issued bonds and raised 36.9 million RMB (US$4.5 million) on the stock market, which could be regarded as the third opportunity to boost Haier's outgrowth in a modern corporatised format. Then, China's rapid economic expansion brought about the fourth opportunity to Haier's fast expansion. Haier bought out Qingdao Refrigerator Factory, Qingdao Air-condition Corporation, and Guangdong Aide Company in 1996. These acquisitions allowed Haier to enlarge its market share in the electrical appliance industry and to restructure corporate management and culture. All of these steps in its development gradually formed the resources and capabilities for Haier to compete in the global market place. As a consequence of growth in size, Haier applied the information systems to reenergize its business management system so that the company could react to the market promptly. Within 2 years, Haier successfully integrated a management information system (MIS) across the corporation. The early adoption of this information system was the fifth opportunity for Haier's success. Following further opening-up of the market, Haier's CEO believed that global expansion was the sixth opportunity for its future development. Therefore an international strategy was vigorously promoted. Accompanied with this strategy, Haier evolved its management in a global perspective. It built its competence in both price and quality and established strategic alliances with many international rivals. Haier constructed a learning organization culture to constantly advance its management knowledge to cope with the rapid changing environment. Its famous logistics innovation in supply-chain management provided a pattern and an example for successful Chinese management (Chen et al, 2004)[141]. Valuable lessons can be learned from Haier' success in how state-owned enterprises can be restructured and reformed for their managerial evolution in order to fit into the market economy.

2.2.2 The Emergence of The Non-State Economy

Besides state-owned enterprises and collective-owned enterprises included in the state sector, the other two types of business – privately-owned enterprises (POEs) and foreign joint-ventures (FJVs), are categorized in the non-state sector. In detail classification, privately-owned enterprises can be consequently divided into two spheres with two specifications respectively. One sphere is domestic enterprises which include individual enterprises with fewer than 8 employees and larger private enterprises with more than 8 employees. The other area is that of foreign investment which includes – wholly-owned foreign firms and joint venture firms. In addition, township-villageship enterprises (TVEs) can be regarded as part of the non-state sector. The boundaries between TVEs and private enterprises has blurred over time, since the prolonged reforms in the TVE sector, especially the nationwide campaign to restructure them, has changed the nature and governance structure of TVEs, so that some have been transformed into collective-owned enterprises; others partially privatized, with township and village governments continuing to hold a minority stake; and others even wholly privatized by the sale of the entire stake to managers, employees and/or community residents (Ding et al, 2004)[142]. Although China's Law on township-villageship enterprises, effective on 1 January 1997, officially defined township-village enterprises as "*different types of enterprises that are established in townships (including villages under their jurisdiction) with the bulk of capital being invested by the rural economic collectives or farmers.*" (Che and Qian, 1998)[143]

2.2.3 The Development Path of The Non-State Economic Sector

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[141] Chen, J. C. H.; Lin, Bin-shan.; Li, Ling-li. and Chen, P. S. (2004), 'Logistics management in China: a case study of Haier', *Human Systems Management*, 23 (1), 2004, pp. 15-27.

[142] Ding, D. Z.; Ge, G. and Warner, M. (2004), 'Evolution of organizational governance and human resource management in China's township and village enterprises', *International Journal of Human Resource Management*, 15 (4), June/August 2004, pp. 836-852.

[143] Che, J. H. and Qian, Y. (1998), 'Institutional Environment, Community Government, and Corporate Governance: Understanding China's Township-Village Enterprises', *Journal of Law, Economics and Organization*, 14 (1), pp.1-23.

The development of the non-state economic sector initiated in 1978, started to break down the ideological obstacles of the soviet model after 1997. This sector's prosperity made a remarkable contribution to the growth of the whole economy. In general, the gradual evolution of the non-state sector into a market structure proceeded through the following paths (Garnaut et al, 2001; Ho, 1994)[144]:

(1) The Liberalization of Individual Businesses

In 1979 after the Cultural Revolution, a good deal of intellectual youth who were sent to the rural counties for re-education, returned to the urban cities. This generated employment pressures and so the government opened up the economy for entrepreneurship. On July 1981, the state council issued laws to clearly define the boundaries of enterprises as 'businesses employing fewer than 8 as the divide between individual enterprises and private enterprises'. As in the early 80s, enterprises hiring more than 8 employees were regarded as 'exploiters' and not part of a socialist economy.

(2) The Prevalence of 'The Contract Farm' On The Basis of the Peasant's Family

From 1980 to 1982, the contract responsibility system prevailed in rural areas after the commune system was dissolved. Peasants with contracted responsibilities were permitted to set up their own family farms on the collective owned lands in their villages. Officially it was called 'collectively-owned corporation economy', although de facto it was a private ownership economy.

(3) The Development of Township-Village Enterprises

During the 80s, the development of township-villageship enterprises prospered and became an important component of the national economy, as well as the key supporting force for economic growth in the 1990s. Total industrial production of township-villageship enterprises reached RMB 160 million (US$ 19 million) in 1992, accounting for 35 per cent of total national industrial production. Employment in township-village enterprises exceeded 100 million people and equaled to total employment in state-owned enterprises in the same year (Chen, 1994)[145]. There is consistent evidence that township-villageship enterprises outperformed state-owned enterprises in productivity growth (Wu, 1995; Jefferson,

[144] Garnaut, R.; Li, G. S.; Yang, Y. and Wang, X. (2001), *Private Enterprise in China*, Asia Pacific Press, Australia.

Ho, S. (1994), Rural China in Transition: Non-agricultural Development in Rural Jiangsu, 1978-1990. Oxford University Press, Oxford.

[145] Chen, N. X. (1994), *The study on direction of policy for township-village enterprises in China*, Economic Management Press, Beijing, p262.

1999)[146], even though township-village enterprises in general had low-technology production methods and obtained technical expertise from state-owned enterprises (Peng et al, 1997).[147] Many township-villageship enterprises adapted an export-oriented development strategy. The exports of township-villageship enterprises had an annual growth rate of 10 percent for five successive years from 1995 to 2000. In 2000, the total value of exports by township-villageship enterprises reached RMB 867 billion (US$ 105 billion), accounting for one third of China's total exports.[148]

Township-villageship enterprises in different areas illustrate different characteristics, and their ownership structures are various. Based on their sources of initial investment, structure of ownership, industrial orientation, income distribution and management systems, Chinese economists (Chen, 1998; Zuo, 2001)[149] have classified township-village enterprises into three models:

- The southern Jiangsu model (Sunanmoshi), characterized by a dominant initial investment by township and village government.
- The Wenzhou model (Wenzhoumoshi), featuring private ownership under the disguise of the 'red hat', i.e. officially 'socialist';
- The Pearl River Delta model, (Guangdongmoshi), distinguished by foreign direct investment and export-oriented manufacturing.

(4) The Expansion of Foreign Joint Ventures During Liberalization

In 1979, the enactment of "Corporation Law of Sino Joint Ventures" (Zhongwai Hezi Qiye Fa) marked the turning point in the market transition from forbidden foreign direct investment (FDI) to encouraging FDI into China. The main focus of this strategy was to gain advanced technology and to learn modern management experience from foreign companies, in order to enhance the competitiveness of indigenous firms. The old strategy of import substitution for China's industrial development is then replaced by an export-oriented strategy driven by

[146] Wu, Yan-rui (1995), 'Productivity growth, technological progress, and technical efficiency change in China: a three sector analysis', *Journal of Comparative Economics*, 21 (2), Oct1995, pp.207-230. Jefferson, G. H. (1999), 'Are China's Rural Enterprises Outperforming State Enterprises? Estimating the Pure Ownership Effect'. In Jefferson, G. H. and Singh, I. (eds) *Enterprise Reform in China: Ownership, Transition, and Performance*. Oxford University Press, New York, pp. 153-170.
[147] Peng, Y.; Zuck, L. G. and Darby, M. R. (1997), 'Chinese Rural Industrial Productivity and Urban Spillovers', *NBER Working Paper, No. 6202*. National Bureau of Economic Research, Cambridge.
[148] China's Township and Village Enterprises Daily, 9th July, 2001.
[149] Chen, J. Y. (1998), *Township and Village Enterprises Model Studies*, China Social Science, Beijing. Zuo, Z. (2001), 'Characteristics and Origin of Pearl River Delta Model', *Journal of Economics & Management Strategy*, 10 (3), pp435-461.

liberalization and foreign direct investment. From 1979 to 1988, the Chinese government established 5 'economic development zones' and initially assigned opening 14 coastal cities as experimental frontiers for the implementation of its marketisation policy. Since the mid-90s the country has been the second large recipient of foreign direct investment worldwide (after USA). This is due to two factors at large: investment incentives offered by Chinese government and the county's abundance of low-cost labor. The expansion of foreign joint-ventures in the market have brought new western management concepts into indigenous firms, and improved the competitive market environment (Warner, 2004; Wong and Salter, 2002; Jiang, 2006)[150]. In the 1980s and 1990s, China's employment pattern and economy has been characterized by the downsizing of the state sector and the fast-growing share of foreign direct investment companies and joint-ventures in the country. Figure 2.3 illustrates this trend. Annual average number of employees in foreign-invested enterprise has increased from 7.75 million in 1998 to 18.99 million persons in 2005 whereas number of employees has declined in state-owned enterprise from 37.47 million in 1998 to 18.74 million in 2005. Therefore, foreign direct investment firms and foreign joint-ventures are major employers that rely heavily on the rural labor force, offering nonstandard (often in the form of temporary) employment on a large scale. As a result, the employment policies and practices of these firms have a strong bearing on reshaping the pool of human resources and the experience of work for a significant proportion of workers in China (Cooke, 2004)[151].

[150] Warner, M. (2004), ''Late development' experience and the evolution of transnational firms in the People's Republic of China', *Asia Pacific Business Review*, 10 (3/4), Spring/Summer 2004, pp. 324-345.
Wong, A. L. Y. and Salter, J. R. (2002), 'Executive development in China: is there any in a Western sense?', *International Journal of Human Resource Management*, 13 (2), Mar2002, pp.338-360.
Jiang, Fu-ming (2006), 'The determinants of the effectiveness of foreign direct investment in China: an empirical study of joint and sole ventures', *International Journal of Management*, 23 (4), Dce2006, pp.891-908.

[151] Cooke, F. L. (2004), 'Foreign firms in China: modelling HRM in a toy manufacturing corporation', *Human Resource Management Journal*, 14 (3), 2004, pp. 31-53.

Figure 2.3 Annual Average Number of Employees in Different Types of Enterprise Ownership[152]

Unit: 10, 000 persons

YEAR	State-Owned Enterprise	Privately-Owned Enterprise	Foreign-Invested Enterprise
1998	3747.78	160.8	775.19
1999	3394.58	229.06	791.86
2000	2995.25	346.42	852.96
2001	2675.11	541.52	938.98
2002	2423.63	732.90	1054.34
2003	2162.87	1027.61	1258.67
2004	1973.20	1515.43	1755.26
2005	1874.85	1692.06	1899.52

Source: China Statistics Year Book 2005, p526-549.

(5) The Legitimatization of Privately-Owned Enterprise

After this process of reform in the early 80s, China's economy was finally opened to foreign investment and for individual businesses. But private businesses (which hired more than 8 employees) were still regarded as abandoned capitalism. But following the growth of the market, private enterprises expanded greatly in the mid-1980s. The Communist Party headed by Deng Xiaoping was determined to admit to the existence of a private economy. Until 1988, the development of the private sector economy was subsumed in an amendment of the Constitution in the 7th People Delegate Congress (Qian, 1993)[153].

Private enterprises were initially permitted as a supplement to the state and collective sectors. Private enterprises first took hold in the rural sectors, as an outgrowth of the virtual privatization of agriculture, and in small-scale individual enterprises in the urban sectors. During the mid-1980s, large private enterprises grew out of these rural and individual enterprises, and out of collective-owned enterprises and state-owned enterprises. Some were sole proprietorships that grew and hired more employees. By 1988, when private firms were officially recognized, China had 500,000 individual enterprises that could be called private

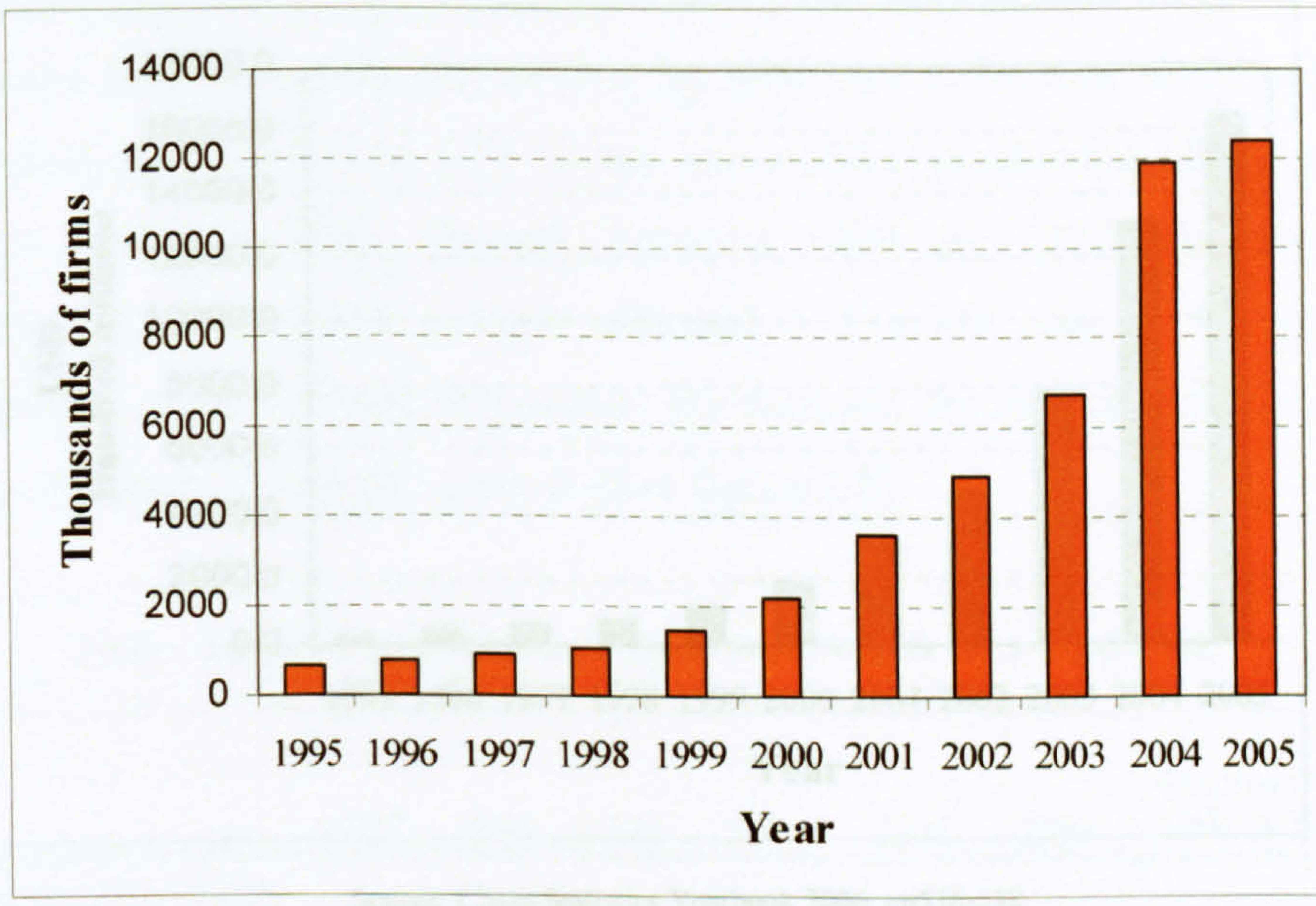
[152] *China Statistics Year Book 2005*, compiled by National Bureau of Statistics of China, China Statistics Press, Beijing, p526-549.
[153] Qian, Ying-yi (1993), *Contemporary economics and China economic reforms, China People's* University Press, Beijing.

firms (Gregory and Tenev, 2001).[154] The change in political sentiment following the voice of protest from some conservative socialists opposed to the emergence of private enterprise caused a temporary setback to the growth of private enterprise. But Deng Xiaoping famous 'south talk' and 'south tour' in September 1992 opened the way for renewed growth. During the 1990s, the government encouraged the privatization of smaller, non-strategic state-owned enterprises and allowed collective-owned enterprises to transform into private enterprises. In 1997, 4,180,000 laid-off workers and employees in the state sector found new work in the private sector. (Zhang, 2002)[155] The number of registered private firms rose from 655 thousand in 1995 to 12 million in 2005, the average growth rate reached 94.5%; Employment in the private sector increased from 9.56 million in 1995 to 169.2 million in 2005, almost 18 fold increment. Relevant production and value added of private industry all mounted up dramatically (See figure 2.4; 2.5; 2.6; 2.7). As Gregory and Tenev (2001) says,

"It is evident that new employment in the private sector has exceeded the combined total for state, collective, and township-and-village enterprises. This explosive development is in sharp contrast to the decline of the State-owned Enterprises and Collective-owned Enterprises. The Private sector has become an important source of job creation, absorbing a significant number of workers laid off from State-owned Enterprises."

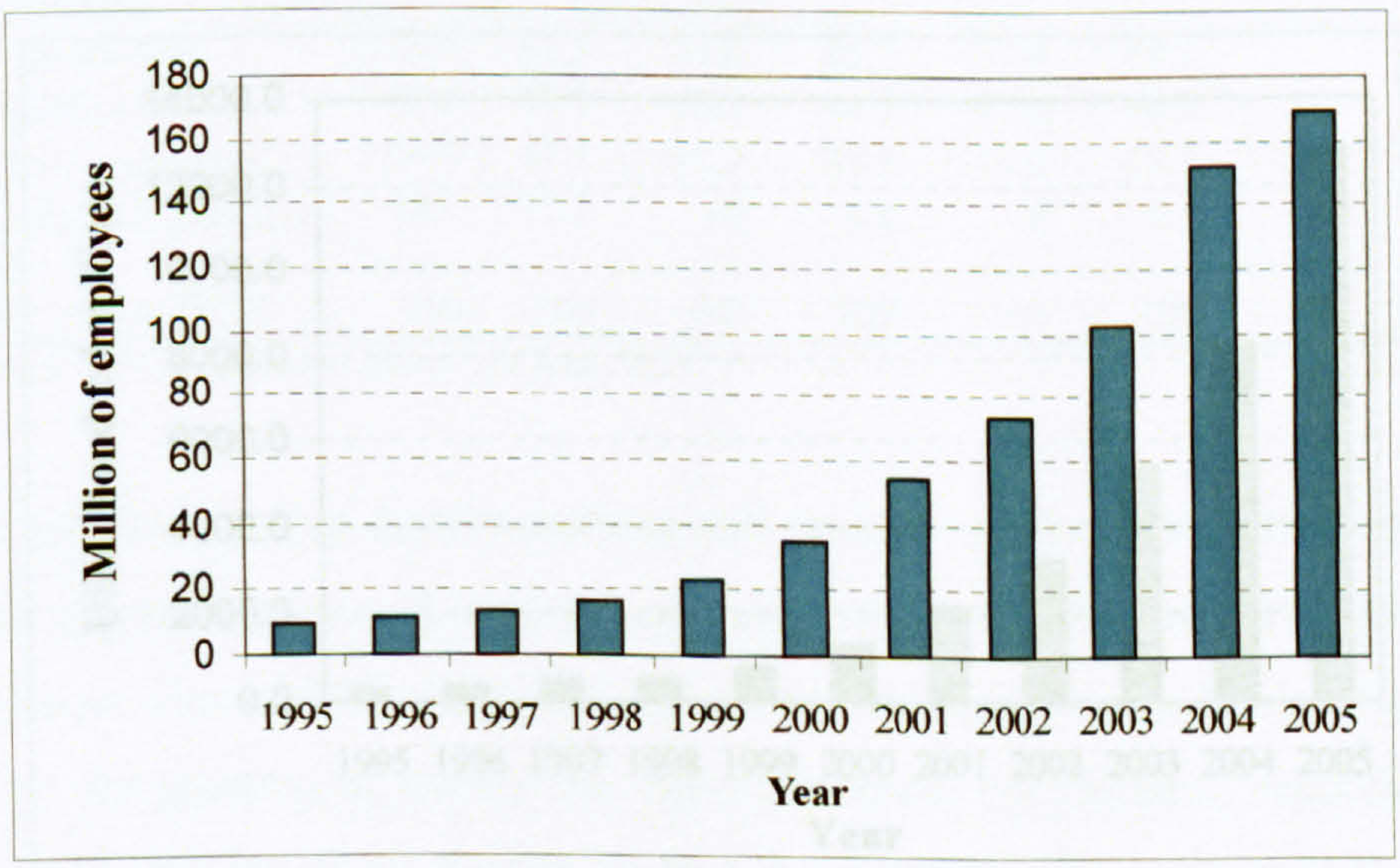
[154] Gregory, N. and Tenev, S. (2001), 'Special Report: China's Private Sector – China's Home-Grown Entrepreneurs', *The China Business Review*, 28 (1), Jan/Feb2001, pp. 14-18.
[155] Zhang, H. W. et al (2002). *The development report of private enterprise in China 2001*, Social Science Literature Press, Beijing.

Figure 2.4 Development in Number of Private Industrial Enterprises



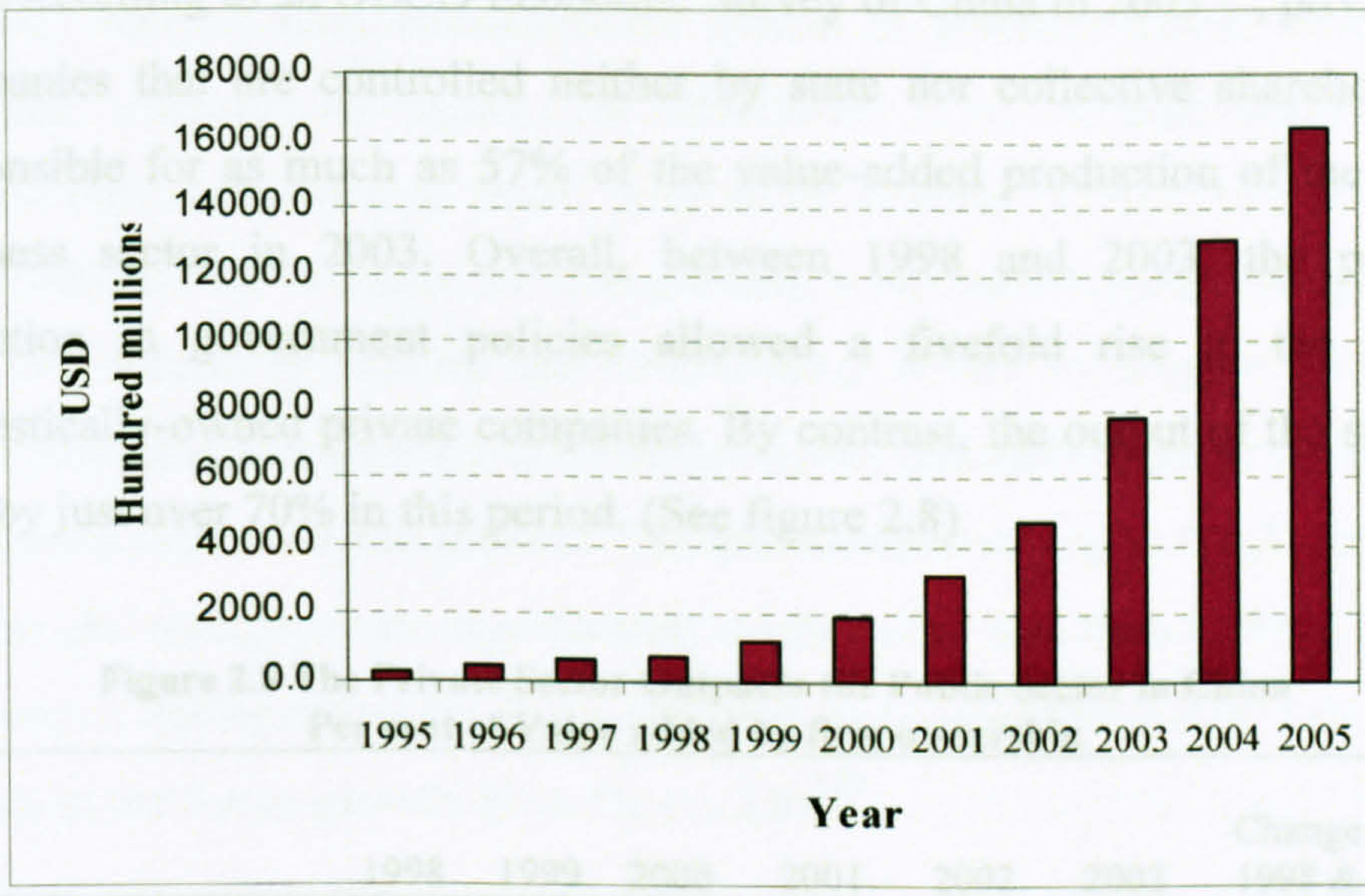
Source: China Statistics Yearbook 2006, pp536-538

Figure 2.5 Development in Number of Employees in Private Industrial Enterprises



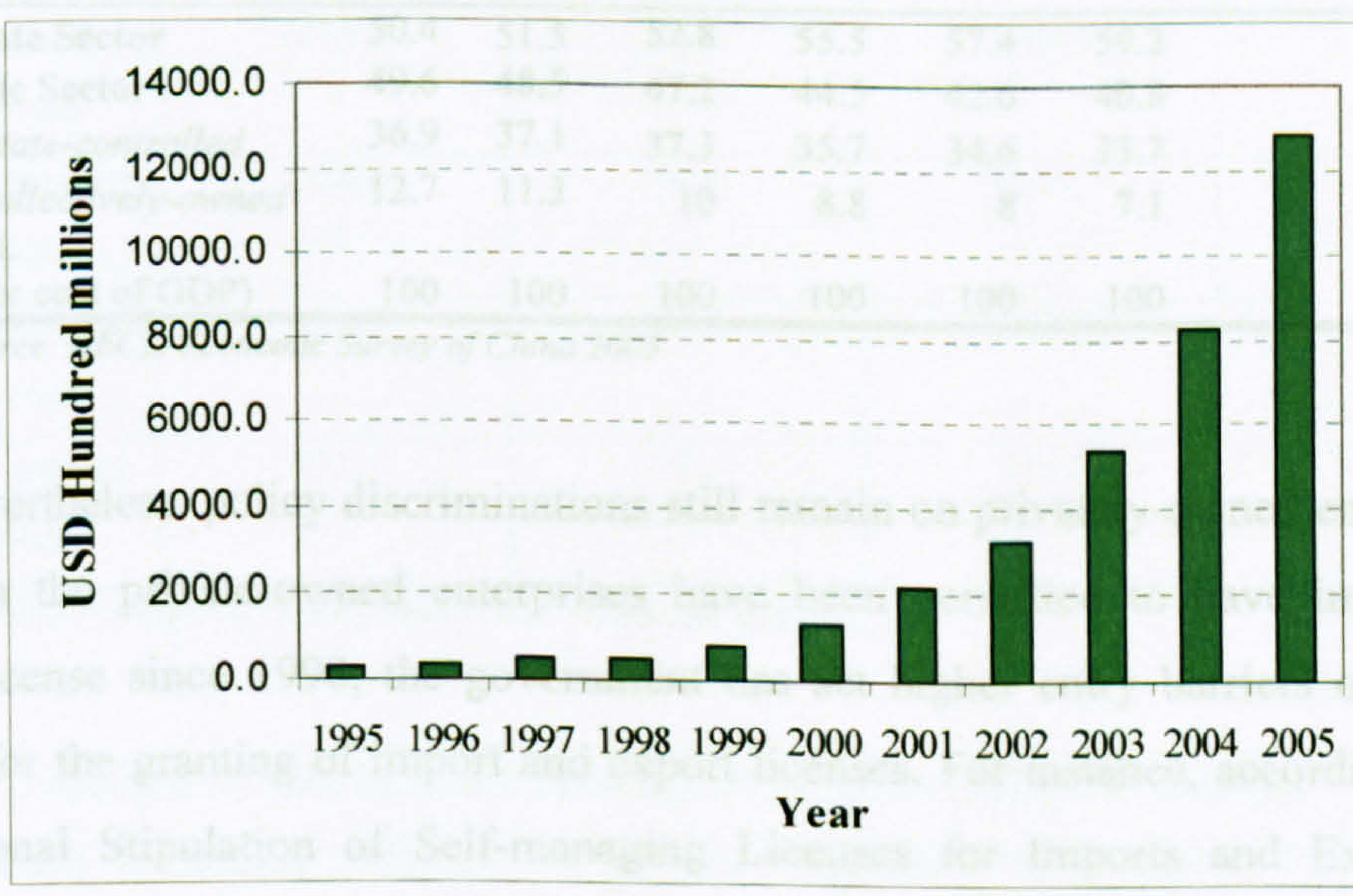
Source: China Statistics Yearbook 2006, pp536-538

Figure 2.6 Development in Total Working Capitals[156] of Private Industrial Enterprises



Source: China Statistics Yearbook 2006, pp536-538

Figure 2.7 Development in Value Added of Industry[157] of Private Industrial Enterprises



Source: China Statistics Yearbook 2006, pp536-538

[156] **Working capitals** refer to capitals that an enterprise can cash or use during one year or one production cycle that may exceeds one year, including cash and savings deposits of various forms, short-term investment, money receivable and prepaid money, inventories, etc. (China Statistical Yearbook 2006, p574)

[157] **Value added of industry** refers to the final results of industrial production of industrial enterprises in money terms during the reference period. Value-added of industry in this China Statistical Yearbook is calculated by production approach as follows:

Value-added of industry = gross industrial output – industrial intermediate input + value-added tax (China Statistical Yearbook 2006, p574)

According to an OECD Economic Survey of China in 2005[158], private-owned companies that are controlled neither by state nor collective shareholders, are responsible for as much as 57% of the value-added production of the non-farm business sector in 2003. Overall, between 1998 and 2003, the progressive evolution in government policies allowed a fivefold rise in the output of domestically-owned private companies. By contrast, the output of the state sector rose by just over 70% in this period. (See figure 2.8)

Figure 2.8 The Private Sector Outpaces the Public Sector in China
Per cent of Value added by firm ownership

	1998	1999	2000	2001	2002	2003	Change (over 1998 & 2003)
Non-farm business sector							
Private Sector	43	45.3	47.7	51.8	54.6	57.1	14.1
Public Sector	57	54.7	52.3	48.2	45.4	42.9	- 14.1
State-controlled	40.5	40.1	39.6	37.1	35.2	34.1	- 6.4
Collectively-owned	16.5	14.7	12.7	11.2	10.1	8.8	- 7.7
Total (79 per cent of GDP)	100	100	100	100	100	100	
Economy-wide							
Private Sector	50.4	51.5	52.8	55.5	57.4	59.2	8.8
Public Sector	49.6	48.5	47.2	44.5	42.6	40.8	- 8.8
State-controlled	36.9	37.1	37.3	35.7	34.6	33.7	- 3.2
Collectively-owned	12.7	11.3	10	8.8	8	7.1	- 5.6
TOTAL (100 per cent of GDP)	100	100	100	100	100	100	

Source: OECD Economic Survey of China 2005

Nevertheless, policy discriminations still remain on privately-owned enterprises. Although the private-owned enterprises have been permitted to have import and export license since 1998, the government has set higher entry barriers on private owners for the granting of import and export licenses. For instance, according to the "Provisional Stipulation of Self-managing Licenses for Imports and Exports by Privately-Owned Enterprises" by the Ministry of Foreign Economy and Trade, the conditions for the granting of licenses to privately-owned enterprises, must be: (1) net assets above RMB 850 million (USD$103 million); (2) net annual sales revenues above RMB 300 million (USD$ 36 million); (3) the possession of teams of

[158] OECD (Organisation for Economic Co-operation and Development) *Economic Survey of China 2005: chapter 2 - Improving the productivity of the business sector*, 16th September 2005.

professionals and specialists in the import and export business (Sun, 2005).[159] Such higher entry barriers have restricted the growth of privately-owned enterprises in international markets. As figure 2.9 illustrates, it is obvious privately-owned enterprises only contribute a small portion of exports (USD$692.5 billion) and imports (USD$419.8 billion) by comparison with state-owned enterprises with USD$1535.9 billion of exports and USD$1764.5 billion of imports in 2004. The dominate players in foreign trade are foreign-owned enterprises which account for the majority share of exports and imports. The growth rates of export (99.3% and 70.8%) for the private enterprise are significantly higher than the state sector (11.4% and 23.9%), which demonstrates the huge potential of competitiveness of private-owned enterprises in the future growth. (See Figure 2.9)[160]

Figure 2.9 China Foreign Trade Composition by Enterprise Ownerships in 2004

Unit: Billion USD$ and per cent[161]

Economic Components	**Export**		**Import**	
	Amount	Growth Rate (%)	Amount	Growth Rate (%)
Total	4922	35.4	5010.2	36.0
State-owned Enterprises	1535.9	11.4	1764.5	23.9
Foreign-Invested Enterprises	3386.1	40.9	3245.7	40.0
Collective-owned Enterprises	317.9	26.5	177.2	33.9
Privately-owned Enterprises	692.5	99.3	419.8	70.8

Source: China Foreign Economy and Trade Yearbook (2005), p64.

2.2.4 Management Practices in the Private Sector under Market Socialism

China's increasing reliance on private companies as a motor for economic growth and new jobs has received official confirmation in a national survey showing

159 Sun, Yu-chin (2005), *The effect of economic reforms on the foreign trade systems*, University Press of Foreign Economy and Trade, Beijing, p153-154.

160 *China Economy and Trade Yearbook (2005)*, Compiled by Committee of Inspection and Adminstration of State Assets, State Council, China Economy Press, Beijing, p64.

161 The level approach is applied to calculating percentage of growth rate in this table, which is derived by comparing the level of the last year of the interval with that of the beginning year. The statistics in this table is adopted from:
China Foreign Economy and Trade Yearbook (2005), compiled by the Committee of Inspection and Administration of State Assets, State Council, China Economy Press, Beijing, p64.

them outpacing the economy as a whole (McGregor, 2004)[162]. Unlike the large size of state-owned enterprises, private enterprises are normally small to medium size. On the whole, small and medium-sized enterprises are extremely important for providing social stability and incomes in the provinces. They are most common in labor-intensive industries, constituting an enormous sphere of employment and a significant source of local revenues at district and county levels. Small and medium-sized enterprises are close to the market and to the customer, and with their flexible operating mechanisms and high potential for renewal; they help expand the scale of the market economy. They are active in spheres where large enterprises do not yet or cannot operate, filling in market niches and engaging in multiple product lines, small-series production and service. Production costs are often lower for small and medium-sized enterprises than for large enterprises, and their simple operating procedures allow these smaller enterprises to accommodate new systems in their businesses fairly painlessly (Fan, 2002).[163] Since the beginning of reforms, the modernization of management systems has taken place mostly in small and medium-sized enterprises. Contracting, leasing, mergers, auctions, bankruptcies, and other reform measures were tried first in small and medium-sized enterprises, where they became widespread (Peng et al, 2004; Sun and Duan, 2003)[164].

2.2.4.1 Characteristics of Privately-Owned Enterprises

Private enterprises are organized in a very informal way because of how the domestic private sector emerged from its history; in the shadow of the state economy. Many private enterprises possess only the vaguest of property rights, ownership structures, corporate governance mechanisms, financial records, and rights to market access. The policy environment to date has heavily favored state-owned enterprises, whether in providing access to markets or to finance. Since 2005, private enterprises have been allowed to establish businesses in many previously restricted areas, such as infrastructure, public utilities and financial services (OECD, 2005).[165] However,

[162] McGregor, R. (2004), 'Chinese growth bound tightly to private sector', *Financial Times*, Friday 27th August, 2004.
[163] Fan, Chun-yun (2002), 'Government support for small and medium-sized enterprises in China', *Problems of Economic Transition*, 45 (11), Mar2003, pp.51-58.
[164] Peng, G.; Huang, W. P. and Guo, Y. S. (2004) *Studies on theory and practice of economic development in China*, China People University Press, Beijing.
Sun, Li. and Duan, Ya-bing (2003), *The development path to the small and medium-sized enterprise: the rise of small giant*, China Times and Economies Press, Beijing.
[165] *OECD, Economic Survey of China 2005*, chapter1: key challenges for the Chinese economy.

policy discrimination is still significant for this privately-owned sector (Li, et al, 2004)[166].

This informality gives entrepreneurs great flexibility to respond to an uncertain business environment composed of unclear and rapidly changing government policies, taxes, and regulations. But it hampers their ability to raise capital, reward managers and employees, and operate efficiently. Due to lack of management skills and professional managers, private enterprises tend to be stuck in a framework of legal, financial, and governance structures that they have outgrown them in terms of the size and complexity of their businesses. In private enterprises, entrepreneurs are the spirit of organization as they start up their enterprises and take the direct and central supervision for management. They make all the decisions and take all the risks for business ventures. Their success or failure determines the fate of their enterprises. As Schlevogt (2001)[167] has suggested, the private Chinese organizational model tends to be very centralized with an informal structure and strong entrepreneurship that emphases enterprise networks and traditional cultural values. These distinguish them from state-owned enterprises and collective-owned enterprises.

2.2.4.2 Family-Owned Enterprises' Management Style

A "family-style management" is a significant feature for a great deal of private enterprises, as a large portion of them have been developed from individual and family-owned businesses. The start-up owners are usually the president or CEO which control the majority or the total shareholding of the company with absolute authority. The phenomenon can be termed 'dictatorship by the owner-manager' (Montagu-Pollock, 1991)[168]. Other core members of the family are often in charge of important positions in the company, which comprise the hierarchical level of core decision-making. Their relatives and friends normally form the management group in charge of daily operations and routines. Outside the hierarchy of family and relatives are the regular employees. This pattern shapes the traditional hierarchy of family-style businesses (Sun and Duan, 2003; Yun and Chen, 2000; Schlevogt, 2001).[169] Whyte

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[166] Li, Shao-min; Ian, V. and Zhou, Dong-shen (2004), 'The emergence of private ownership in China', *Journal of Business Research*, 57(10), 2004, pp.1145-1152.
[167] Schlevogt, K. A. (2001), 'The Distinctive Structure of Chinese Private Enterprises: State versus Private Sector', *Asia Pacific Business Review*, 7 (3), Spring 2001, pp.1-33.
[168] Montagu-Pollock, M. (1991), 'All the Right Connections', *Asian Business*, 27 (1), 1991, pp. 20-24.
[169] Sun, Li and Duan, Ya-bing (2003), *The development path to the small and medium-sized enterprise: the rise of small giants*, China Times and Economies Press, Beijing.

(1995)[170] states that in private firms 'the dynamics of Chinese families are absolutely central'. Within this centralization of family-order hierarchy, the boundary of responsibility is not clearly defined and the division of work is vague. The parents of the family directly supervise all the business affairs and intervene in all the decisions-making (Yun and Chen, 2000). The advantages of this type of centralized hierarchy can be viewed as follows:

- Top management (family members) knows what is going on in daily operations and business development, so they can respond quickly to market changes. Their prompt decision-making avails the company to grasp opportunities in the changing market place.
- The stability of decision-making reduces the risk of key staff turnover, and tends to maintain comparatively steady business operations.
- The core of the enterprise, comprised by family members and relatives, is coherently unified with the same family values. Trust among them significantly reduces the management cost at large, and drives the coherence in achieving organizational goals.

Chinese family enterprises emphasize traditional cultural values as the core spirit in their organizations. These stress loyalty and filialness, humaneness, diligence and obedience to patriarch authority. They insist on the value of harmony and stress the need to establish business networks with personal relations, including good relationships with governments. More specifically, Lockett (1988)[171] also emphasizes some basic characteristics of Chinese culture as important influencing factors on organizational structure and management practices: respect for age and hierarchy, group orientation, "keeping face" and the importance of relationships (guanxi). These characteristics are regarded as the main reasons for family-based enterprises' success overseas as well as in China. However, problems for this type of management style often emerge when they grow in size. Then the shortcomings of this style of management structure and concepts appear as consequence. For instance, due to the highly centralized decision-making by one entrepreneur – the owner, the survival of

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Yun, G. P. and Chen, Q. Z. (2000), *Study of Chinese enterprises' management in East-South Asia*, Economies & Management Press, Beijing.

[170] Whyte, M. K. (1995), 'The Social Roots of China's Economic Development', *The China Quarterly*, 144 (3), December 1995, pp. 999-1019.

[171] Lockett, M. (1988), 'Culture and the Problem of Chinese Management', *Organization Studies*, 9 (4), 1988, pp. 475-496.

the enterprise is bounded to one person so that the wrong decision once made, will inevitably lead to a big loss or failure for the whole organization. The highest authority that ascends from father to son cannot guarantee the son is the most capable of being an effective manager to run the organization. The informal accounting system often lacks public credibility. Their emphasis on business networks with personal relations also narrows their awareness of legitimacy, particularly a heavy reliance on government relationships for business opportunities. This can lead to a vulnerable position as they get affected by changes in policy and governments, although these could be advantages when they are in small scale. Weidenbaum (1996)[172] argues that Chinese family businesses are unlikely to become global as Chinese entrepreneurs are deeply rooted in philosophical traditions which make it difficult for the Chinese to enter into a structured and professional management style in a Western sense. The literature on Chinese business includes criticism of management practices derived from Chinese traditions: *lack of formal structure; opaque systems and unclear decision-making processes; collectivism; lack of individual initiative and over-reliance on relationships (guanxi) to gain advantage* (Laaksonen, 1988; Warner, 1992; Boisot and Liang, 1992; Child, 1994;).[173]

In a contingency perspective, 'there is no single best way to organize for effective performance of an organization. Rather, the key to organizational effectiveness rests in matching internal organizational characteristics to the demands of the work the organization must perform in achieving its goals' (Lorsch and Morse, 1974)[174]. Therefore, when the organization expands in scale, it should change its internal structure and management in order to match the external environment. For example, such internal changes should be made in aspects of the adoption of the modern corporation to replace the old centralized patriarchal structure, and the divorce of ownership and management for a more professionalized management style.

[172] Weidenbaum, M. (1996), 'The Chinese family business enterprise', *California Management Review*, 38 (4), 1996, pp. 141-156.
[173] Laaksonen, O. (1988), *Management in China during & after Mao*, De Gruyter, Berlin.
Warner, M. (1992), *How Chinese Managers Learn: Management and Industrial Training in China*, Macmillan, London.
Boisot, M. and Liang, X. G. (1992), 'The nature of managerial work in the Chinese enterprise reforms, a study of six directors', *Organization Studies*, 13 (2), 1992, pp. 161-184.
Child, J. (1994), *Management in China during the Age of Reform*, Cambridge University Press, Cambridge.
[174] Lorsch, J. W. and Morse, J. J. (1974), *Organisations and their members: a contingency approach*, Harper & Row Publishers, New York.

2.2.4.3 Features of Township-Village Enterprise

As Deng Xiaoping has commented the success of township-village enterprises in the non-state economy is their outgrowth from agriculture reforms. Therefore, township-village enterprises cannot be neglected from studying management practices in this sector. Many researchers have looked for underlying reasons to explain the historical remarkable success of township-village enterprises in the Chinese economy. Researchers have found their success is due to the shortage of major product markets in 1980s in China, cheap rural labor, tax concessions by local government, and distortions in state industries (Byrd and Lin, 1990; Ho, 1994; Naughton, 1994).[175] Others have noted that These enterprises unique institutional structures facilitate co-operation through implicit contracts among community members (Weitzman and Xu, 1994)[176]; the inter-organizational relationships between township-village enterprises and township-village governments (Jin and Qian, 1998; Zhang, 1999) [177] and township-village enterprises capacity to adapt and configure their strategy in response to the external competitive environment contributes to their success (Luo et al., 1998)[178]. Further, systematic research on human resource management practices in twenty cases of township-village enterprises has identified that as firms move toward clearer property rights relations and more formal institutional structures, recruitment, rewards, performance evaluation, labor relations and so on have been affected in order to become sources of competitive advantage and to contribute to firm's performance (Ding et al, 2004). A vast majority of these enterprises have undergone structural reforms in property rights and ownership through various stages of development. In many firms, the initial stakes held by local township-village enterprises have been totally or partially privatized. Five common types of township-village enterprises with regards to their governance and structures and their respective features of

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[175] Byrd, W. A. and Lin, Q. S. (1990), *China's rural industry, structure, development, and reform, Oxford University Press*, Oxford.
Ho, S. (1994), *Rural China in transition: non-agricultural development in rural Jiangsu, 1978-1990*, Oxford University Press, Oxford.
Naughton, B. (1994), 'Chinese institutional innovation and privatization from below', *American Economic Review*, 84 (2), 1994, pp. 266-270.
[176] Weitzman, M. and Xu, C. (1994), 'Chinese township –village enterprises as vaguely defined cooperatives', *Journal of Comparative Economics*, 18 (2), 1994, pp. 410-437.
[177] Jin, H. and Qian, Y. Y. (1998), 'Public versus private ownership of firms: evidence from rural China', *The Quarterly Journal of Economics*, 113 (4), August 1998, pp. 773-809.
Zhang, Z. (1999), 'Rural industrialization in China: from backyard furnaces to township and village enterprises', *East Asia*, 18 (2), Autumn 1999, pp. 61-87.
[178] Luo, Ya-dong.; Tan, J. J. and Shenkar, O. (1998), 'Strategic responses to competitive pressure: the case of township and village enterprises in China', *Asia Pacific Journal of Management*, 15 (1), Apr1998, pp. 33-50.

management practices are classified by Ding et al (2004)[179] in their research. These are:

(1) Responsibility systems (zeren zhi). Under this system, the general managers sign the responsibility contract with the township-village Enterprises. The general manager has substantial decision-making autonomy over the firm's operations and is highly motivated to achieve the pre-set goals. However, the incentive to pursue profit maximization is hindered by the fear of this year's success becoming next year's disaster. Line-workers and lower-level managers tend to have very small bonuses as incentives, which hamper their motivation for better performance.

(2) Collateral or non-collateral contracting (diya chengbao or wudiya chengbao). In the early and mid90s, leasing contracts were popular in small and medium-sized township-village enterprises. Under this governance, the local township-village enterprises search for an appropriate contract bidder and grants full authority to operate the firm for a certain period of time in exchange for the rent payment as stipulated in the contract. The ownership of property and assets remain with the local township-village enterprise, but the 'lease contractor' has total authority to run the firm, and is fully motivated by their own control over residual profits. However, the decision-making tends to be biased toward maximizing the short-term profits for the contracting period, which is in many cases at the expenses of the firm's long-term benefits. As the scale of firm is normally small, the human resource management functions are very preliminary and investment in training and development is scant.

(3) Joint ventures with foreign investment (hezi qiye). Township-village enterprises entering strategic alliances with foreign firms are encouraged and preferred by the Chinese authority, because local firms can benefit from the capital, technology and advanced management concepts brought in by the foreign investors. Indeed, township-village enterprises are exposed to foreign management concepts and mentalities. As new management systems are introduced, fundamental changes often take place in management practices in all major management areas, including recruitment, training and development,

[179] Ding, D. Z., Ge, G. and Warner, M. (2004), 'Evolution of organizational governance and human resource management in China's township and village enterprises', *International Journal of Human Resource Management*, 15 (4), June/August 2004, pp. 836-852.

reward and performance evaluation. The degree of change depends largely on the business objectives of joint venture partners.

(4) Joint stock firms (gufen gongsi), also referred to as the 'share-cooperative system'. Followed by enterprise reforms, township-village enterprises are restructured in terms of the clarification of property rights relations and separation of government administration from the enterprise management, so as to improve their efficiency. Under this governance, the existing capital of the township-village enterprise is divided into shares held by various stakeholders. The local township-village enterprise that has bulk investment may partially or totally privatize its stake and withdraw its control over business operations. The patterns of how the company shares are distributed have a great bearing on management practices. The general manager or the key managers who have relatively high percentage of shares tend to have a high incentive to perform, whereas the line-workers may not significantly change their attitude to work. In firms where the majority share is held by a single person, human resources are managed as if in a truly private company.

(5) Publicly-listed companies (shangshi gongsi). In the process of transforming a formerly centrally planned economy into a market-oriented one, the Chinese government has experimentally established an equity capital market by setting up two stock exchanges in Shanghai and Shenzhen. Since then, it has been maintaining high standards vis-à-vis the qualifications of the firms to be listed; that is, only very successful companies can get approval. These firms, large in scale, have a formal management systems and accounting procedures. They have the most developed and formal management functions, compared with management practices under other governance forms. Especially, Ding et al (2004)'s research discovered that for 'publicly-quoted firms' with over 2000 employees, "*The importance of management is emphasized from a strategic perspective for management planning and managing, as usually a deputy general manager or a member of the board of directors is in charge of main management functions, the major departments having full authority to make all decisions in their own domain.*"

As a general pattern, township-village enterprises recruit line-workers locally, but search nationwide for professionals. Local recruitment gives preference to local residents in order to release local unemployment issues. In most township-village enterprises, training is limited to improving employees' technical skills for better performance. In publicly-quoted companies, there are more formal training programs and they invest substantially in staff development.

One of the significant differences between state-owned enterprises and township-village enterprises is their performance-based reward systems. Due to an abundant supply of migrants from rural areas, line-workers' wage levels are kept low in the form of fixed monthly salaries with little or no bonus. On the other hand, generous commissions are applied to marketing staff, because of the perception that they are professionals and essential to the firm's profitability and success. Chinese traditions of hierarchy mean that officials and academics are regarded as in the higher levels of social hierarchy and given preferential treatment. The lowest level of hierarchy consists of those with no education and no formal training (Weber, 1983).[180] The reward systems for TVE top managers have become diversified a result of property rights reform. Under different governance structures, a variety of rewards have emerged, including floating income (fudong gongzi), annual income (nianxinzhi), basic salary plus annual bonus (jibenggongzi jia nianzhongjiang) and basic salary plus dividends (jibenggongzi jia guquan). More and more township-village enterprises have realized that a highly motivated top manager is a critical factor for improving company's performance.

However, social security systems are weak in township-village enterprises, which are in contrast with state-owned enterprises 'guaranteed life-long employment' and all round welfares – e.g. from housing to medical care, and from social activities to child care. In conformity with the enterprise reform of separating party activities from business operations, the presence of the party is very low in township-village enterprises compared to state-owned enterprises. Due to their informal structures, township-village enterprises provide little protection for their workers. Until the implementation of the 1994 Labour Law which requires all employers, regardless of ownership type to contribute to five welfare funds (i.e. pension, accident and injury, maternity, unemployment and medical funds), township-village enterprises have begun to abide by the minimum legal obligations, but the amount of contribution by enterprises varies between different firm sizes and governance structures. Furthermore, as a result of their informality, trade unions play a weak role in township-village

[180] Weber, M. (1983), *Max Weber on capitalism, bureaucracy and religion*: a selection of texts, edited and in part newly translated by Stanislav Andreski, Allen & Unwin, London.

enterprises, mainly organizing recreational and sports activities. (Ng and Warner, 1998)[181]

It is out of township-village enterprises, that privately-owned ventures have emerged. The operational characteristics of these are now described.

2.2.4.4 Operational Strategies of Privately-Owned Enterprises

Privately-owned enterprises, evolving out of township-village enterprises, have prevalently adopted the strategy of producing low-price commodities to develop their market for start-up, by fulfilling the gaps left by the state economy (Naughton, 1995; Li et al, 2004; Sun and Duan, 2003)[182]. Take the Wenzhou Pattern (Wenzhou moshi) privately-owned enterprise, as an example. These individual businesses start with specialized products targeting market niches which were neglected by the state economy. They are small scale with low-costs, formed in joint-structures of 'front retail-shop with backyard workshop' that can minimize the cost of production. The backyard-workshop produces the goods and these are sold in their own front retail-shops. These individual small firms usually change their business locations frequently in accordance with different profit-oriented businesses. They do not have clear and strategic objectives for development and future. They are able to exist in the seller's market where the state economy dominated and where there is less competition.

Taking Michael Porter's competitive theory as an analyzing tool for strategic development of private enterprises in Chinese industrial environment, this suggests there are 'Five Forces in industry competition' as the main driving factors that determine how competition is formed. In the regular context of industry competition, five influencing forces – buyers, suppliers, substitutes, potential entrants and industry competitors – drive the rivalry among existing firms. In coping with the five competitive forces, Porter points out three potentially successful generic strategic approaches to outperforming other firms in an industry: 'Overall cost leadership', 'Differentiation' and 'Focus' (Porter, 1980)[183]. In the Chinese economy, the pricing

[181] Ng, S. H. and Warner, M. (1998), *China's Trade Union Management*, Macmillan, London.
[182] Naughton, B. (1995), *Growing out of the plan: Chinese economic reform 1978-93*, Cambridge University Press, Cambridge.
Li, Shao-min; Ian, V. and Zhou, Dong-shen (2004), 'The emergence of private ownership in China', *Journal of Business Research*, 57(10), 2004, pp.1145-1152.
Sun, Li and Duan, Ya-bing (2003), *The development path to the small and medium-sized enterprise: the rise of small giant*, China Times and Economies Press, Beijing.
[183] Porter, M. E. (1980), *Competitive strategy: techniques for analyzing industries and competitors*, The Free Press, London.

system has transformed from a planned to a market-oriented mechanism. During the transformation of a 'dual-track economy', many commodities are still under planned price controls and there are limited supplies. Therefore, in this sellers market – supply falls short of demand for commodities and so the emergence of private enterprises has inevitably adopted low-cost strategies for market entry. Their flexibility and profit-orientation have given them competitive advantages to succeed under this opportunistic market environment. Driven by this strategy, the 'price-war' for dumping on the market often happens as the main means for privately-owned enterprises to compete with other competitors. Low prices are the main strength for privately-owned enterprises. As Porter (1980)[184] states,

"Low cost relative to competitors becomes the theme running though the entire strategy, though quality, service, and other areas cannot be ignored. Having a low-cost position yields the firm above-average returns in its industry despite the presence of strong competitive forces. Its cost position gives the firm a defense against rivalry from competitors, because its lower costs mean that it can still earn returns after its competitors have competed away their profits through rivalry. A low-cost position defends the firm against powerful buyers because buyers can exert power only to drive down prices to the level of next most efficient competitor. Low cost provides a defense against powerful suppliers by providing more flexibility to cope with input cost increases. The factors that lead to a low-cost position usually also provide substantial entry barriers in terms of scale economies or cost advantages. Finally, a low-cost position usually places the firm in a favorable position vis-à-vis substitutes relative to its competitors in the industry. Thus a low-cost position protects the firm against all five competitive forces because bargaining can only continue to erode profits until those of the next most efficient competitor are eliminated, and because the less efficient competitors will suffer first in the face of competitive pressures."

The structure of the market has changed significantly in China since 1990s. For example, the state-owned enterprises have begun to play a more market-focused role; foreign direct investment has enhanced the intensiveness of competition; the impact of globalization and technology innovation and so forth, has transformed an often sellers market into a buyers market – supply often exceeds demand. Under these changing circumstances, many private enterprises have shifted their strategies from

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[184] Porter, M. E. (1980), *Competitive strategy – techniques for analyzing industries and competitors*, The Free Press, London, p35.

low prices to product differentiation to secure their market share. Many privately-owned enterprises have attempted to adopt multiple operations in various industries to reduce their risk in one field and diversify their product ranges. Such trend has its historical background, as this strategy has been encouraged by the Chinese government since the middle-1980s (Li, 2003).[185] However, diversified operations require three prerequisites: capital, technology and management, and without any one prerequisite will lead to fail. A blinding belief in diverse operations can destructively affect the cultivation of the core competencies of enterprises.

Good examples for illustrating the development of privately-owned enterprises practices with two contrast strategies are two famous IT companies in China – Lenovo and Giant. Lenovo (formerly Legend)[186] has grown to be a successful multinational corporation and has become a world-known company by buying out IBM's personal computer division in December 2004. Giant's start-up contemporized with Lenovo and even had better fame and a stronger foundation in the 1990s. However, within 8 years, Giant collapsed and Levono outgrew to become a world famous multinational corporation. Why? The answer is the 'strategy'. The different operating strategy leads to different outcomes.

Giant was established in 1988 with the core business of own-designed software products. By the end of 1992, its sales had reached RMB 200 millions (US$ 24 million) with net profits of RMB 35 millions (US$ 4.2 millions). Giant was growing annually by 500%, becoming a prominent star in information technology. Giant's leader, Shi Yuzhu set his company's strategy as "diversified investment" and "all round growth". He believed that if an enterprise can succeed in one industry, it can gain the same success in other fields. Under this guiding strategy, in 1993 his company stepped into two new and different industries - real estate and health food. But too fast expansion resulted in chaos in decision-making structure which still maintained a centralized pattern dependent upon one brain - Shi Yuzhu. In 1996, Giant went bankruptcy. In contrast, Lenovo's leader, Liu Chuanzhi's concept of a company's operation was to focus on its core competency, to optimize the quality of its products and service with all its development within the information industry. He believes that an enterprise can only make success in one industry, and this does not

[185] Li, Xiao-jie. (2003), *The essentials of management: structure and integration*, China Economy Press, Beijing, p154.

[186] 'Lenovo' is the new name to replace 'Legend' in 2004, as it was originally called 'Legend' when it initiated in early 90s. http://www.lenovogrp.com/ (accessed 9th December, 2004)

mean that it can be successful in other fields. Therefore, Lenovo never became involved in popular industries such as health products and real estate. In 1990, Beijing Legend (now is known as Lenovo) began the design, manufacture and distribution of its own line of PCs, the Legend brand. Lenovo was the first company to introduce the home computer concept in China. In 1993, Lenovo invested in Huiyang, Guangdong Province for the construction of the Legend Science and Technology Park that serves as the group's manufacturing base. In 1997, Legend computers became the best selling brand in China and one of the leading computer brands in the Asia Pacific region. Obviously, in consequence, Lenovo's focused strategy has insured its utilization and optimization of its resources in its own industry and market.

Following the successful formation of the market economy, many changes have taken place in all aspects of management, such as management culture (Warner, 2002)[187], information systems and organizational structures. For instance, under an information intensive economy, 'guanxi' (relationship networks) in its traditional form may be getting less important, although it will be sustained as a virtual link facilitating the diffusion of personal transactions. Along with the prevalent venture into e-commerce technology to sell goods or source parts, Chinese firms have further changed their management practices to meet the challenges of a web-based world (Richter, 2000)[188]. Since China is becoming a legalized and technologized 'normal' market, the importance of traditions of guanxi networks will gradually become weakened and Chinese management practices will more closely match those that are experienced in other parts of the world. As Child and Mcgrath (2001)[189] suggest,

"*The transition from an economy based on materials to an economy based on flows of information has created considerable challenges for organization design by unfettering many organizational aspects from physical constraints. Core themes reflected are an acceptance of contradiction and paradox, a shift in the goal of organizing from buffering against uncertainty to responding to it, a strategic focus on structure and process design, a reemphasis on the social and interpersonal, and a reemergence of issues of legitimacy.*"

[187] Warner, M. (2002), 'Conclusion: The Future of Chinese Management', *Asia Pacific Business Review*, 9 (2), Winter 2002, pp. 205-224.
[188] Richter, F. J. (2000), 'China's entry into the WTO and the impact on Western firms', *China Economic Review*, 11(2), 2000, pp.423-426.
[189] Child, J. and Mcgrath, R. G. (2001), 'Organizations unfettered: organisational form in an information intensive economy', *Academy of Management Journal*, 44 (6), 2001, pp. 1135-1148.

These changes have enhanced and formed the perspective of strategic planning and thinking in privately-owned enterprises' future development. A learning organizational culture and a trend of strategic management have gradually emerged to syncretise privately-owned enterprises' management practices.

2.2.4.5 Chinese Entrepreneurs in the Market Economy

Chinese entrepreneurs emerge along with the changing economic structures and the development of private enterprises in the market economy. These new entrepreneurs have the vision to leave the security of modest factory jobs, hoping to make their fortunes. They are adventurers, risk takers, and most run their businesses on "rule of thumb" but they possess the trait of sensitive perception of market opportunity. They are able to catch opportunities promptly and have great flexibility to respond to an uncertain world that is composed of unclear and rapidly changing government policies, taxes, and regulations. The market economy, commonly regarded as the revival of capitalism, pays off for Chinese entrepreneurs and these private enterprises, and it brings big money to them in modern China. The Sunday Times magazine (2004) [190] commented:

"*As China's economy booms, its tycoons are puffing on cigars and flying in private jets.*"

These initial "nouveau riche" are emerging within the special phases of economic transition under sponsorship of government policy, when insufficient competition is present and high demand markets and opportunities exist. However, due to the historical background of privately-owned enterprises, these entrepreneurs are often poorly educated and manage their businesses very informally. However, they have the desire for formal management patterns and knowledge to handle their increasingly complex business environment and growth. A survey of 3539 entrepreneurs in small to medium-sized enterprises reveals the main needs of Chinese entrepreneurs are (Sun and Duan, 2003)[191]: '*The proper mechanism of recruitment and selection*'; '*modern emolument and appraisal system*'; '*complete supervisory and control system*'; '*specific professional training to the weaknesses of operations.*'

[190] *The Sunday Times Magazine*, October 17, 2004. p.52.

[191] Sun, Li and Duan, Ya-bing (2003), *The Development path to the small and medium-sized enterprise: the rise of small giants*, China Times and Economics Press, Beijing, p54.

Enhancing the quality of entrepreneurs is a condition for the emergence of more professionalized management practices in the Chinese market.

They are facing the challenges as China's accession to the World Trade Organization (WTO) provides new impetus for the government to move toward a rules-based, nondiscriminatory policy environment for private enterprises. This will not only expose the domestic private sector to new competition from abroad, but will also introduce new financial institutions to serve the needs of private business. Hence the environment will continue to evolve rapidly. The challenge for the government and entrepreneurs alike is to put the domestic private sector on a solid footing so that it will be ready to seize new opportunities as they arise. China's home-grown entrepreneurs have shown impressive flexibility and dynamism in expanding their businesses in the absence of secure legal frameworks, and with very limited access to external finance (Gregory and Tenev, 2001) [192]. Recent policy changes offer businesses a sounder footing and access to new sources of capital. Although Chinese leaders publicly support the private economy and have ordered that it be treated on the same basis as State-owned Enterprises, many banks still struggle to break the habit of giving priority in lending to government companies (McGregor, 2004)[193]. China's ability to compete with foreign firms depends on the ability of these entrepreneurs to match best practices in the West. 'The Chinese government places more reliance on entrepreneurs to keep the economy growing and create jobs', as is evidenced in the Annual Survey by the All-China Federation of Industry and Commerce, a government body monitoring business.[194]

2.2.4.6 Management Practices of Foreign Joint Ventures in China

Foreign Joint Ventures in China are formed in two main types: wholly-owned foreign enterprises and Chinese-foreign joint ventures. Foreign Joint Venture is an important market force in the Chinese market. Not only do they bring new management practices and technology to domestic firms, but also facilitate and shape

[192] Gregory, N. and Tenev, S. (2001), 'Special Report: China's Private Sector – China's Home-Grown Entrepreneurs', *The China Business Review*, Jan-Feb. 2001, pp. 14-18.
[193] McGregor, R. (2004), 'Chinese growth bound tightly to private sector', *Financial Times*, Friday 27th August, 2004.
[194] *Financial Times*, 26th August 2004. p20.

the formation of a competitive market economy. (Yan and Warner, 2001) [195] Compared to indigenous firms, their management practices possess some distinctive characteristics.

As mentioned in chapter 1, Foreign Direct Investment has been a significant factor in the growth of Chinese economy. Luo and O'Connor (1998)[196] describe that a number of diverse approaches used by Foreign Joint Ventures to an increasing commitment of resources and financial investment – *Opportunistic Experimenter, Strategic Investor and Dominant Local Player.* Opportunistic Experimenter is an approach of a group of foreign companies with a low level of corporate commitment, who merely aim to learn how to conduct business in China. Strategic Investors characterize the majority of foreign companies that have aimed to enjoy the early-mover benefits, possibly by building a broader multi-regional or national presence through marketing or establishing facilities. Dominant Local Players, describe companies with a high level of corporate commitment to investing in China. Foreign joint-ventures in this latter group usually have had a highly localized management system and aim to secure dominant market positions within their own industry sectors. Since mid 1990s, there is an increase in the proportion of foreign direct investment in equity joint-ventures. It is argued that foreign joint-ventures seem to increasingly favor 'go it alone' patterns to pursue success in the market after they have acquired practical experience in China (Yan and Warner, 2001).

During the 1990s, management practices in China gradually moved in a market-driven direction, as the labor supply is opened to a free market. Foreign joint-ventures have benefited from this change. Particularly, they do not have to accept whichever personnel their Chinese counterparts assigned to them, but rather recruit competent candidates in the labor market. The graduates of universities are no longer obligatory allocated to whichever enterprises or work units by the government plan. Yet, the labor market can be described as both high labor-supply and low labor-supply, albeit addressed to different categories (Warner, 1992)[197]. High labor-supply generally refers to non-skilled and surplus technical labor, which is simply a nationwide-burden. The local managerial and executive staff group constitutes the low-supply category. It

[195] Yan, D. and Warner, M. (2001), 'Sino-foreign joint ventures' versus 'wholly foreign owned enterprises in the People's Republic of China', The Judge Institute of Management Studies, Cambridge. *Working Paper, No. 11,* Oct2001.
[196] Luo, Y. and O'Connor, N. (1998), 'Structural Changes to Foreign Direct Investment in China: an evolutionary perspective', *Journal of Applied Management Studies*, 7 (1), June 1998, pp. 95-109.
[197] Warner, M. (1992), *How Chinese Management Learn*, Macmillan, London.

has been found that the expatriate failure-rate is often quiet high, while the cost to the multinational corporation of having an expatriate is almost five times that for a local executive (Goodall and Warner, 1997)[198]. Moreover, the impact of the Asian financial crisis coupled with cost pressures on foreign firms in China has served to accelerate many firms' localization program. [199] The call to transfer management from expatriates to local managers echoes across China (Gamble, 2000)[200]. The rapid localization has become the mantra of many foreign joint ventures in China (Melvin, 1997)[201]. The cost differential and trend of localization then induces a great demand on the limited local managerial staff labor-supply.

"The Executive-Search company predicted a 400 percent increase in demand for local executives in this decade. Every qualified Chinese candidate usually has ten managerial positions to choose from." (Goodall and Burgers)[202]

As Yan and Warner (2001)[203] comment, Chinese enterprise management is being transformed gradually and must move step by step into the nascent labor market, while awaiting an increase in supply. Foreign Joint Ventures are chasing a still limited but expanding supply of highly skilled human resources.

As suitably qualified local managers need to be developed over a long time perspective, their qualifications to meet the satisfactory level of demand require formal business education and professional training, as well as a timely learning experience in an advanced industrial context. Particularly, for historical reasons, the middle-aged labor force in China is the generation which are victims of the educational 'fall-out' of the Culture Revolution (1966-1976) (Warner, 1999)[204], and they need management training. As Gamble (2000)[205] suggests,

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198 Goodall, K. and Warner, M. (1997), 'Human Resources in Sino-Foreign Joint Ventures', *International Journal of Human Resource Management*, 8 (6), July 1997, pp. 569-594.
199 *Financial Times*, 25th November 1998, p22.
200 Gamble, J. (2000), 'Localizing management in foreign-invested enterprises in China: practical, cultural, and strategic perspectives', *International Journal of Human Resource Management*, 11 (5), Oct2000, pp. 883-903.
201 Melvin, S. (1997), 'Passing the Torch', *The China Business Review*, 23 (3), 1997, p.32.
202 Goodall, K. and Burgers, W. (1998) 'Frequent Fliers', *The China Business Review*, 17 (2), May-June 1998, pp.50-52.
203 Yan, D. and Warner, M. (2001), 'Sino-Foreign Joint Ventures' versus 'Wholly Foreign Owned Enterprises in the People's Republic of China', *Working Paper, The Judge Institute of Management Studies, Cambridge*, No. 11, Oct2001. p31.
204 Warner, M. (1999), *China's managerial revolution*, Frank Cass, London.
205 Gamble, J. (2000), 'Localizing management in foreign-invested enterprises in China: practical, cultural, and strategic perspectives', *International Journal of Human Resource Management*, 11 (5), Oct2000, pp. 883-903.

"*Localization is likely to proceed at a much slower pace than its main advocates may wish or anticipate, and there are practical, cultural and strategic factors which may, and perhaps should, inhibit rapid localization.*"

The management practices of foreign joint-ventures in China vary in accordance to their growing diversity in terms of size, industry, ownership structure, product market, strategy and management style. As Cooke (2004)[206] suggests the literature on management practices in foreign joint-ventures can be classified into two diverse strands. First are the studies on management practices in foreign direct investment enterprises, which mainly focus on multinational corporations and joint ventures (Child, 1994; Goodall and Warner, 1997; Lu and Bjorkman, 1997)[207]. Bjorkman and Fan (2002)[208] have observed, for example, the early-established Western MNCs have adapted their management practices to the Chinese environment; a trend seemed to have emerged during the 1990s towards introducing more Western style policies. Blue chip MNCs (e.g. Motorola, Nokia) are generally considered to have more sophisticated management system than Chinese domestic firms. It has been argued that these management 'best practices' are mainly western practices transferred and adapted to suit the Chinese environment. They are often hailed by the Chinese media as good models to be followed by domestic firms (Cooke, 2004)[209]. The other strand of literature on foreign firms in China focuses largely on their management of labor process and employment practices: these firms are often branded as 'sweatshops' operating in a mass production mode and characterized by poor working conditions and work intensification (Xu, 2000; Chan, 2001)[210]. These foreign joint ventures are staffed by unskilled rural migrant workers who have few formal educational

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[206] Cooke, F. L. (2004), 'Foreign firms in China: modelling HRM in a toy manufacturing corporation', *Human Resource Management Journal*, 14 (3), 2004, pp. 31-53.

[207] Child, J. (1994), *Management in China during the age of reform*, Cambridge University Press, Cambridge.

Goodall, K. and Warner, M. (1997), 'Human resources in Sino-foreign joint ventures: selected case studies in Shanghai and Beijing', *International Journal of Human Resource Management*, 8 (5), 1997, pp. 569-594.

Lu, Y. and Bjorkman, I. (1997), 'MNCs standardization versus localization: MNC practices in China-Western joint ventures', *International Journal of Human Resource Management*, 8 (4), 1997, pp. 614-628.

[208] Bjorkman, I. and Fan, X. C. (2002), 'Human resource management and the performance of Western firms in China', *International Journal of Human Resource Management*, 13 (6), 2002, pp. 853-864.

[209] Cooke, F. L. (2004), 'Foreign firms in China: modelling HRM in a toy manufacturing corporation', *Human Resource Management Journal*, 14 (3), 2004, pp. 31-53.

[210] Xu, F. (2000), *Women Migrant Workers in China's Economic Reform*, Macmillan, New York.

Chan, A. (2001), *China's Workers under Assault: the Exploitation of Labour in a Globalising Economy*, M. E. Sharpe, New York.

qualifications and little bargaining power. This segment of the labor market is the least protected by legislation, and hence the most vulnerable to exploitation by foreign joint-ventures (Cooke and Rubery, 2002)[211]. The ethical dimension of management practices by these firms operating in a 'boundaryless' world is therefore vigorously questioned (Legge, 2000)[212].

Cooke (2004) argues – based on the evidence from his case studies – that an organization's management practices are influenced by a range of institutional and cultural factors both at the national and organizational levels and that not all foreign direct investment manufacturing firms operate in a sweatshop mode even if they have the opportunities to do so. His study has found that, to a large extent, the foreign joint-ventures have adopted a mixed package of management practices. For example, in his case company there were advanced western management techniques as well as good practices from state-owned enterprises (e.g. worker's welfare and culture). It had also adopted some bad practices for which the private sector in China in notorious – those of non-union recognition and non-compliance with labour regulations.

As an outcome of localization, a hybrid model of management practices for the best suitable fit in the local environment seems to be the favorable characteristic among foreign joint-ventures. Taylor's study (2001)[213] reveals that,

"*Chinese managers may be given the power to formulate their management practices where localization is seen to have strategic advantage. More so, managers seek to use a variety of local and 'universal' strategies and practices to control and utilize labor within the constraints of local institutional context.*"

Indeed, Cooke proposes that the managers who are delegated empowerment and autonomy play an important role in shaping management practices. Their judgment and knowledge determine the factors of management practices. Indigenous models of leadership appear to have become more common among multinational corporations and joint ventures in China recent years, largely due to the fact that many expatriate-

211 Cooke, F. L. and Rubery, J. (2002), 'Minimum wage policies, gender and the urban/rural divide in China', *Consultancy Report, International Labour Organization (ILO)*, Geneva.
212 Legge, K. (2000), 'The ethical context of HRM: the ethical organization in the boundaryless world', in *Ethical Issues in Contemporary Human Resource Management*, (eds) D. Winstanley and J. Woodall, Macmillan, London, pp. 23-40.
213 Taylor, B. (2001), 'The management of labour in Japanese manufacturing plants in China', *International Journal of Human Resource Management*, 12 (4), 2001, pp. 601-620.

based management systems have failed to take root and have caused local resentment and resistance (Cooke, 2002; Legewie, 2002)[214].

Western corporations through the management practices that they introduced in China have more and more influence on the practices adopted by Chinese firms. Proponents of the 'convergence' hypothesis propose that there is a tendency for countries to become more alike in terms of management policies and practices under the impact of globalization and the emergence of international 'best practices'. As Warner (2002)[215] suggests:

"Linking-up with foreign firms, especially multinational corporations, has been a major source of new capital, techniques and innovations. Corporate governance has been transformed accordingly."

2.2.5 The Role of Trade Union in Management Practices under Market Economy

The market reforms in China accompanied fundamental changes in the field of labor relations. They were caused by the transformation of the relationship between the state and enterprises on the one hand, and between management and labor on the other. Previous roles of work units, party organizations and trade unions changed accordingly.

From the mid-1980s, Chinese trade unions have experienced changes at both top and bottom levels (Chan, 1993; Jonathan and Chan, 1995)[216]. At the top level, the ACFTU (the All-China Federation of Trade Unions) has made many efforts to strengthen the status of trade unions and to protect workers' interests. It began to participate in policy decision processes, for example the legislation of the 1994 Labour Law. It also tries to organize bottom level trade union organizations in non-state-owned enterprises. At the grassroots level the role of enterprise trade unions are being widened as labour disputes increase. They stand in a middle position between management and labour and are developing new fields of influence. Chinese trade

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[214] Cooke, F. L. (2002), 'Ownership change and reshaping of employment relations in China: a study of two manufacturing companies', *Journal of Industrial Relations*, 44 (1), 2002, pp. 19-39.
Lewegie, J. (2002), 'Control and co-ordination of Japanese subsidiaries in China: problems of an expatriate-based management system', *International Journal of Human Resource Management*, 13 (6), 2002, pp. 901-919.

[215] Warner, M. (2002), 'Introduction: Chinese Management in Perspective', *Asia Pacific Business Review*, Winter 2002, 9 (2), pp. 1-21.

[216] Chan, A. (1993), 'Revolution or corporatism? Workers and Trade Unions in post-Mao China,' *The Australian Journal of Chinese Affairs*, No. 29, Jan1993, pp31-61.
Jonathan, U. and Chan, A. (1995), 'China, Corporatism, and the East Asian Model,' *The Australian Journal of Chinese Affairs*, No. 33. Jan1995, pp. 29-53.

unions are, within a limited boundary, breaking from their former features of administration that were only responsible for labour insurance work. Until now, economic reform policies -- which are focusing on the improvement of economic efficiency -- assigns only secondary importance to the development of trade unions, though the government prepared the official scheme to manage new industrial relations such as the formation of the Labour Law and of mediating procedures of labour disputes. Also, the support of trade unions by ordinary workers is not so active. (Seung, 2000)[217] The power of trade unions comes from workers' trust. But when workers encounter salary delays, welfare infringements, overwork, security protection dangers, and other unlawful infringements, workers become indifferent to trade unions.

In most cases, trade unions in Chinese enterprises are quiet defective in effective actions. The loss of trade union's voice on core employment issues is not going to be regained through organizing sports meetings and handing out film tickets. In many companies, the weak position of trade unions is an irrefutable fact. Some multinational corporations' enterprises in China openly resist establishing trade unions, such as Wal-Mart, Dell, Sumsung, Kodak, KFC and McDonalds; none of them have trade unions. With deepening reforms, the private sector in China has undergone rapid development, which gives rise to increasing numbers of employees in foreign-invested enterprises and private enterprises. However, the establishment of labor unions encounters resistance in most enterprises. (China Economic Net, 2007)[218]

Since trade unions have few significant activities and give little help to workers, the evaluation of workers for trade unions is not positive. According to the survey on 7301 workers and staff by the Zhejiang province General Trade Union in 1994, when asked whom they went to first to get help about work-related problems, only 13.1% selected "trade union". Many workers answered "I rely on myself" (43.9%), the next was "relatives and friends" (23.2%). When workers were asked "Can trade unions represent workers and protect their interests?" those who answered "basically possible" and "possibly" were just 33.1%, whereas "though having intention but capacity is limited" was 37.7%, and "difficult to protect" was 29.2%. According to

[217] Seung, W. B. (2000), 'The changing trade unions in China', *Journal of Contemporary Asia*, 30 (1), 2000, pp.46-66.
[218] China Economic Net (2007), *Trade unions need update*, Monday, 19th Mar 2007. http://en.ce.cn/Business/Enterprise/200412/19/t20041219_2613934.shtml (accessed 19th Mar 2007)

the survey, about 2/3 workers and staff did not believe trade unions were doing their job.[219]

To sum up, Chinese trade unions do not bargain collectively like Western unions, instead they try to discipline and ensure the production commitment of the labour force (Lee, 1986)[220]. They are organised on both an industrial and a geographical basis. The ACFTU is for much of the time a 'transmission belt' of government policy and will play its part in whatever current campaign the Party delegates to it, such as attempting to seek out corrupt officials or being a watch-dog about excessive price increases (Warner, 1991)[221].

2.3 Concluding Remarks

By reviewing the evolution of enterprises in economic transformation from a central-command economy to a market economy, the characteristics and historic heritages have been explored to explain the emergence of new forms of management practices in contemporary China. Four types of enterprises have emerged and these reveal significant differences in many aspects of management, such as structure, strategy, cultural values and human resource management. The same is true with China's economic hybrid model; management practices are a combination of western and Chinese characters. These emerging trends in managerial practices can be explored in four types of business ownership that have emerged under market socialism. These are: state-owned enterprises (SOEs), collective-owned enterprises (COEs), privately-owned enterprises (POEs) and foreign joint-ventures (FJVs). Through analysis and comparison of these four types of enterprise, emerging forms of management practice under market socialism can be explored. These are now investigated by reference to an empirical study of each of these types of enterprise ownership conducted in China during 2005 and 2006.

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[219] *Chinese Trade Unions Statistical Yearbook* (1994), ZGGTN, Beijing, p399-400.
[220] Lee, L. T. (1986), *Trade Unions in China, 1949 to the Present*, Singapore University Press, Singapore, p26.
[221] Warner, M. (1991), 'Labour-management relations in the People's Republic of China: the role of the trade unions', *International Journal of Human Resource Management*, 2 (2), Sep1991,pp.205-221.

CHAPTER THREE:

Research Methodology: The research investigation and the selection of case studies

Introduction

The first two chapters have discussed the evolution of market socialism in China and how this is leading to different forms of business ownership. This review provides the background for the empirical research into types of enterprise management as these are emerging in China. Because of the rapid growth in number of enterprises - particularly in the private sector (Peng, et al, 2004)[222] – there is a deficiency of management theories for understanding these within the context of the transition of the market economy. More theories of how emerging enterprises operate under market socialism and how economic reforms affect organizational changes are badly needed.

Evolving from a command socialist economy, Chinese enterprises are changing from sole ownership in the state sector to diversified ownership forms in both state and private sectors. Foreign direct investment (FDI) in different industries is also shaping management practices in China. Through ownership diversification, institutional restructuring and FDI involvement, four types of business ownership have arisen within the transition of market socialism. The research aim is to explore the characteristic features of each type of ownership. This chapter describes how the fieldwork research was undertaken. Four business enterprises - characterized by different ownership forms - were studied in the textile industry. This is the most competitive sector and at the frontier of economic reforms in China. It is a sector that reflects nascent managerial trends in the changing Chinese economy.

Following the approach of Philliber et al (1980)[223], in this chapter, we will discuss the research design - as a blueprint for research - to elaborate four aspects of the research methodology: (1) what questions to study; (2) what data are relevant; (3) what data to collect; (4) and how to analyze the results. This research aims to seek explanations and to answer the fundamental question of this research: 'What are the management characteristics of emerging forms of business venture under market socialism in China?'

3.1 Contingency Theory

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222 Peng, G. & Huang W. and Guo, Y. (2004), *Studies on the Theory and Practice of Economic Development in China*, The People's University of China Publisher, Beijing, pp.257-258.
223 Philliber, S. G., Schwab, M. R., & Samsloss, G. (1980), *Social Research: Guides to a decision-making process*. Peacock, Itasca.

The underpinning theory of this research is the 'Contingency Approach', as applied to explaining organisational forms emerging under market socialism in China. This approach provides theoretical principles for understanding how a changing business environment and different ownership forms can impact on management practices. In contingency theory, there is no one best design of organisation. "*The most appropriate structure and system of management are therefore dependent upon the contingencies of the situation for each particular organisation*" (Mullins, 2005).[224] It suggests that organisation theory should provide insights into the situational and contextual factors which influence management decisions. Our research design follows this approach. The contingency approach focuses attention on the relationships between the effects of uncertainty in a changing external environment and the impact upon organisational change and management practices. It is concerned with understanding the interdependent relations between the internal characteristics of an organization and its external environment.

The proponents of this perspective differ in the ways in which they have conceptualized and /or measured internal organizational characteristics and the work of the organization. For example, Woodward (1970)[225] focused on a variety of types of technology as the key variable. Lawrence and Lorsch (1967)[226] conceptualized the organization's work as dealing with its external environment and viewed the important internal organizational parameters as differentiation, integration, and conflict resolution. Thompson (1967)[227] has been concerned with both technology and environment, as well as with a different set of organizational variables (e.g. structure, discretion and control). Lorsch and Morse (1974)[228] suggested how the personal characteristics of organization members are related to organizational factors and these shape organizational effectiveness.

Organization processes and management practices must fit the requirements of the surrounding culture. The cultural context shapes the perception and interpretation

224 Mullins, L. J. (2005), *Management and organizational behavior*, 7th Ed., FT Prentice Hall, England, p84.
225 Woodward, J. (1970), *Industrial Organizations: theory and practice*, Oxford University Press, London.
226 Lawrence, P. R. and Lorsch, J. W. (1967), *Organization and Environment: managing differentiation and integration*, Harvard University Press, Boston.
227 Thompson, J. D. (1967), *Organisations in action: social science bases of administrative theory*, McGraw-Hill, New York.
228 Lorsch, J. W. and Morse, J. J. (1974), *Organisations and their members: a contingency approach*, Harper & Row Publishers, New York.

of organizational change and constrains choices concerning how to manage it (Faucheux, Amado, and Laurent, 1982; Triandis, 1994)[229]. Change may be seen as linear, rational, and the result of planned actions or as the circular, continuous, and the spontaneous interplay between interdependent forces. Conceptions of change determine choices concerning an organisation's management. Those who engage in cross-cultural, change-related practices often ignore the surrounding cultural context. Furthermore, Budhwar and Debrah (2001)[230] propose that an analytical distinction should be made between different levels of context, including the national cultural context, industrial context and organizational strategy-level context. These 'context-specific' and 'culture-bound' factors influence the nature of HR practices. '*Complexity, uncertainty, and diversity emerge as important determinants of organizational form. These determinants, in turn, mirror the type of task the organization must perform, with entrepreneurial, creative tasks resulting in greater uncertainty, complexity and diversity for the organization.*' (Dessler, 1976)[231]

Contingency theory seems to provide a suitable approach for understanding the evolution of management in contemporary China, as it addresses interrelations of organizational change within the context of a changing business environment. 'Contingency' models of organization highlight the interrelationships between structure, methods of operations, technology and the nature of environmental influences, and provide a further possible means of differentiation between alternative forms of organization and management. Managerial practices cannot be independent of the environment within which organizations operate. This approach better explains the complexity and dynamics within such rapidly changing environments – 'socialist' to 'market socialist'; 'closed' to 'open' political paradigm; and 'planned' to 'free' economy. The sole focus on an organization's internal environment is not valid in view of the fundamental political and economic changes that are occurring in China. It is important to address the evolution of ownership in market socialism as it has evolved from the past planned economy. Market socialism is the context for the

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229 Faucheux, C.; Amado, G. and Laurent, A. (1982), 'Organization development and change', *Annual Review of Psychology*, 33 (3), pp. 343-370.
Triandis, H. C. (1994), *Cross-cultural industrial and organisational psychology*, Consulting Psychology Press, CA.

230 Budhwar, P. and Debrah, Y. (2001), *'Introduction' in Human Resource Management in Developing Countries* (ed), Routledge, London. P1-15.

231 Dessler, G. (1976), *Organisation and Management: A contingency approach*, Prentice-Hall, Inc. Englewood Cliffs, N.J. p.54.

growth of emerging ventures while economic reforms are the activator of such emergence. Unlike western enterprises which were born in a free capitalist market, Chinese enterprises grew out of socialist market transformations. Their management practices are significantly affected by this ownership paradigm and political economy. This research explores these issues on the basis of detailed case studies of four different types of business ownership.

3.2 The Utility of Case Studies

Case studies were conducted in the present research to collect data in order to explain the nature of management and organizational behavior in emerging business ventures as these are related to different forms of ownership properties under market socialism. Through case investigation, we aim to demonstrate some connections between theory and practice. The development of management theory is based on summarizing and analyzing management practices. As McGregor (1987) [232] puts it:

"*Every managerial act rests on assumptions, generalizations, and hypotheses – that is to say, on theory. Our assumptions are frequently implicit, sometimes quite unconscious, often conflicting; nevertheless, they determine our predictions that we do a, b will occur. Theory and practice are inseparable.*"

Robert Stake (1995)[233] argues that "*the best use of case studies is for adding to existing experience and humanistic understanding. Its intentionality and empathy are central to the comprehension of social problems, but so also is information that is holistic and episodic. The case studies are likely to continue to be popular because of their style and to be useful for exploration for those who search for explanatory laws. And, moreover, because of the universality and importance of experiential understanding, and because of their compatibility with such understanding, case studies can be expected to continue to have an epistemological advantage over other inquiry methods as a basis for naturalistic generalization. The method has been tried and found to be a direct and satisfying way of adding to experience and improving understanding.*"

In each of the four case studies, open-ended interviews were conducted with key informants in each organization's management team. As Noaks and Wincup

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[232] McGregor, D. (1987), *The Human Side of Enterprise*, Penguin, England, p. 6.
[233] Stake, R. E. (1995), The art of case study research, Sage, London, p24.

(2004)[234] note, "*in order to achieve 'rich data', the key note is 'active listening' in which the interviewer allows the interviewee the freedom to talk and ascribe meanings while bearing in mind the broader aims of the project.*" These aims have been described as "*understanding the language and culture of the respondents*" (Fontana and Frey, 2000)[235]. In order to achieve such understanding, the open-ended interviewer must resolve three main issues:

- "*Deciding how to present yourself, e.g. as a student, as a researcher, etc.*
- *Gaining and maintaining trust, especially where one has to ask sensitive questions.*
- *Establishing rapport with respondents, e.g. attempting to see the world from their viewpoint without going native.*" (Fontana and Frey, 2000)

As Byrne (2004)[236] suggests; "*qualitative interviewing is particularly useful as a research method for accessing individuals' attitudes and values – things that cannot necessarily be observed or accommodated in a formal questionnaires. Open-ended and flexible questions are likely to get a more considered response than closed questions and therefore provide better access to interviewees' views, interpretation of events, understandings, experiences and opinions. Qualitative interviewing when done well is able to achieve a level of depth and complexity that is not available to other.*"

The key purpose of our case studies is to explore evidence in relation to the following questions:

(1) What are the distinctive management characteristics of emerging forms of enterprise under market socialism? (2) How do rapid environmental and institutional changes in economic reforms impact upon them, particularly in re-shaping their management models? (3) What are some of general patterns in the development of business ventures under the dynamic conditions of the Chinese economy?

Four cases were selected and so that each represents a particular type of ownership of business venture. All the selected case companies operate within the textile industry. They are selected for comparison in order to explore the casual links

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[234] Noaks, L. and Wincup, E. (2004), *Criminological Research: Understanding Qualitative Methods*, Sage, London, p80.
[235] Fontana, A. and Frey, J. (2004), 'The Interview: from structured questions to negotiated text' in N. Nenzin and Y. Lincoln (eds), *Handbook of qualitative Research*, 2nd ed. Thousand Oks, Sage, CA. pp654-655.
[236] Byrne, B. (2004), 'Qualitative interviewing', in C. Seale (eds) *Researching Society and Culture*, 2nd ed. Sage, London, p182.

between ownership and organizational development and performance. The literature review suggests that transitional re-deployments in economic configuration have changed the nature of business relations and deepened institutional restructuring in the state sector. Equally, the rapid growth of the private sector has led to continuous ownership diversification and increased market competition. The selected case studies cut across the state sector and private sectors in order to highlight the casual links between organisational change and emergence of management models within the context of the unique features of Chinese market socialism.

3.3 Operational measures used in the research

3.3.1 General Logic in Setting Operational Measures

Emerging forms of business ventures under market socialism in China are examined according to the following scheme:

Figure 3.1 The Analytical Framework

Government economic policies and legal reforms are the 'push' factors causing a changing business environment to be characterised by increasing market competition, globalization, technology advancement and institutional restructuring. China's WTO accession further opened up the domestic market to world markets and gradually changed the regulatory environment in which businesses operate to more international standards. These 'push' factors change and shape enterprise management and development. Data are collected from the four case study enterprises to explore these issues. The main features of management practices under different types of ownership are conveyed by reference to the emergence of different business ventures as derived from economic reforms and institutional transformation. The links between situational factors and organizational characteristics are corroborated by empirical data.

As Yin (1994)[237] suggests, "*To explain a phenomenon is to stipulate a set of casual links about it. These causal links are similar to the independent variables. In most studies, the links may be complex and difficult to measure in any precise manner. The better case studies are the ones in which the explanations have reflected some theoretical significant propositions. For example, the casual links may reflect critical insights into public policy process or into social science theory. The public policy propositions, if correct, can lead to recommendations for future policy actions; the social science propositions, if correct, can lead to major contributions to theory-building.*"

3.3.2 Using the McKinsey 7-S framework

For the purposes of collecting data and undertaking the case studies the McKinsey 7-S framework was adopted. This was used for 'organizing' and 'pinpointing' the main characteristics of each of the case study organisations. This framework was originally designed by Peters and Waterman (1982)[238] for their study of 62 American companies with so-called "excellence traits". From their research Peters and Waterman report that: "*any intelligent approach to organising had to encompass, and treat as interdependent, as least seven variables: structure, strategy, people, management style, systems and procedures, guiding concepts and shared value (e.g. culture), and the present and hoped-for corporate strengths or skills. We*

[237] Yin, R. K. (1994), *Case Study Research: Design and Methods*, 2nd ed., Sage Publications, Inc., London, pp110-111.
[238] Peters, T. J. and Waterman, R. H. (1982) *In Search of Excellence*, Happer & Row, Publishers, New York, p.9.

defined this idea more precisely and elaborated what came to be known as the McKinsey 7-S framework. With a bit of stretching, cutting and fitting, we made all seven variables start with the letter S and invented a logo to go with." This 7-S-model can be used as an analytical tool and as an organising framework for collecting data and for obtaining insights in organisations.

Richard Pascale and Anthony Athos' book, "The art of Japanese Management" was an exemplary case study for further developing the 7-S-model in examining management practices. It successfully explored Japanese management practices in a case study of Matsushita by comparison with an American company. As Pascale and Athos (1982) claim, *"the 7-S framework has been approved as an effective way of perceiving and cutting through the complexity of the organisation. These 7 variables selected are of crucial importance. More would be hard to grasp systematically; fewer would leave something central out.'*

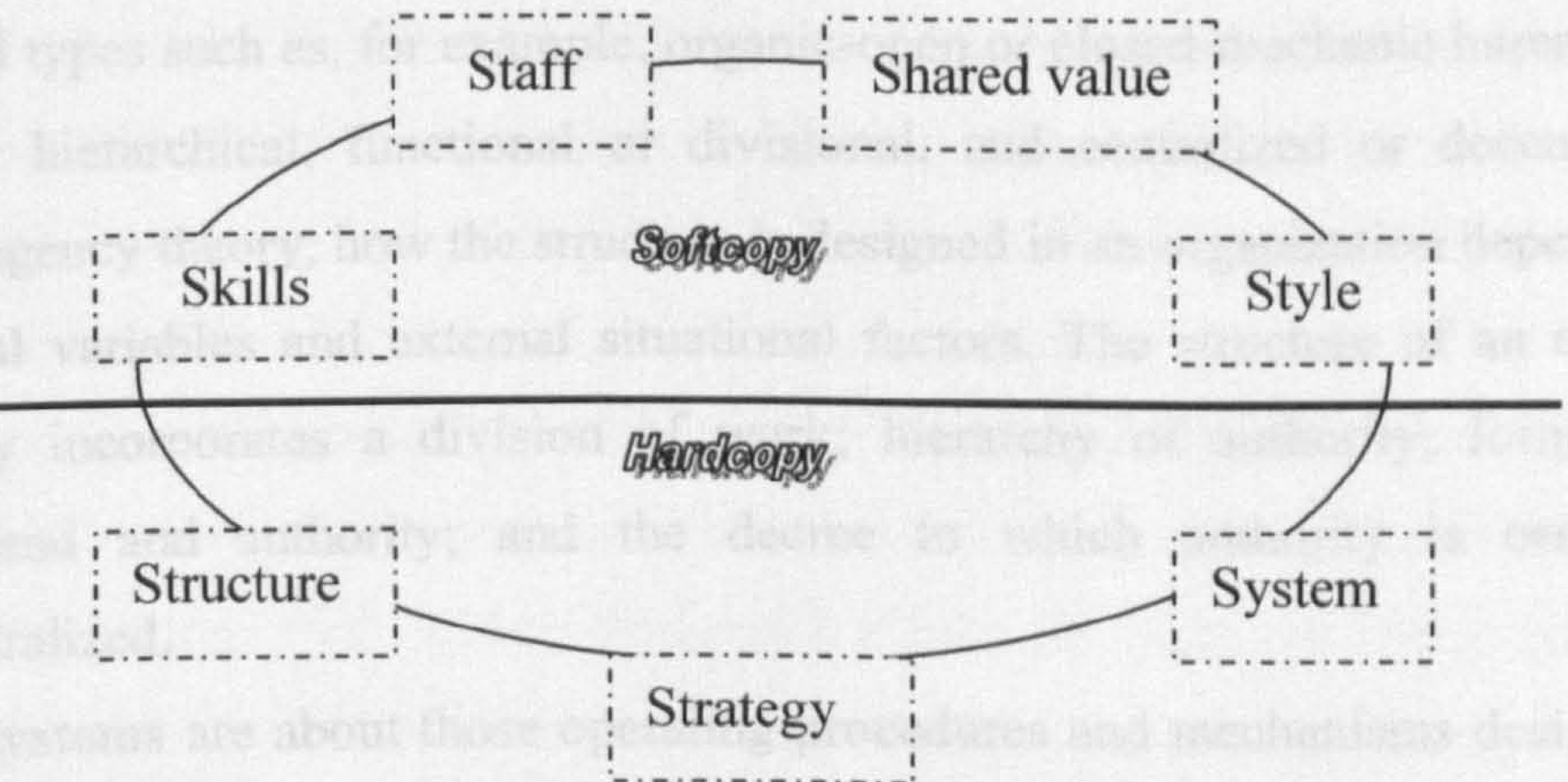

Figure 3.2 McKinsey 7-S Framework

(source: Pascale & Athos, 1986, pp80-81)[239]

Three elements in the 7-S, structure, strategy and system are seen as 'hard' S's, and the other four are regarded as 'soft' S's. The figure 3.2 visualizes at this point the seven elements for describing and understanding an organization as a whole. The 7-S framework is not merely an analytical tool; it also serves as a conceptual underpinning to indicate what range of information needs to be collected. Each S-factor can be operationally stipulated and used for measuring key organisational variables. However, these factors interact and explain each other; they cannot exist alone. For example, structure shapes strategy and vice versa; the characterization of

[239] Pascale, R. T. and Athos, A. G. (1986), *The art of Japanese management*, Penguin Books, London, pp80-81.

structure can be revealed by the ways staff work; the style of managers' behaviour reflects the culture and beliefs of the organisation. The interconnectedness of these seven variables is the key feature of this framework. By examining variables within the 7-S framework, 'a profile of organisational characteristics' can be established. Accordingly, it is a framework that allows us to compare and contrast organisational features by performance to types of ownership. At this point, it is useful to describe in more detail each of the components of the McKinsey 7-S framework.

Structure is the characterization of the organization chart. As Mintzeberg (1983) states: "*the structure of an organization can be simply defined as the sum total of the ways in which its labor is divided into distinct tasks and then its coordination is achieved among these tasks.*"[240] Peters and Waterman (1980)[241] also suggest that "*the structure is how the organization divides up tasks, is one of emphasis and coordination – how to make the whole thing work.*" The structure can be classified in several types such as, for example, organic-open or closed-mechanic bureaucracy, flat or tall hierarchical, functional or divisional, and centralized or decentralized. In Contingency theory, how the structure is designed in an organization depends on both internal variables and external situational factors. The structure of an organization usually incorporates a division of work; hierarchy of authority; formal lines of command and authority; and the decree to which authority is centralized or decentralized.

Systems are about those operating procedures and mechanisms designed within the skeleton of the structure that determine how work is done and tasks undertaken. Peters and Waterman (1980) define it as "*by systems, we mean all the procedures, formal and informal, that make the organization go, day by day and year by year.*" Systems also refer to how decisions are made and include such factors as financial systems, planning procedures, hiring practices, marketing systems etc. These systems are seen as '*management's most powerful tool for expressing how it wants an organization to work and what they want to accomplish* (p273).'[242] It provides the key understanding of how an organization really does (or doesn't) get things done. Therefore they include communication channels/procedures & routine processes

[240] Minzberg, H. (1983), *Structure in Fives: designing effective organisations*, Prentice-Hall Inc., New Jersey. P2.
[241] Waterman, R. H., Peters, T. J. and Phillips, J. R. (1980), 'The 7-S Framework – structure is not organization', *Business Horizons*, June 1980, pp273-276.
[242] Pascale, R. T. and Athos, A. G. (1986), *The art of Japanese management*, Penguin Books, London, p36.

(paperwork, information flow, meetings, in a formal or informal manner); control systems (e.g. financial control); planning systems (how managers plan to achieve for objectives); reward and sanction systems (principle criteria for management efficiency and performance in each division as well as evaluation for individual); and marketing systems (product, sales, marketing communications).

Strategy is about planning in relation to the allocation of a firm's scare resources, over time, to reach identified goals. According to Peters and Waterman (1980): "*by strategy, we mean those actions that a company plans in response to or anticipation of changes in its external environment – its customers, its competitors. Strategy is the way a company aims to improve its position vis-à-vis competition – perhaps through low-cost production or delivery, perhaps by providing better value to the customer, perhaps by achieving sales and service dominance* (p273)." It can be viewed as consisting of two aspects: the corporate and tactical. Corporate strategy refers to the long term planning in relation to organizational development and making decisions in relation to the external environment in order to achieve goals. The 'tactical' is about short-term planning in guiding the operations of those major functions of an organization, such as production, marketing, and finance.

Johnson and Scholes (2002)[243]suggest the absence of an explicit strategy may result in members of an organization working at cross-purposes. The intentions of top management may not be communicated clearly to those at lower levels in the hierarchy who are expected to implement these. Change comes about from either subjective or intuitive assessment, which becomes increasingly unreliable as the rate of change increases. Developing a corporate strategy demands explicit creative effort. If strategic planning is to be successful, it requires effective communication flows within the total organization.

Staff refers to the "demographic" description of an organization, that is, its human resource capabilities. Peters and Waterman (1980) define 'staff' in two ways: "*at the hard end of the spectrum, we talk of appraisal systems, pay scales, formal training programs, and the like. At the soft end, we talk about moral, attitude, motivation and behavior* (p274)." Lynch emphasizes the importance of people as a vital resource for sustaining competitive advantage. And for some industries people

[243] Johnson, G. and Scholes, K. (2002), *Exploring Corporate Strategy*, 6th ed. Prentice-Hall, London.

are not just important but the key factor for successful performance.[244] HR policies and practices have an important role to play in facilitating the effective implementation of management processes, such as 'total quality management'. Research by West and Patterson (1998) in an intensive examination of more than 100 medium-sized manufacturing firms in the UK over seven years confirmed the strong link between effective people management and business performance. Their results draw attention to appropriate HR practices including: (1) effective recruitment and selection; (2) strategic training and appraisals; (3) jobs designed to promote autonomy, flexibility and problem-solving; and (4) favorable reward systems, harmonization and involvement.[245]

Style is characterization of how key managers behave in achieving the organization's goals as well as managing their employees. However, Peters and Waterman (1980) stress that "*we think it is important to distinguish between the basic personality of a top-management team and the way that team comes across to the organization. Not words, but patterns of actions are decisive. The power of style, then, is essentially manageable. One element of a manager's style is how he or she chooses to spend time. Anther aspect of style is symbolic behavior* (p275)." According to Mullins (2005), the essential part of management is coordinating the activities of others and guiding their efforts towards goals and objectives of the organization. Leadership is a central feature of any organization which can vary from very democratic to directive approaches.

Shared values: These refer to the significant meanings or guiding concepts that an organization imbues in its members. Such as belief in the value and ways of doing business, and the social as well as economic purpose of the business. Peters and Waterman (1980) define it as "*by super-ordinate goals (shared values), we mean guiding concepts – as set of values and aspirations, often unwritten, that goes beyond the conventional formal statement of corporate objective. They are the fundamental ideas around which a business is built. They are its main values. They are the broad notions of future direction that the top management team wants to infuse throughout the organization. They are the way in which the team wants to express itself, to leave its own mark* (p275)."

[244] Lynch, R. (2003), *Corporate Strategy*, 3rd ed., Financial Times Prentice Hall, London.
[245] West, M. and Patterson, M. (1998), 'Profitable Personnel', *People Management*, 8 (1), Jan1998, pp28-31.

Handy (1993) [246] has contributed to the discussion of shared values and organizational culture by outlining four culture types: power culture, role culture, task culture and person culture. *Power culture* depends on a central power source with rays of influence from the central figure throughout the organization. It is frequently found in small entrepreneurial organizations and relies on trust, empathy and personal communications for its effectiveness. Control is exercised from the centre by the selection of key individuals. There are few rules and procedures, and little bureaucracy. *Role culture* is often stereotyped as a bureaucracy and works by logic and rationality. It rests on the strength of strong organizational 'pillars' – the functions of specialists in, for example, finance, purchasing and production. The work of, and interaction between, the pillars is controlled by procedures and rules, and coordinated by the pediment of a small band of senior managers. Role or job description is often more important than the individual and position power is the main source of power. *Task culture* is job-oriented or project-oriented. An example is the matrix organization. Task culture seeks to bring together the right resources and people, and utilizes the unifying power of the group. Influence is widely spread and based more on expert power than on position or personal power. *Person culture* is where the individual is the central focus and any structure exists to serve the individuals within it. When a group of people decide that it is in their own interests to band together to do their own thing and share office space, equipment or clerical assistance then the resulting organization would have a person culture. Management hierarchies and control mechanisms are possible only by mutual consent. Individuals have almost complete autonomy and any influence over them is likely to be on the basis of personal power.

Geert Hofstede (1980)[247] has extended the work on organizational cultures by discussing the impact of national cultures. Arguing that culture is, in a memorable phrase, 'collective programming' or 'software of the mind', Hofstede initially identified four dimensions of culture: *power distance, uncertainty avoidance, individualism and masculinity*. A fifth dimension of culture, long-term/short term orientation, was originally labeled as 'Confucian work dynamism'. This dimension was developed from the work of Bond in an attempt to assess the impact of Chinese

[246] Handy, C. B. (1993), *Understanding Organizations*, 4th ed., Penguin, London.
[247] Hofstede, G. (1980), *Culture's Consequences*, Saga, London.

cultural values on the workplace.[248] These five dimensions can be used to explore organizational values and culture from a cross – national comparative analysis.

- *'Power distance'* is essentially used to categorize levels of inequality in organizations, which Hofstede claims will depend upon management style, willingness of subordinates to disagree with supervisors, and the educational level and status accruing to particular roles. China is seen to display a high level of power distance. In contrast, the USA is characterized as a low power distance society.
- *'Uncertainty avoidance'* refers to the extent to which members of a society feel threatened by unusual situations and risk. China is estimated as medium to uncertainty avoidance, and the USA is said to be low-to-medium.
- *'Individualism'* refers to the relatively individualistic or collectivist values and ethics evident in a particular society. Thus, according to the Hofstede, the USA displays high individualism which is in contrast with Hong Kong and China which are collectivist societies.
- *'Masculinity'* refers to a continuum between 'masculine' characteristics, such as assertiveness and competitiveness, and 'feminine' traits, such as caring, a stress upon the quality of life and concern with the environment. High masculinity societies included the USA and Hong Kong, whereas China is estimated at "medium" on this dimension.

Every organization will have its own unique culture and core values and most large businesses are likely to be a mix of cultures in varying areas of its organization. However, the type of culture built within an organization should facilitate management effectiveness and unify the organization as a whole. Nowadays, attention is given to the importance of culture construction in organizational development and performance. It is recognized that a "strong" culture can provide the norms and guidance for solving conflicts and releasing tensions. An organization will benefit from a shared value belief in its long-term strategic development and growth.

Skills refer to the distinctive capabilities of key personnel and the firm as a whole. Like Peters and Waterman (1980) define – "*these dominating attributes or capabilities are what we mean by skills* (p276)." It also refers to the core competences

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[248] Hofstede, G. and Bond, M. H. (2005), 'The Confucius Connection: from cultural roots to economic growth' Organisational Dynamics, Spring, 1988, pp. 4-21. Cited from Mulins (2005), *Management and Organisational Behaviour*, 7th ed. Pearson Education Limited, England, pp47-49.

the firm possesses. In a rapid changing environment, particularly in the market with institutional transition, Chinese organizations are facing challenges in building management capacity. Management skills are practically lacking and inhibit organizational development. Technological skills are also vital for innovation and competitive advantage.

These are the factors that make up the McKinsey 7-S framework. Each interacts with the other to create an organizational profile. As Peters and Waterman state, the 7-S framework is an analytical tool for exploring the dynamics of organizational life. They stress that it is for the research investigator to construct organizational dimensions for each of the 'S's that are relevant for the enquiry being undertaken. For the purposes of this research, the dimensions created for each 'S', as the basis for data collection were as follows:

Strategy

(1) Business long-term strategies and goals for the next 5 to 10 years;

(2) Implementation planning processes;

(3) Short-term strategies at the operational level;

(4) Strategic development and changes in relation to influencing factors of the external business environment;

(5) Strategy decision-making participants – top teams and key influentials.

Structure

(1) Organisational charts and their specification of roles, responsibilities and authorities;

(2) Key decision-making processes;

(3) Operational management systems

(4) Performance targets and management objectives;

(5) Departmental functions, job specialization, relations and coordination between departments;

(6) Departmental goals and performance measuring mechanisms; budgeting and planning control processes.

Systems

(1) Financial systems and methods of management accounts;

(2) Communications channels – formal and informal;

(3) Planning systems for achieving management objectives;

(4) Reward and sanction systems;

(5) Marketing and production processes;

(6) Mechanisms for innovation, R&D and technological development.

<u>Style</u>

(1) Leadership and senior management styles;

(2) Approaches to problem and conflict solving;

(3) Work Climate – strategies for employee motivation and morale;

(4) Communications mechanisms (e.g. paper, face-to-face, formal or informal meetings);

(5) Influence of western management theory (e.g. learning and practice).

<u>Staff</u>

(1) Professional and expert competences of key personnel;

(2) Recruitment policies of HR (e.g. selection criteria, training and mentoring process for new recruits);

(3) Training program and policies;

(4) Staff development policies;

(5) Performance evaluation systems;

(6) Impact of western HR management ideas in working practices.

<u>Shared values</u>

(1) Management philosophies (indicators including consideration, respect and trust; recognition and credit; involvement and availability; fair and equitable treatment; positive action on individual basis; and emphasis on end-results.);

(2) Organizational culture (indicators including routines; rituals; stories; symbols; power structures and control methods);

(3) Key values driving employees' beliefs and understanding of business development.

<u>Skills</u>

(1) Capabilities and expertise of key personnel;

(2) Technologies employed (including office, manufacturing and R&D);

(3) Competitive advantages in relation to 'core' competences.

As complementary to the 7-S dimensions, <u>Situational Factors</u> are also examined to further explain how the external environment shapes management practices. These situational factors include:

1. Opportunities and threats in the evolving market;

2. The impact of legal reforms and government policies;
3. History and background of the enterprises and the 'legacy effect' in business development.

3.3.3 The Selection of Case Studies

As reviewed in the first two chapters, the state sector was the only form of ownership in China under the earlier socialist regime. After two decades of reforms, the economy has evolved into a state sector and a private sector, with diversified forms of ownership. Four case study companies were chosen to represent these two sectors. These are (1) a state-owned enterprise (2) a collective-owned enterprise (3) a foreign joint venture and (4) an entrepreneurial enterprise.

The four cases representing different types of ownership are selected from the textile industry. Three of the case companies are located in Dalian, Liaoning Province, one of most internationalized cities in south-east China with a population of over 6 million. The city's annual Fashion Festival is a major international event and the clothing industry is a major economic component of its industrial structure. In 1997, the central government decided to use the textile industry as the experiment for restructuring state sector enterprises. Therefore, as both a traditional and competitive industry, the textile sector is a pioneer for the implementation of government reform experiments. It offers a perfect case for assessing the impact of legal reforms and organizational change for management practices. This is why the four case studies were chosen in this sector.

As a consequence of the prior planned economy, the textile industry was overstaffed, over-debt and with heavy social responsibilities. The textile industry had always suffered losses; in 1997, this amounted to RMB 1060 billion (US$128 billion), and accounted for the highest percentage of state enterprise losses. 54% of state-owned enterprises in the textile industry were in debt at a rate far higher than the average for state industries (CTIA, 2000/2001). [249] After the reforms in the textile industry since 1997, some significant improvements have been achieved. Losses have been reduced and new technologies installed as a result of capital investment programmes. Enterprises are more market-focused and management skills have been

[249] China Textile Industry Associate (CTIA) '*China development report of Textile industry*' (2000/2001) China Textile Press, Beijing, p139.

improved (Wang, 2001).[250] The textile industry plays a pioneering role in economic reforms and demonstrates significant management restructuring. Following China's accession to WTO, the textile industry has access to international markets. This has given the sector opportunities for rapid business growth. The textile industry also provides a useful context to study economic reforms, the emergence of new forms of ownership and re-structured management practices. In this sector, the number of state-owned enterprises now makes up only 6% of all enterprises; collectively-owned enterprises 4.7% of the sector; foreign joint ventures 43.5% and entrepreneurial enterprises 45.8% (CTIA, 2002/2003).[251] All four types of business ownership are represented in this sector, offering an appropriate industry for a comparative study of case companies characterized by different ownership forms.

3.3.4 The Four Case Study Companies

The four case study companies selected for this research are: (1) '*Liaoning Times Group*' (LTG) – a state-owned enterprise (SOE); (2) '*Shenyang Liming Anna Clothing*' (SLAC) – a collectively-owned enterprise (COE); (3) '*Dalian Dali Cashmere Product Company*' – a privately-owned enterprise (POE); and (4) '*Dalian Sunfed Fashion Clothing*' (DSF) – a foreign joint-venture (FJV).

Liaoning Times Group (LTG)

LTG as a traditional state-owned enterprise was founded in 1955. It witnessed the market transformation from a planned socialist economy to a competition-driven market nowadays. Followed by legal reforms of SOEs, LTG became a partly-owned public company listed on the 'A' stock market of Shanghai in 2000. Today it consists of six wholly-owned and partly-controlled factories, and its operational functions include fabric dyeing and garments production. Its annual production is more than 2 million garments and 105 million meters of dyed fabrics. LTG has total assets of one billion RMB (US$121 million) with over 6000 employees. As one of the leaders in garments export in China, it has amassed more than forty years experience in the import and export of all types of woven and knitted garments, as well as related materials, ranging from raw material, fabrics, trims and accessories. Products are

[250] Wang, Tiankai (2001), *The first breakthrough of enterprise reform in the textile industry*, the forum of minister and academician, Beijing 2001.
[251] China Textile Industry Associate (CTIA) '*China development report of Textile industry*' (2002/2003), China Textile Press, Beijing, p128.

shipped to more than 60 countries, and the company is internationally known for its quality and reliability. Three geographical areas – North America, Europe and Japan/Korea – are strategically targeted by specialised overseas divisions of LTG. The work of these divisions is further facilitated by its multi-function of transportation, warehousing and quality assurance. It has representative offices located in the United States, Germany, Japan and Hong Kong, ensuring seamless worldwide business relations.

Shenyang Liming Anna Clothing (SLAC)

The case of SLAC, as a collectively-owned enterprise has recently undergone ownership reforms in 2002. This case combines private ownership and collective ownership; a typical collective form of business venture in contemporary China resulting from market transformation. Such cases are few nowadays, as the statistics indicate that only 4.7% of enterprises in the textile industry consist of this type of collective ownership. SLAC was originally founded in 1956 as a collectively-owned enterprise in the state sector. It was reformed in 2002 by which private ownership became involved as the dominant shareholder while the collective ownership retreated as secondary shareholder. A mixed management model is prominent in this case company. It currently has 600 employees and fixed asset value of RMB20 million (US$2.4 million) in equipment and buildings. This allows for an annual production capacity of 1 million garments. As a professional garments company, it integrates manufacturing, marketing, retailing, and export & import functions. Its product range covers women and men's suits, shirts and trousers to causal wear, fashion clothes, Jeans and snowsuits. Its main markets for sales comprise domestic cities and overseas countries, such as Japan, South Korea, Europe and USA. SLAC owns two patented trademarks: "Anna Lee" for woman's fashion clothes and "Yawenshi" for man's suits and shirt. These brands are only for domestic market sales and account for only a minor portion of all profits. Its major profits are from manufacturing and processing garments for foreign brands.

Dalian Dali Cashmere Company (Dali)

The case of Dali Cashmere, as a privately-owned enterprise, is a typical entrepreneurial company. The owner as a risk-taking entrepreneur who started his business in 1995 and developed the company from nothing to a company equipped with RMB50 million (US$6 million) assets and 200 employees. Its annual sales in cashmere product reach to RMB30 million (US$4 million), including both overseas and domestic markets. The ownership in this case is simple and clear. It represents the driving force in the private sector and an outcome of marketisation and privatization. Its ten-year's development and success has reflected the rapid growth of the private sector in contemporary China under market socialism.

Dalian Sunfed Fashion (DSF)

The case of DSF is an American-Chinese joint venture, founded in 1997. Sunfed Group U.S. invested 30, 000 US dollars capital with its Chinese partner, Mr. Li, an overseas Chinese, who brought into this venture 36, 000 US dollars capital to set up a joint venture company in the clothing business. Affiliated with the Sunfed Group in the U.S., Dalian Sunfed Fashion (DSF) has established a branding reputation in Dalian for its sophisticated style and fine craftsmanship. The brand has become very popular in Dalian and it has consecutively made the top list in recent Dalian International Fashion Exhibitions from 2003 to 2005. It was awarded the "BEST OF TEN" ladies fashion in the ninth, tenth and eleventh Dalian International Fashion Festivals with its excellent styles and high sales. As a distinctive professional women's wear company, the DSF collection is outstanding with its fresh and bright looking, unique designs and long lasting styles. It breaks through the boundary between "professional" and "informal"; professional but stylish. DSF is a brand-focused company and produces high value-added products. In eight years, it has acquired over RMB40 million assets (US$5 million) with annual sales RMB99 million (US$12 million) in 2005. Despite this, it remains small with 200 employees.

3.4 The collection of Data

Multiple sources of evidence were used; that is, data were collected from the four different types of organization, but focusing on the same set of facts/findings through one organizational framework, the McKinsey 7-S framework. The case study databases, as a formal assembly of evidence are in both paper and computerized forms and comprise *questionnaires and interviews* (in paper format archives); *documents and companies archives* that are categorized in case unit files; *financial data; recorded tapes* of all interviews; and *photos* of each case company.

A chain of evidence is maintained as explicit links between the questions asked, the data collected, and the conclusions drawn; it is characterized with clear cross-referencing methodological procedures and illustrations of interrelations to the resulting evidence. According to Yin's suggestion (2003)[252], the incorporation of these principles into a case study investigation can increase its quality substantially. In order to ensure quality control in the data collection process, the fieldwork investigation was well designed and organized in a scientific manner and certain formally required procedures were rigorously followed in the process of fieldwork. For instance, a protocol of fieldwork research was designed before the investigation started, which included the field procedures to be followed; criteria of case selection; time table for interviews' arrangement; dimensions of questionnaires and criteria for data analysis.

3.4.1 Fieldwork

It was very difficult gaining access to the case study companies. The state-owned enterprise (LTG) was accessed through personal contacts. This is virtually the only way a researcher can gain entry into Chinese companies. The fieldwork in the four case companies took one year in total to complete, starting from May 2005 to May 2006. Arranging access to selected companies and networking with entrepreneurs and government officials took place at the initial stage of the research. More than four case companies (seven to eight) were initially selected but through verification according to case selection criteria (ownership) and the need for full access, the four case companies were finally selected. After informal networking and interviews with key informants, the formal fieldwork investigation began with the privately-owned enterprise in June 2005, the state-owned enterprise in September, collectively-owned enterprise in December and the foreign joint-venture enterprise in March 2006. During the fieldwork in each case company, two to three interviews were arranged for each week, and these were often repeated two or three times due to the detailed information required. Re-visits were also caused by the limited time of senior managers at single meetings, so that several appointments with interviewees had to be arranged.

[252] Yin, R. K. (2003), *Case Study Research: Design and Methods*, 3rd ed., Sage Publications, London.

All the interviews were type recorded and then filed in computerized form. Duplicated paper copies of all interviews were also taken and documented. Relevant photos to demonstrate the product, office and work climate were taken at each case site. The interviews were structured according to the McKinsey 7-S framework, and each required three hour interviews with respondents. All four case companies also provided relevant documents and financial data for the research. A letter of introduction was sent to all case companies involved in the investigation explaining the academic purpose of the research and guaranteeing confidentiality of company information (See Appendix 3). The questionnaire used in the case studies is reproduced in Appendix 4.

3.4.2 Sources of Data Collection

There were four sources of data that provide the evidence for each of the case study companies.

(1). Formal and informal Interviews

These were concluded with the CEO of each case company in an open- ended nature and in a conversational manner. The key informants in each of the four cases devoted more than three hours for the interviews. Rich information was offered in an open-ended manner. (For a list of these key informants see Appendix 5.) Key Departmental managers of each organization were also interviewed as well as government officials responsible for policy issues in relation to business and the regulatory environment in which organizations operate. The interviews were tape recorded and notes of interviews were also taken. These are available for inspection in both paper form and computerized databases. They are responded in the Mandarin language.

According to the case study theory of Yin (2003), the use of interviews acts as an essential source of evidence in case studies because these allow for the exploration of organizational behavior and management processes. Human affairs need to be reported and interpreted through the eyes of organizational leaders who are managing and directing the whole organization. They are the most valuable informants to provide important insights into the core of management practices in an organization. Interviewing is undertaken as a precedent approach because it can give shortcuts to the history of the organization, helping to identify other relevant sources of evidence.

(2). The Use of Documents

Documents were inspected in relation to management procedures, personnel policies, contracts and other issues relevant for exploring the 7-S framework topics. These were also used to compare with the data offered by the key informants in the interviews.

(3). The Use of Archival Records

Organizational records such as organizational charts and budgets/finance were analysed. These provided quantitative data about financial performance.

(4). Non-Participant Observation

While conducting the interviews, the researcher also observed formal and informal patterns of behavior as indicators of culture, style and management practices. She observed meetings, supervisory styles and office lay-out.

3.5 Analyzing the data

"*Data analysis is exciting because you discover themes and concepts embedded throughout your interviews. As you continue with the data analysis, you weave these themes and concepts into a broader explanation of theoretical or practical import to guide your final report. Data analysis is final stage of listening to hear the meaning of what is said.*" (Rubin and Rubin, 1995)[253]

Throughout the 12 months fieldwork, more than 50 interviews were conducted with 30 interviewees (incl. revisits) and all relevant data gathered. These form the completed archives for each case study. The next goal after the initial data collection was to analyze this data to discover key information and cross-check evidence. *De facto*, the data analysis stage started during the interview process and this information was added to through later interviews with other respondents. More interviews and questions were put to informants, while the questionnaires were also modified to suit emergent and contingent situations in the field research.

At the stage of data analysis, with over 50 digital recordings, along with six boxes of documents, I listened to the interviews repeatedly one by one and read through all documents from each case organization. I then categorized them in relevant subjects in accordance with how I had specified the operational measure in relation to the McKinsey 7-S framework. By reading and listening to the data, I recorded each time a particular idea or concept was mentioned or explained, and

[253] Rubin, H. J. and Rubin, I. S. (1995), *Qualitative Interviewing : the art of hearing data*. Sage, London, p226.

referenced these according to the structured topics of the 7-S framework. Then, I grouped these responses together describing the same idea or process and examining everything that I put in the same category. In other words, the data are organized to describe the structure, strategy, system, staff, style, skills and shared values (7-S), for each of the four case study organizations. The following chapters, on the basis of the collected data, describe each of the four case study organizations representing as they do, different types of enterprise ownership emerging under the evolving market socialist economy of China.

CHAPTER FOUR:

Case Study (1): The State-Owned Enterprise

Liaoning Times Group Plc.

Introduction

Studies of business organisations in China have yet to focus on the impact of different types of ownership upon management styles and organisational behaviour. Clearly, different ownership types can lead to different organisational processes giving rise to variations in strategy, structure, systems, values, management style and decision-making. In addition, the legal context and regulations as these relate to different types of business venture create organisational differences in the market environment in which business ventures operate. This is a distinctive feature of market socialism that cannot be neglected.

Privately-owned and foreign-owned joint-ventures that have emerged under market transformation are continuously changing. State-owned enterprises (SOE) are also undergoing management restructuring, corporatization and ownership diversification. The reform of state-owned enterprises has long been restricted by the Communist Party's socialist ideology but, even so, they have undergone various reforms. This chapter, on the basis of case study data, discusses a state-owned enterprise in the textile industry.

4.1 Background of Liaoning Time Group

'Liaoning Times Group Inc.' (LTG) is a state owned public corporation which was legally "spun-off" from 'Liaoning Garments Import and Export Corp.' (LGIEC), a large State garments trading company in Liaoning Province in 1998. Its past name reflects re-structuring since 1955 by administrative reforms from "centralization" to "decentralization" and a market-focused organisation. (See Figure 4.1) It was originally 'China Sundries Import & Export Company, Liaoning Branch'. It then specialised in the textile industry and became 'China Textiles Import & Export Corporation, Liaoning Branch (CTIEC) in 1960. It was an adjunct of the State administrative system, managed by the Central Party Committee. In 1987, it developed as a market-focused trading company with an emphasis on the import and export of garments and related products. Since1989, it has achieved significant financial performance as reflected in figure 4.2.

Figure 4.1 Historical development of Times Group Inc.

Year	Name
1955.03	Liaoning Branch of China Sundries lmp. & Exp. Co.
1960.06	Liaoning Branch of China Textiles lmp. & Exp. Co.
1987.03	Liaoning Garments lmp. & Exp. Co
1998.07	Liaoning Times Group Inc.

Figure 4.2 Achievements of the Times Group Inc.

Year	Achievements
1989	The Excellent enterprise in Liaoning Province for Foreign Outsourcing & Processing
1990	Grade II State Enterprise
1990	Advanced National Enterprise for Export exchange earnings, committed contractor, credible and reliable enterprise
1990-1991	Advanced Enterprise in Liaoning Province
1993	The Outstanding Enterprise on the Achievement Exhibition of China Export Commodity Base Construction
1997	Credit Grade AAA Enterprise in Liaoning Province
1997	Advanced Collective in Nationwide System of Foreign Trade and Economy
1998	Advanced Enterprise for High Quality & Profitability in Nationwide System of Foreign Trade and Economy

Changes in the global economy and China's accession to the WTO provided the company with the opportunity to reform and become the organisation of today: a public company listed on the 'A' stock market of Shanghai in 2000. In August, 2001, it became legally incorporated with an independent board of directors. Today it consists of six wholly-owned and partly-owned factories, and its operational functions include fabric dyeing and garments production. Its annual production is more than 2 million garments and 105 million meters of dyed fabrics. On the basis of this core activity, the company is gradually diversifying into different industries, such as real estate, property management and retail services. It is also attempting to gain a foot in the capital market for investment management.

Today, LTG has total assets of one billion RMB (US$121 million) with over 6000 employees. As one of the leaders in China in garments exports, it has amassed more than forty years experience in the import and export of all types of woven and knitted garments, as well as related materials, ranging from raw material, fabrics, trims and accessories (See Appendix 6, photos of product categories). Products are shipped to more than 60 countries, and the company is internationally known for its quality and reliability. Three geographical areas, North America, Europe and Japan/Korea, are strategically targeted by specialised overseas divisions of LTG. The work of these divisions is further facilitated by its multi-function of transportation, warehousing and quality assurance. It has representative offices located in the United States, Germany, Japan and Hong Kong, ensuring seamless worldwide business relations.

In the light of LTG's performance, the statistics demonstrate steady but slow growth in profitability and a dramatic improvement in shareholder equity. Its fix assets have significantly increased from 291 million RMB (US$ 35 million) in 2000 to 830 million RMB (US$ 100 million) in 2005. (See Figure 4.3 Operational Performance of LTG) The main trading business, Times Garments Export and Import (TGIEI), contributes to the majority profit of LTG's total annual gains. Its profit share has increased from 75% in 2002 to 90% in 2005. (See figure 4.4 Profit Distribution in three industries 2002 - 2005) The major profit from TGIEI is from overseas markets, basically from the three areas of Europe, USA and Japan. The profit from China's domestic sales is only 19% in 2004. (See Figure 4.5 Profit share in different markets)

Figure 4.3 Operational Performance of LTG

Unit: RMB Yuan

Year	Gross Profit of Main Business	*Plus/ Minus (%)*	Shareholder Equity	*Plus/ Minus (%)*	Total Liabilities	*Plus/ Minus (%)*	Total Assets	*Plus/ Minus (%)*
1999	86,570,331		121,705,384		164,776,943		291,836,406	
2000	88,987,478	*2.79*	346,936,349	*185.06*	262,959,991	*35.48*	617,069,314	*111.44*
2001	103,736,445	*16.57*	381,855,352	*10.06*	229,805,381	*11.10*	619,483,000	*0.39*
2002	104,548,601	*0.78*	403,548,608	*5.68*	257,723,204	*12.15*	669,387,238	*8.06*
2003	111,542,633	*6.69*	429,986,761	*6.55*	255,785,361	*-0.75*	688,647,625	*2.88*
2004	120,835,412	*8.33*	450,250,668	*4.71*	262,655,377	*2.61*	718,537,418	*4.34*
2005	123,445,944	*2.16*	466,252,970	*3.55*	318,178,490	*17.45*	830,315,141	*15.56*

Figure 4.4 The Distribution of Profits within LTG, 2005

Industries	Total Profit 2002 (RMB)	%	Total Profit 2003 (RMB)	%	Total Profit 2004 (RMB)	%	Total Profit 2005 (RMB)	%
Manufacturing	25,525,867	24.42	26,719,155	23.86	24,602,199	20.29	10,927,521	8.81
International Trading	79,289,330	75.84	85,120,224	76.02	96,555,386	79.63	112,674,440	90.89
Service	133,777	0.13	125,241	0.11	94,309	0.08	364,875	0.29
TOTAL	*104,548,975*	*100*	*111,964,621*	*100*	*121,251,895*	*100*	*123,966,837*	*100*
Domestic	20,899,103	19.99	23,131,875	20.66	22,643,164	18.67	10,554,229	8.51
Overseas	83,649,871	80.01	88,832,745	79.34	98,608,731	81.33	113,412,608	91.49

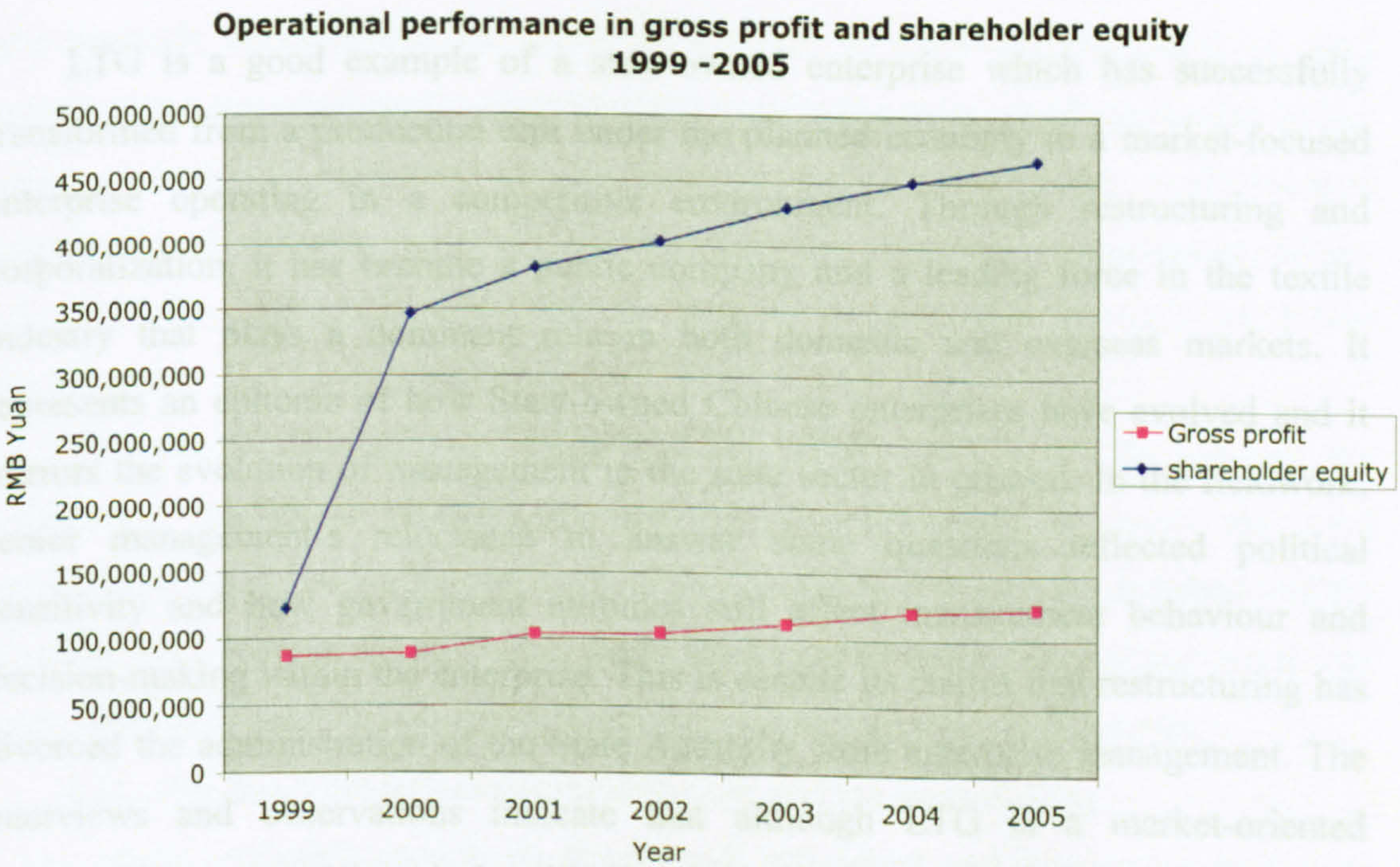
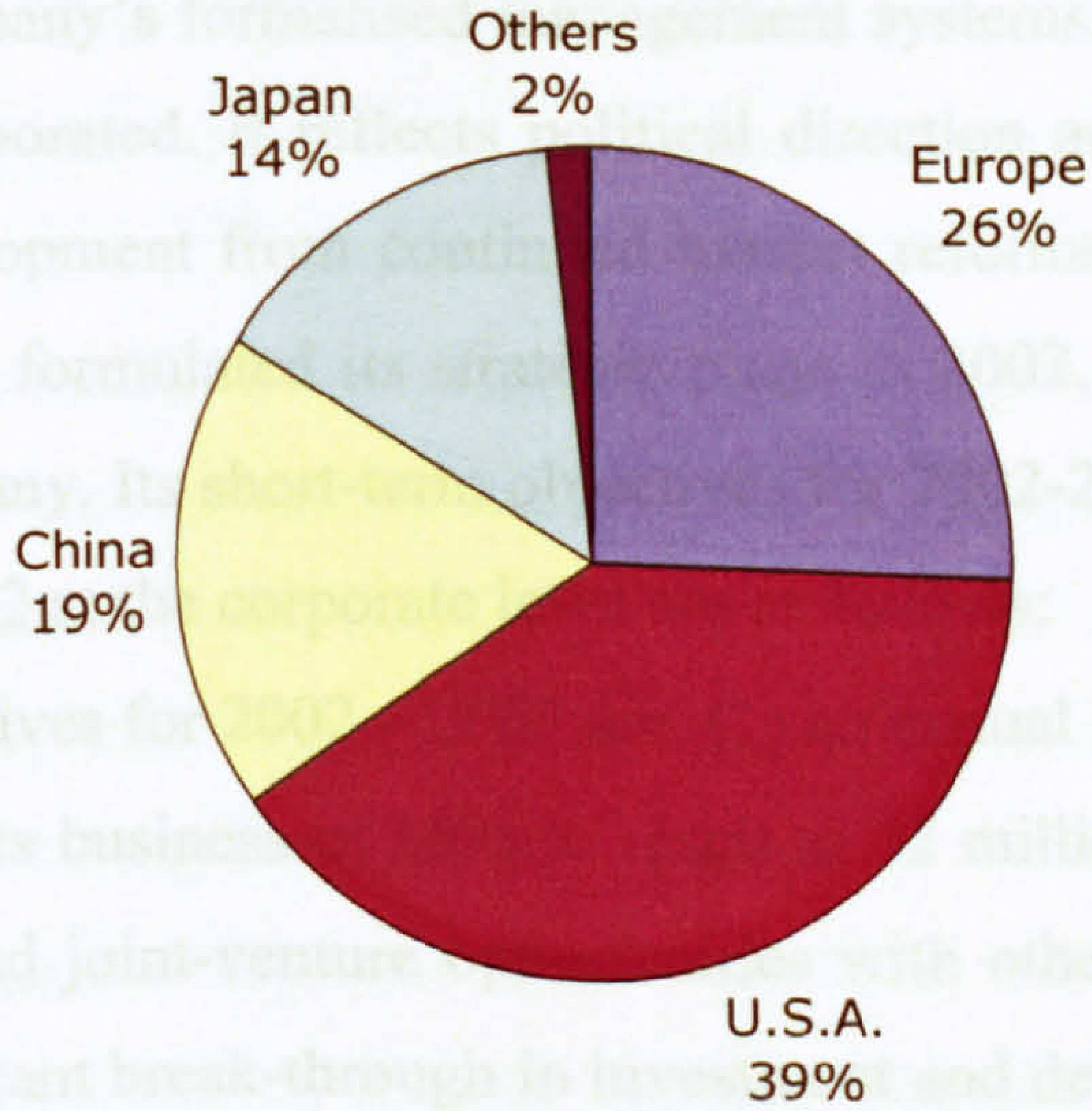


Figure 4.5 Contribution to Profits by different markets, 2004



LTG is a good example of a state-owned enterprise which has successfully transformed from a production unit under the planned economy to a market-focused enterprise operating in a competitive environment. Through restructuring and corporatization, it has become a public company and a leading force in the textile industry that plays a dominant role in both domestic and overseas markets. It represents an epitome of how State-owned Chinese enterprises have evolved and it mirrors the evolution of management in the state sector in general. In the fieldwork, senior management's reluctance to answer some questions reflected political sensitivity and how government attitudes still affect management behaviour and decision-making within the enterprise. This is despite its claims that restructuring has divorced the administration of the State Authority from enterprise management. The interviews and observations indicate that although LTG is a market-oriented conglomerate corporation, it is still directly influenced by the State and political forces. As discussed in chapter 3, this company is analysed by reference to each of the dimensions of the McKinsey 7-S framework.

4.2 McKinsey 7-S framework analysis:

4.2.1 Strategy

LTG has strategic planning for 5-year short-term objectives and 10-year long term goals. The statement of strategy is explicit at both the corporate and operational levels. Like the company's formalised management systems, the strategy is officially documented and elaborated. It reflects political direction and government policy as well as LTG's development from continued market reforms. According to company documentation, LTG formulated its strategic plans in 2002, when it became a partly publicly-listed company. Its short-term objectives for 2002-2007 as well as its longer-term goals, 2002-2012 at the corporate level are as follows:

Five year objectives for 2002 – 2007 are, (1) an annual increase in profit margins for the main garments business of 10% to reach to 72 million RMB in 2007; (2) the search for merger and joint-venture opportunities with other compatible enterprises; (3) to make a significant break-through in investment and development diversification, for new profit opportunities; (4) the subsidiary companies to diversify in investment and business opportunities for profit growth; (5) to improve the quality of staff selection and management development; (6) to raise the earnings of employees in line with productivity increases; (7) to develop a high-performing, profit-focused organisational culture; (8) to thoroughly enhance the core competences of the company for competitiveness and to ensure the potential strength of future development.

The ten year development goals of LTG (2002 – 2012) are '*To enhance the company's innovative capacity in business diversification; to grow the total profitability by 1.5 times on the basis of 2002, and to achieve one hundred million RMB in 2012. To develop LTG as a large-scale conglomerate with strong assets and competitiveness; and to diversify into trading and manufacturing industries.*

LTG also has 5 guidelines for the five-year and ten-year strategy:

(i) to retain profitable growth by operational efficiency and investment in quality management systems and advanced technology; (ii) to give priority to export and import trading; (iii) to establish joint ventures with foreign companies in relevant industries and to establish strategic alliances to expand in international markets; (iv) to continually re-structure LTG and to diversify its investment for future growth; (v) to develop a corporate culture that stresses spiritual as well as material values.

In accordance with these guidelines, LTG has three phrases of development:

The First Phrase 2003 -2006	Strategic Transformation Period
The Second Phrase 2006 - 2010	Rapid Growth Period
The Third Phrase 2010 – 2012	Stable Development Period

The main tasks relating to the first phrase of strategic transformation are: (a) to consolidate the core business and to make export and import trading as the leading engine for the development of LTG. LTG has strengths in skills in international trading and has a long-term reputation for business credibility; (b) to accelerate the upgrading of manufacturing factories and to develop a structure and culture that is market-focused for the development of new products. Through joint ventures with famous foreign brands, it intends to build its own brand value and core brand products; (c) to be actively involved in developing businesses in new industries through investment projects; to seek investment opportunities in the areas of real estate and information technology; and (d) to eliminate state support and the losses of some of its subsidiary companies.

LTG clarifies its objectives for both the short and the long term, and each stage of development is phrased for different tasks. But there is a paradox between its strategy of 'Focus' and 'Diversification'. LTG emphasises that both these strategies are at the centre of its business development. But it gives priority to its main business with diversification in different industries as complimentary to this.

The five-guidelines for strategy planning incorporate all the government policies for the reform of state-owned enterprises, which differentiate their management from other types of enterprises that operate in the same market. The state-owned enterprises are much more politically driven than pure market-oriented companies, such as privately-owned enterprises and foreign joint-ventures. The strategic planning of LTG is not fully decided by its own senior management but is mostly driven by the administration agency – The Administration and Inspection Committee of State Assets - that reinforces political direction. Conventional Communist Party thinking on the planned economy still affects the ideology and behaviour of managers in LTG. This is evidenced in the later section on staff.

4.2.2 Structure

It is essential to explain the structure of this State-owned enterprise at both administrative and governance levels as it reflects the impact of state ownership over the formation of its structure. "The Administration and Inspection Committee of State Assets" (AICSA) was set up in 2002 by the 16th Congress of the Communist Party. This was followed by the issue of a "Provisional Decree of The Enterprise and State Assets Administration and Inspection". This provides the basic infrastructure for the administration of state assets. The Decree defines the role of AICSA to be that:

"In accordance with its authorization, AICSA fulfils the owner's duty to implement discretion in State owned and controlled enterprises in terms of independence, merger, purchase, bankruptcy, dismissal, decrease or increase in capital, issue of bonds, cessions of shares, etc. and other such grand proceedings. It also appoints at all levels of senior posts, such as the president, vice president, the general manager, vice general manager, principle accountant, and Board of Directors."[254]

This new administrative agency – AICSA - is responsible for the administration and supervision of State assets after the separation of political and enterprise governance. It has the role of 'Boss' or the 'representative of the owner' to fulfill owner responsibilities; that is, election of management, claims on profits, major decision-making, and the disposal of assets. However, as Fang (2004)[255] from The State Finance Ministry says:

"The degree of this function and how far this administration can go are not specified in detail. For example, there is no current law on how to distribute the profits of State-Owned Enterprises although there is a proposal for operational budget planning. But it does not explain clearly the relations between the operational budget of State assets and State finance at the extent to whether the gains of State assets should be included into the revenue of State finance."

As a result, some conflicts and undefined relations still confuse its implementation. The present Party Secretary of LTG, Ms Liang says in an interview:

"As a state owned enterprise, the current management structure of LTG is still inefficient and the reforms have not had much significant effect upon improving our

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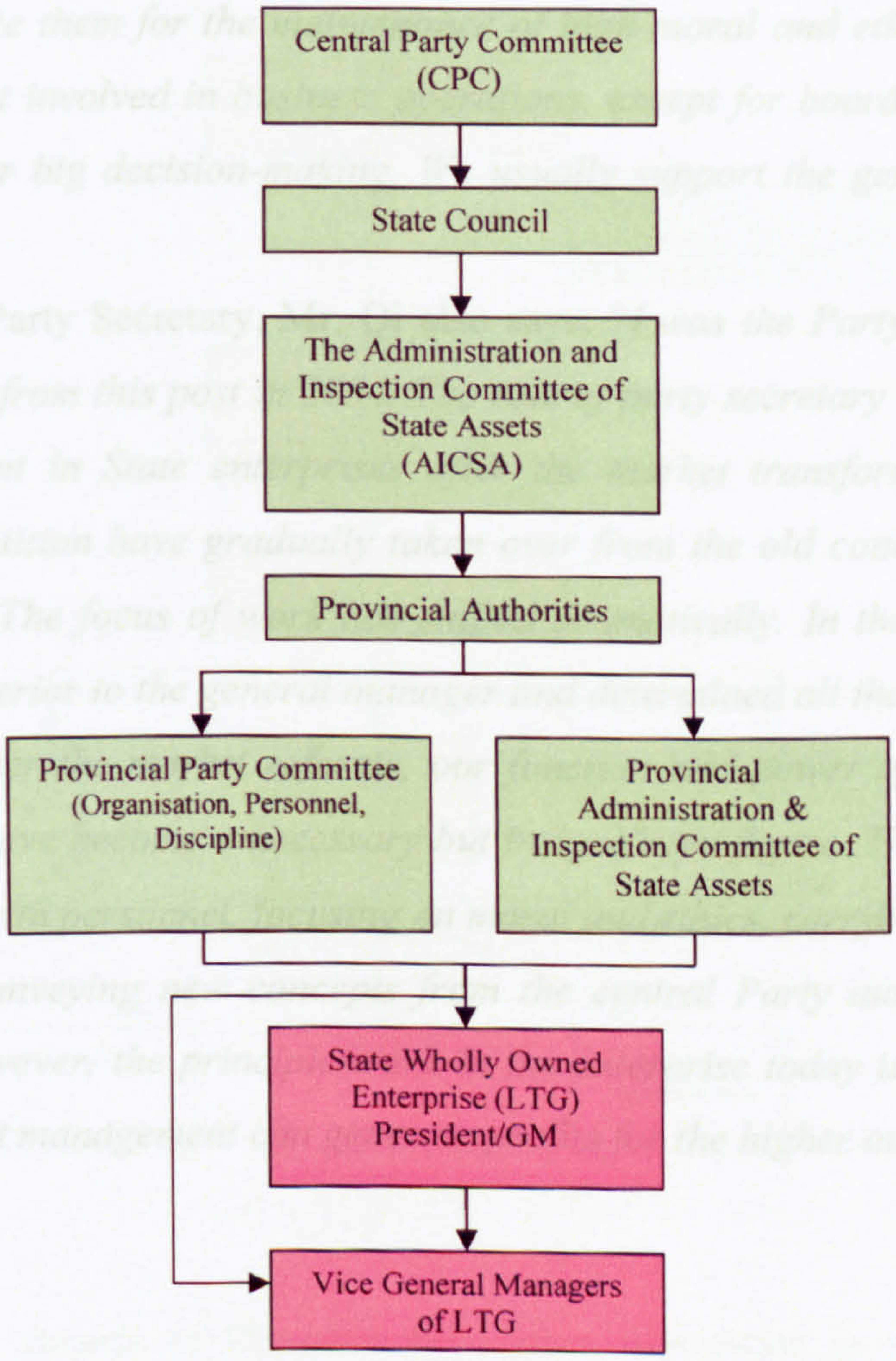
[254] Li, Xin-xin (2004), Improving administrative mechanism of state assets', *The State Assets Management*, (by The Finance Ministry, The State Council, and The Administration and Inspection Committee of State Assets), 160 (7), July 2004, pp. 4-7.

[255] Fang, Zhouwen (2004), (Officer of The State Finance Ministry) 'The role of CASISA and target models of State assets administrational institution', *The State Asset Management*, 160 (7), July 2004, pp. 8-10.

management efficiency. We still have not established the appropriate mechanisms in relation to the market. The old management systems in conjunction with the State administration still remain the same. If you ask the former Party Secretary, who was in the post at the company from 1987 to 2004, you would find that the current structure of LTG is quiet similar to what it was before. Personally, I think the quality of management in this state-owned enterprise is far behind that of the advanced foreign enterprises. Moreover, there is so much uncertainty and confusion in many of the guiding policies from the central authority. As an enterprise, we are still waiting for how to move to the next step in structural reforms. It tells you that nothing is certain at this time. What I say today might change later. Especially my personal opinions need to be in concordance with central authority, but we now wait for new instructions. The state-owned enterprise is not very flexible like privately-owned enterprises, as there are many restrictions on our operations and management. For example, in our marketing and sales, the strategy and plans are fixed and settled without flexibility, so we are unable to adjust and adopt changes in line with demands that arise from customers and the market. We have a different structure in place as a state-owned enterprise."

Interviews with the former Company Party Secretary, Mr. Qi Zhengming; Vice General Manager, Mr. Li Xiao, as well as other divisional managers also demonstrated similar attitudes of inflexibility and "constraint" within the Company's complex and multi-dimensional structure. The organisational chart, provided by the Company's Planning Department is shown in figure 4.6.

Figure 4.6 Structure of government administration responsible for LTG



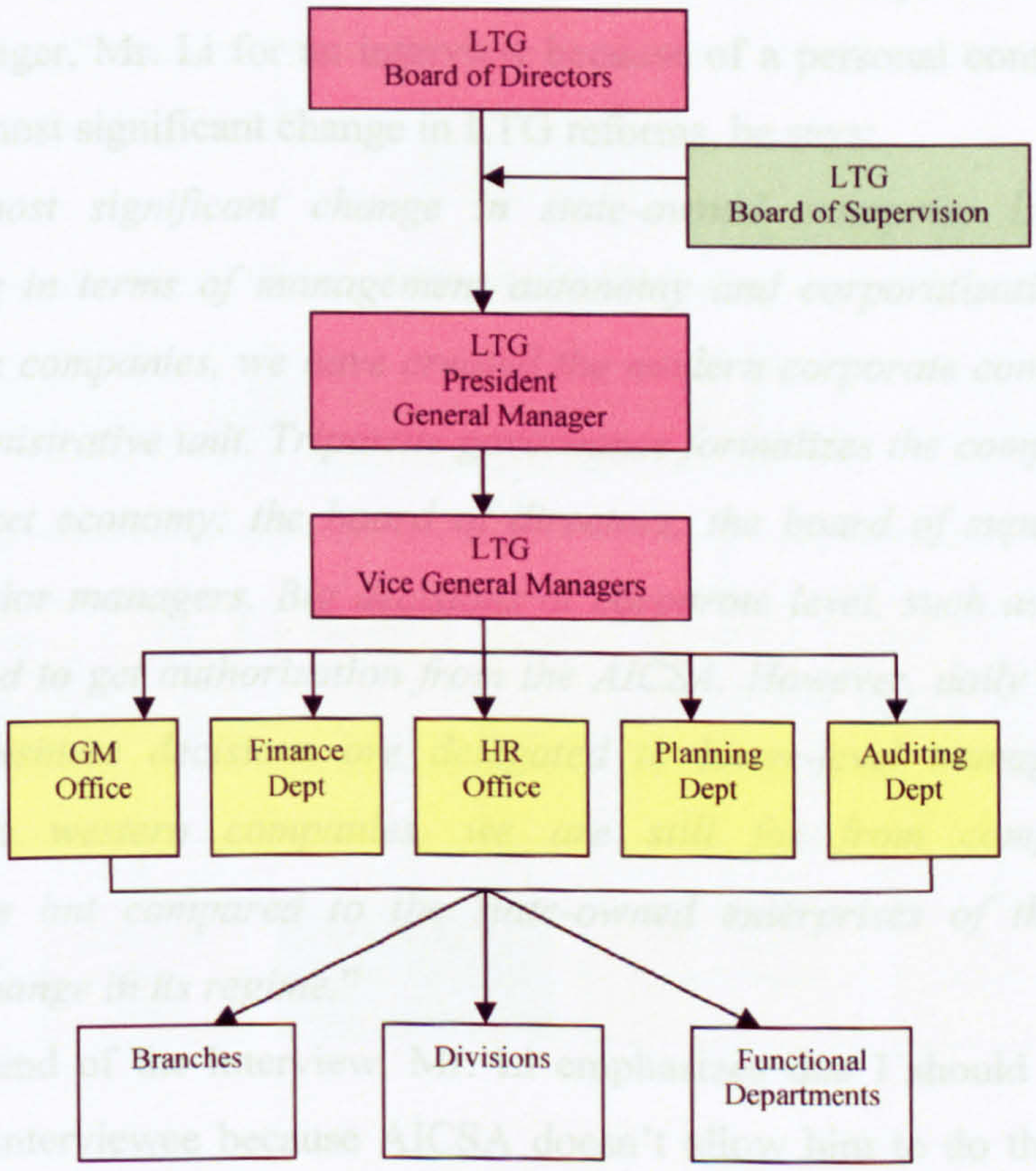
It is a rigid hierarchy, controlling personnel, finance and corporate strategy. The AICSA represents the State and the Communist Party and exercises direct administration over both wholly-owned and share-holding enterprises. The central state authority still has holistic and tight administrative control over state-owned enterprises, but its power is aggregated in one body – AICSA. This top-down administration restricts the enterprise's ability to responding to changing markets and customer demands. Instead, political issues dominate the nature of management in State-Owned Enterprises. Although the Party Committee has parallel power to AICSA, it has a weaker impact. As the current Company Party Secretary, Ms Liang says:

"As the Party Secretary, our role is to smooth the management, and help people stay in the same direction as the party. We hold frequent meetings and discussion

sessions for the consistent education of the Party's ideas as well as for the assurance of political concordance. We solve conceptual conflicts in management, and spiritually motivate them for the maintenance of high moral and ethics at work. We normally don't get involved in business operations, except for board meetings at the corporate level for big decision-making. We usually support the general manager's decisions."

The former Party Secretary, Mr. Qi also says: "*I was the Party Secretary from 1987, and retired from this post in 2004. The role of party secretary becomes weaker and less important in State enterprises after the market transformations. Market values and competition have gradually taken over from the old concepts of equality and life-security. The focus of work has shifted dramatically. In the past, the party secretary was superior to the general manager and determined all the decisions in the enterprise, but after the market reforms, our function and power of influence have faded away. We have become a necessary but insignificant figure. The work involved in our routine is with personnel, focusing on moral and ethics, carrying Party ideas to employees and conveying new concepts from the central Party authority to senior management. However, the principle work in the enterprise today is to focus on the market and so that management can generate profits for the higher authorities.*"

Figure 4.7 Structure of Functions Within LTG



Since 2001, Boards of Directors have been introduced in almost all public companies. The formal structure of management is illustrated in figure 4.7. This consists of the Board of Directors, Board of Supervision, President and General Manager. Final decisions are made by the board of directors, and the board of supervision oversees the board of directors. The general manager and vice general managers exert direct control through their functional departments – General Manager's Office, Finance, Personnel, Planning and Auditing. Authority and hierarchy are the key features of the LTG structure. The general manager is basically the final decision-maker with relevant consultation to vice general managers. He also reports to AICSA for authorization on key decisions that relate to corporate strategy, financial investment and key personnel appointments. His job is not only about management at the corporate level but also in reporting to the higher authority – AICSA. Maintaining good relations with this higher authority is essential for senior managers, as AICSA has the discretion to appoint or dismiss them. In interviews, they are very cautious in what they say and keep discreet behaviour. This is because AICSA stresses they should not give media interviews and should not disclose any information in public without authorization. In the case study, we obtained the vice general manager, Mr. Li for an interview because of a personal contact. When I ask him for the most significant change in LTG reforms, he says:

"The most significant change in state-owned enterprise is organisational restructuring in terms of management autonomy and corporatization. By learning from western companies, we have created the modern corporate company to replace the old administrative unit. Tripartite governance formalizes the company's efficiency for the market economy: the board of directors, the board of supervision and the board of senior managers. Big decisions at corporate level, such as investment and strategy, need to get authorization from the AICSA. However, daily operational and divisional business decisions are delegated to lower-level managers. If we are compared to western companies, we are still far from complete corporate independence but compared to the state-owned enterprises of the past, it is a distinctive change in its regime."

At the end of the interview, Mr. Li emphasizes that I should treat him as an anonymous interviewee because AICSA doesn't allow him to do this. He mentions that AICSA is very powerful and places very tight control and restrictions over senior managers in state-owned enterprises.

LTG as a conglomerate corporation that has six major subsidiary companies in different industries. The ownership relations among these companies are illustrated in Figure 4.7. Ownership is diversified in forms of *state-wholly-owned*, *state-controlled* and *state-investment subsidiaries*. For instance, four subsidiary companies that are *wholly-owned* by LTG are as follows:

(1) 'Liaozhong Phoenix' (a garment factory in Liaozhong city);

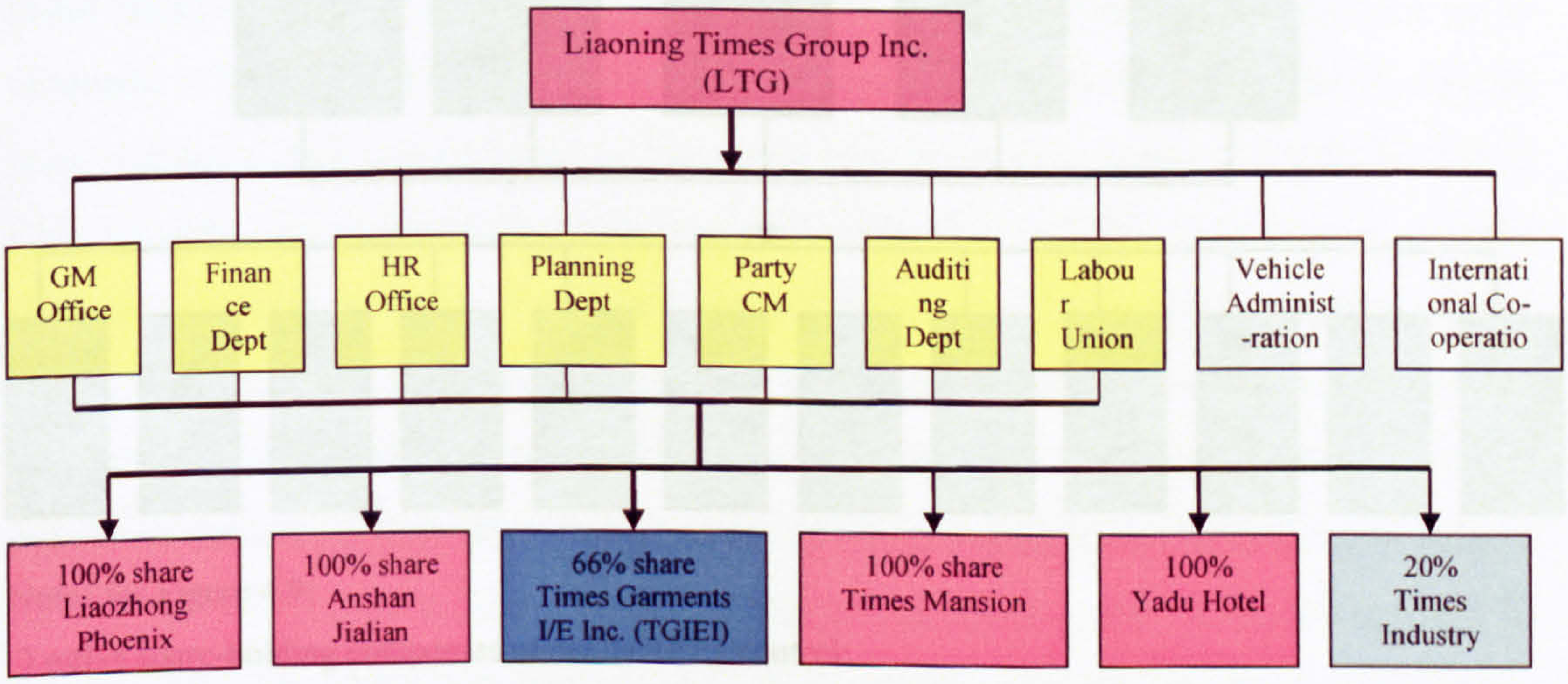
(2) 'Anshan Jialian' (a garment factory in Anshan City);

(3) 'Times Mansion' (A 28-floors Modern Office Building in the centre of Dalian)

(4) Yadu Hotel (a three star hotel in town center of Dalian).

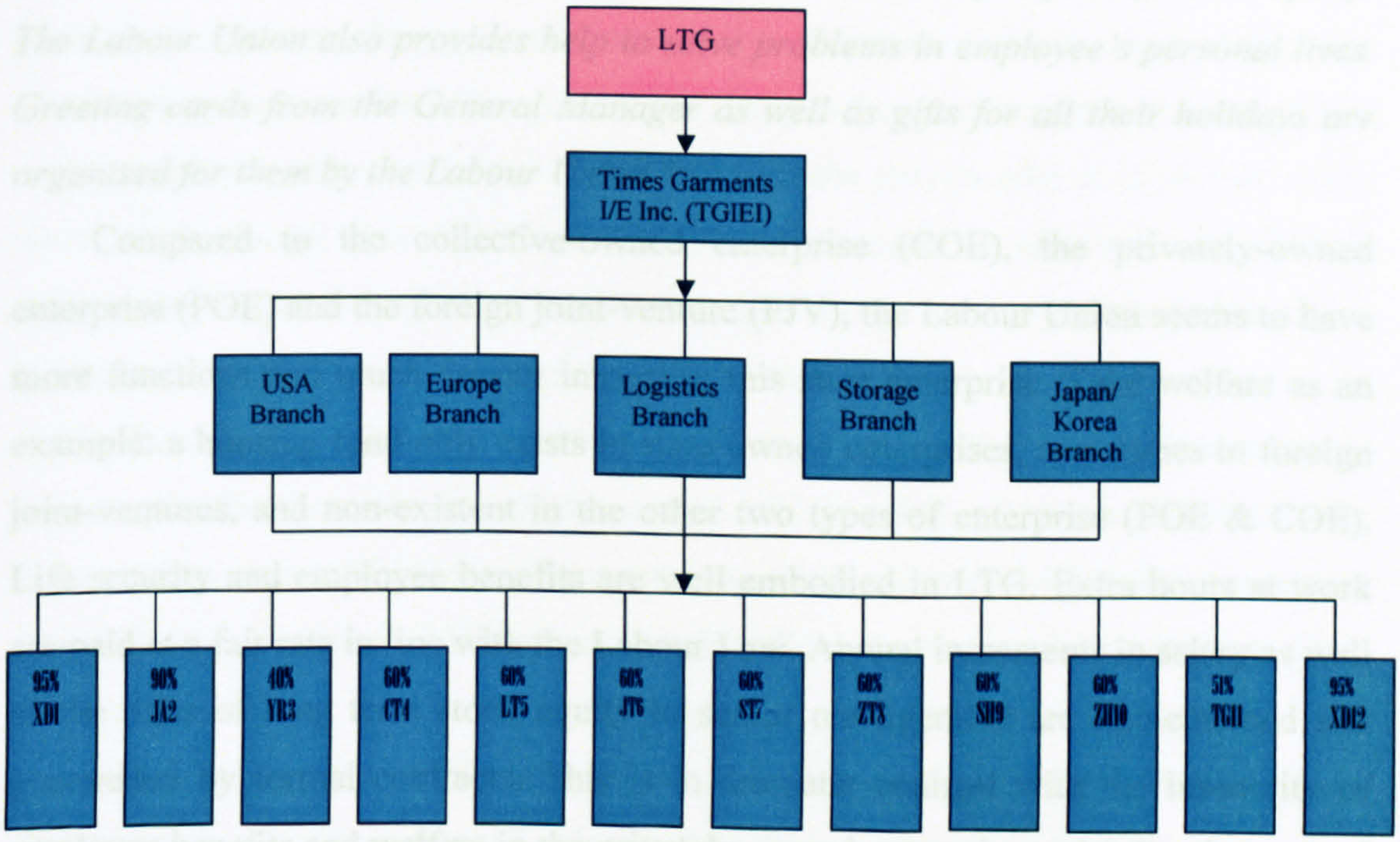
One subsidiary company - Times Garments I/E Inc. (TGIEI) is *State-controlled*; and is the outcome of restructuring reforms. It is also the main body on the public listing. LTG holds the majority share (66%) of TGIEI and has total control over its management. TGIEI is the core member and key business in LTG. LTG has also diversified its investment in real estate business and owns 20% share of the real estate company - 'Times Industry'. As LTG originated from international trading, it has acquired a large percent share of overseas markets in USA, Europe, and Japan for the past 30 years. Three overseas branches are directly managed by LTG and TGIEI, and two supporting branches for logistics and storage, insure smooth management in overseas markets. (Figure 4.8)

Figure 4.8 Organisational Chart of Ownership Relations btw LTG and its Subsidiaries



As a complementary to figure 4.8, the organisational chart of Times Garments I/E Inc. (TGIEI) is illustrated in figure 4.9. TGIEI is the main business of LTG which produces the majority of the profits. It contains twelve branches of which the majority shares of these subsidiaries are owned by TGIEI. These subsidiaries are trading companies or manufacturing units which serve export businesses and produce garments for overseas markets.

Figure 4.9 Organisational Chart of TGIEI



Notes for Figure 4.9:

Twelve share-holding companies under TGIEI's control:

XD1 - Xiongyue Dyeing Co., Ltd.

JA2 – Jiahang Cargo Agent Co.

YR3 – Yisheng Times Real Estate Co.

CT4 – Chengyue Trading Co., Ltd.

LT5 – Lianyi Trading Co., Ltd.

JT6 – Jinfeng Trading Co., Ltd.

ST7 – Shishang Trading Co., Ltd.

ZT8 – Zhuojun Trading Co., Ltd.

SH9 – Shangjia Trading Co., Ltd.

ZH10 – Zhengqian Trading Co., Ltd.

TG11 – Times Garments Manufactory

XG12 – Xiongyue Garments Manufactory

The Labour Union (LU) has a role in this state-owned enterprises structure. It holds an Employee Congress and has the right to speak for employee's rights and welfare in LTG. As the former Party Secretary, Mr. Qi says, "*We hold a large Employee Congress once a year. Employees can freely express their opinions, proposals and suggestions. We put valuable opinions to the management for adoption. It is an organisation to protect employees' rights and benefits in accordance with the*

'Labour Law'. Social events and activities for employees are held on a regular basis to improve their social and corporate life, and to make them feel part of the company. The Labour Union also provides help to solve problems in employee's personal lives. Greeting cards from the General Manager as well as gifts for all their holidays are organised for them by the Labour Union."

Compared to the collective-owned enterprise (COE), the privately-owned enterprise (POE) and the foreign joint-venture (FJV), the Labour Union seems to have more functions and much greater impact in this state enterprise. Take welfare as an example: a housing fund only exists in state-owned enterprises, sometimes in foreign joint-ventures, and non-existent in the other two types of enterprise (POE & COE). Life security and employee benefits are well embodied in LTG. Extra hours at work are paid at a fair rate in line with the Labour Law. Annual increments in salary as well as the offer of long term stock equity to senior management are implemented and guaranteed by formal contracts. This is in dramatic contrast with the insecurity of employee benefits and welfare in the privately-owned enterprise and collective-owned enterprise, where only minimal levels are promised. Employees' rights are ignored in these companies. The worst case is the COE in our case studies. The breach of Labour Law often happens, and employees work at weekends for long hours without extra pay. The state enterprise is still operating in the same way as government agencies in that they have almost the same rules for staff and employee contracts.

In order to strengthen competitiveness in the market and to implement government requirements, LTG has invested one and half million RMB for the adoption of International Standards Organisation (ISO) 9001 in 2000 and Quality Management System (QMS) in 2001. This system further formalizes the routine and management procedures for quality control in service and products. To quote what interviewees said about the QMS:

"We are required to implement QMS in order to improve the efficiency of management, as it specialises and clarifies the responsibilities and procedures for product and service management in each division and office. It constructs a formal procedure in company management, which regularises the flow of supervision in terms of series of procedures and processes, makes quality control more predictable in planning. But the problem for this quality control system is that it is too complex to follow and these compulsive procedures are inflexible sometimes. " (Mr. Liu, Director of Planning Department)

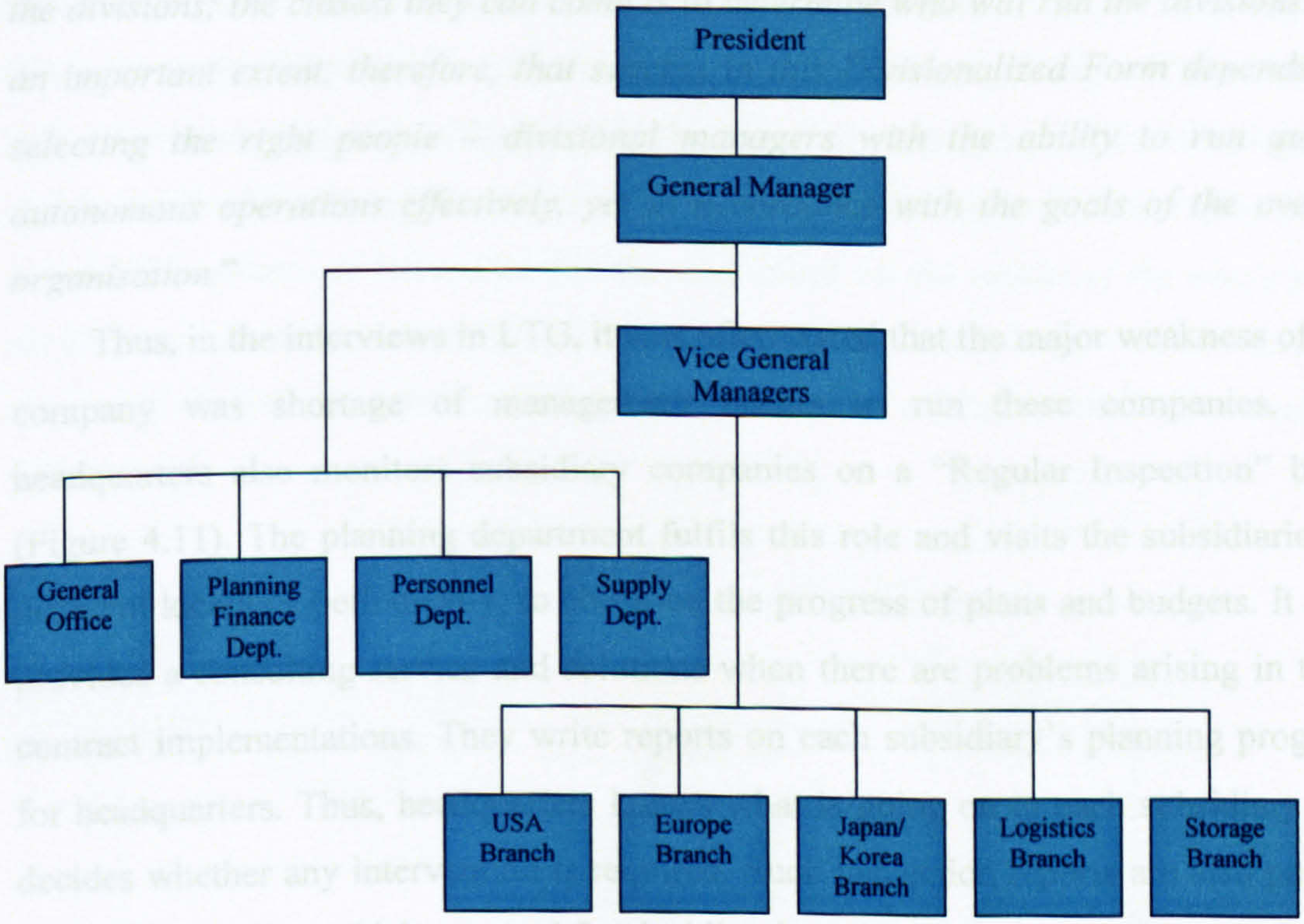
"We think it is essential for us to have ISO 9001 and Quality Management System, as LTG is a very large company and we do need to have formal procedures in place to clarify everything to avoid confusion and argument. In my view, this system has improved our routine management, so that product and service are controllable and manageable. We don't have to worry about the person who is in charge of the work if he leaves, because the records and procedures of work are filed in documentation. This system implementation has solved such problems." (Mr. Chen, Manager of International Co-Operation Department)

"The reforms in this SOE are intended to make for more efficient management to prevent inefficiency in the State sector. Responding to State administrative requirements, most SOEs are encouraged to adopt advanced QMS for managerial improvement. We spend RMB one and half million for the implementation of QMS. This seems worthy as it noticeably redefines and formalizes our management processes and fortifies LTG's competitiveness to fit in the market systems that are demanding better management." (Mr. Qi, Past Party Secretary of LTG)

Figure 4.10 demonstrates the structural relations and responsibilities between the senior managers and their subordinates for the quality management system in LTG. The President and the General Manager is the same person in LTG, and there are four Vice General Managers under him. The General Manager is directly in charge of four principal departments – The General Manager's Office; Finance & Planning Departments; Personnel; and Supply Department, whereby all his commands and instructions go through to lower hierarchical levels. These vice general managers, under his supervision, are respectively responsible for the overseas markets and relevant supporting divisions. Their roles are specialised in detailed responsibilities and defined by the level of authority. The communications within this configuration flow through several hierarchical orders and layers of management. The core company – TGIEI is directly run by the senior management of LTG (President, GM and VGM). Other branches operate as independent businesses which function with delegated management and under different performance control systems.

This state-owned enterprise is the only case study company that has passed the requirement of QMS and successfully implemented such internationally standardised quality-control systems. None of the other three types of companies have implemented such formal standardization in their quality control systems. As it stressed by the interviewees in state-owned enterprise, such implementation of QMS is a compulsory command of the state administration. QMS fits the demand of institutionalisation and the corporatization of state-owned enterprises. Moreover, the strong state financial background of LTG gives it the possibility to adopt QMS. The style of state administration and its ideas shape the management practice of this enterprise. Whereas the other types of enterprises – POE, FJV and COE – respectively reflect their owners' interests. Leadership in relation to ownership function is vital in shaping management structures, as it is crucial to direct enterprises for either success or failure. This is particularly the case in LTG as an example of a state-owned enterprise.

Figure 4.10 Administrative Structure of Quality Management of LTG



4.2.3 Systems

Management authority is decentralized to subsidiary companies and divisions through a Performance Control System which monitor results instead of routines. According to the director of the planning department, this control system is designed according to three methods – 'Contract', 'Rental' and 'Stock-sharing'. The branches and divisions in the 'Contract' and 'Rental' systems are given the autonomy to run their own businesses. They control their operations and determine their own strategies for markets. Each branch is responsible for its profit and loss and reports to the headquarters of LTG on an annual basis. The 'Contract' method is to fix a target for profits and production that the branch has to achieve at the end of each year with agreed terms and conditions. The 'Rental' method is to lease the facilities and assets to the subsidiary companies based on an agreement to pay rent each year. Headquarters retains control over these relatively independent branches by monitoring results in accordance with their accomplishment of profit targets. But if the contracted targets are not achieved, headquarters replaces the managers of the divisions/branches. As Mintzberg (1993)[256] suggests,

"This is a crucial power in the Divisionalized Form, because the structure precludes direct interference by the headquarters managers in the operating affairs of the divisions; the closest they can come is to determine who will run the divisions. To an important extent, therefore, that success in this Divisionalized Form depends on selecting the right people – divisional managers with the ability to run quasi-autonomous operations effectively, yet in accordance with the goals of the overall organisation."

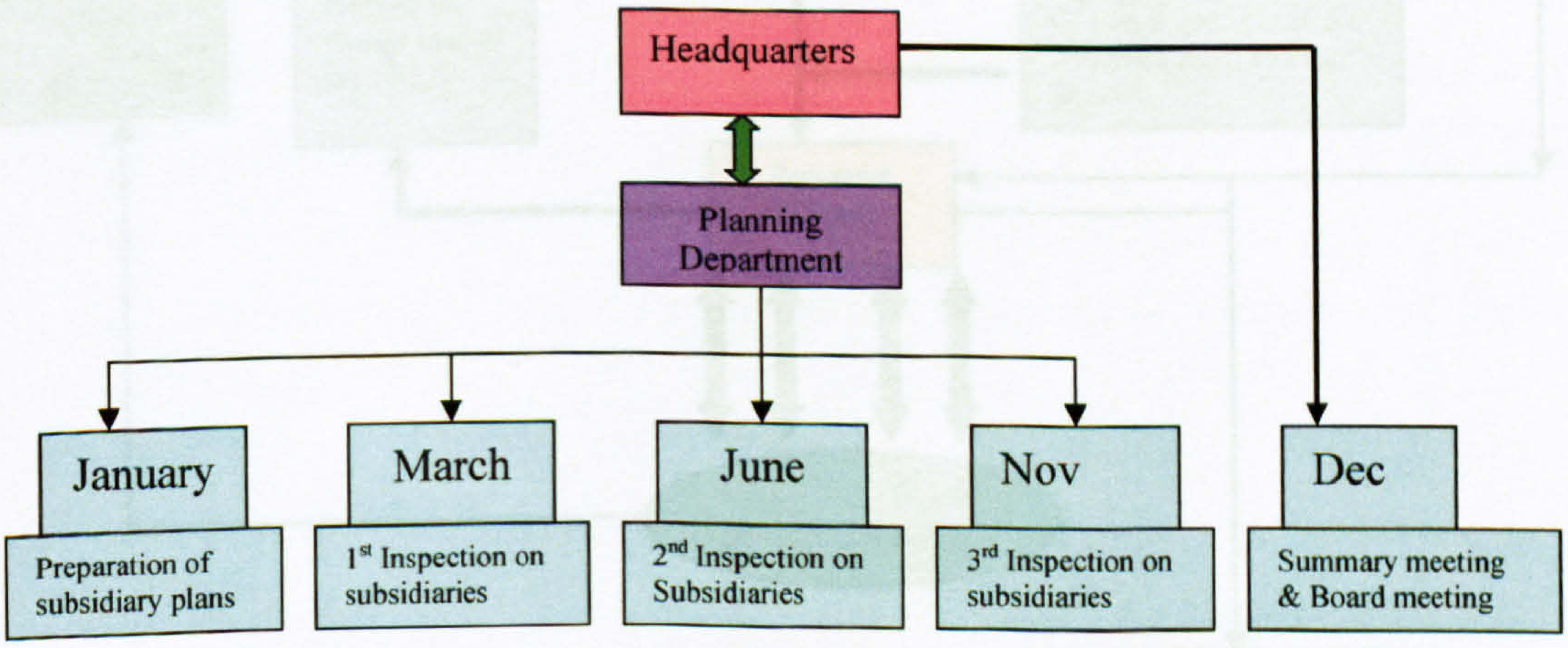
Thus, in the interviews in LTG, it was often stated that the major weakness of the company was shortage of management talents to run these companies. The headquarters also monitors subsidiary companies on a "Regular Inspection" basis (Figure 4.11). The planning department fulfils this role and visits the subsidiaries at different locations periodically, to check on the progress of plans and budgets. It also provides a consulting service and solutions when there are problems arising in their contract implementations. They write reports on each subsidiary's planning progress for headquarters. Thus, headquarters knows what is going on in each subsidiary and decides whether any intervention is required. Such inspection reports are also part of evaluation systems which are used for deciding bonuses and other employee rewards. As the Director of Planning Department, Mr. Liu says,

"We monitor the performance of subordinate subsidiaries by a regular inspection scheme, which is part of our planning processes. We study the performance statistics of the past year in terms of profitability, turnover and cost of materials in January of each year. According to the official "Regulation of State Assets", we need

[256] Mintzberg, H. (1983) *Structure In Fives: Designing Effective Organisations*, Prentice-Hall Inc., New Jersey, p223.

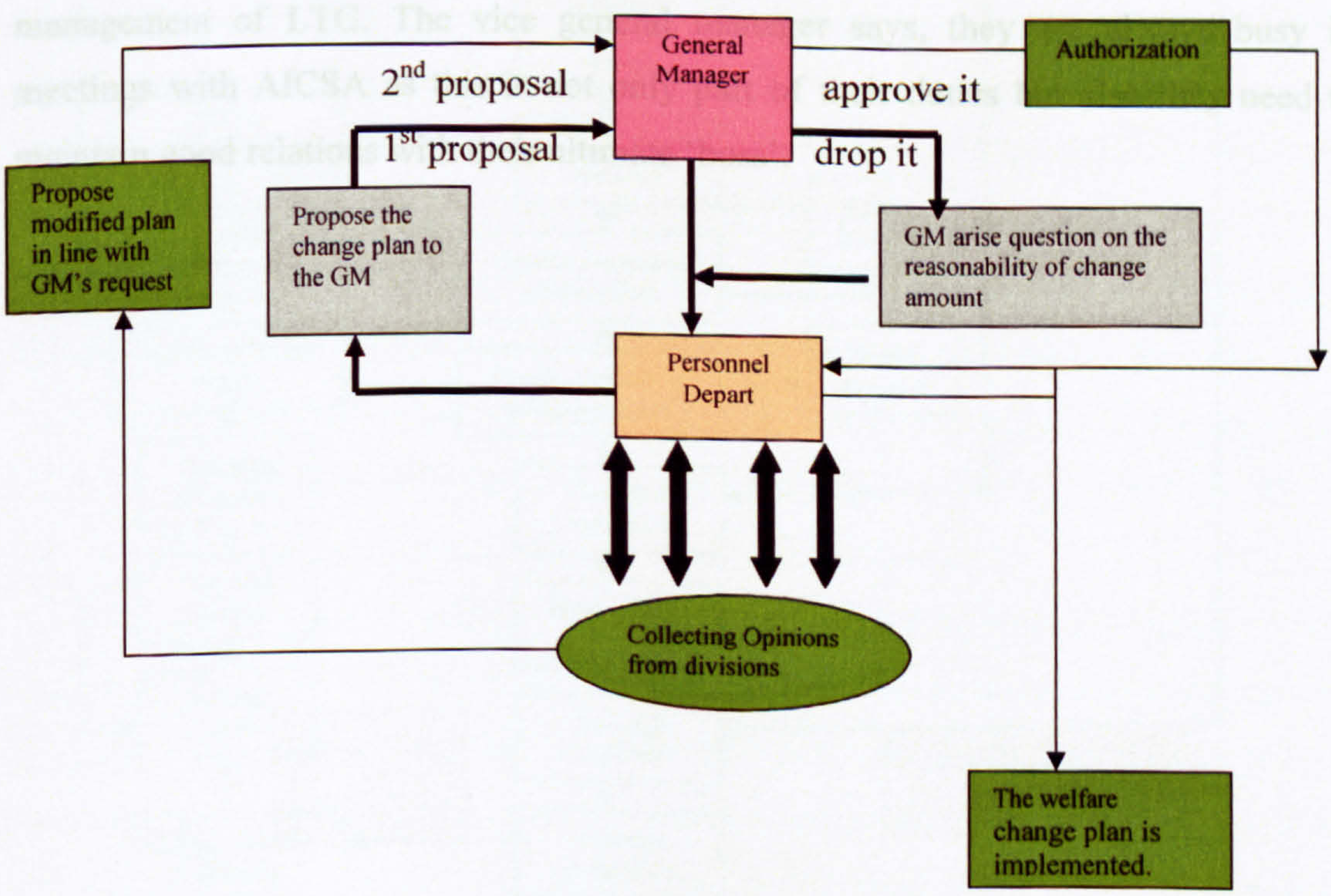
to make sure the state assets appreciate annually by 5%. The appreciation rate cannot be lower than the average of total increment for all state-owned enterprises at the provincial level. We set the basic target objectives for the subsidiary companies in line with this principle criterion. We also get feedback from subsidiary principals on their expected targets, and use these for setting new plans. We visit each subsidiary at different locations for the first inspection of planning progress between March and April. We check on their implementation of plans and discuss with them possible problems and assurance for their accomplishment. For example, sometimes they propose an increment in cost of materials, which we will take into consideration for the adjustment of target goals in their profitability and production plans. The report on this change will be handed to headquarters and the Board of Directors for authorization. By the middle of the year, normally in June, we revisit these subsidiaries for a second inspection to check whether the plan in the first half of year has gone well and is on schedule. Adjustments and problem solving are involved in this stage of the inspection. Reports on the status of their planning implementation will be made to headquarters. The last inspection will take place by the end of year, around November and December, for the final check on the results of the whole year performance. Summary meetings and board meetings at headquarters will be held by the end of the year and the beginning of the next year, and all subsidiary managers will attend."

Figure 4.11 Regular Inspection Scheme



The Finance Department is directly responsible to the General Manager in association with the Planning Department. The decision-making process is determined by the level of hierarchy and degree of authority. Simple and small decisions that do not relate to the whole organisation can be made at the middle management level without approval authority from the top. Operational decisions that relate to the strategy and finance of the whole organisation require approved authority from headquarters – the General Manager. Big decisions in relation to strategy and institutional change require authorization from both the Board of Directors and AICSA. Mr. Liu, Director of the Planning, gives two examples of such decision-making. The first is for an operational decision – a change required in welfare regulation in term of the annual heating fee for the employees. The following diagram (Figure 4.12) illustrates how this decision is made. The Personnel Department proposes this change plan to the General Manager, but he thinks the amount of change is unreasonable and passes the proposal to the Personnel Department for revision. The Personnel Department then passes this request to the subsidiary companies for the collection of opinions. Revisions are made on the basis of these suggestions. The second proposal is then handed to the General Manager for approval. Authorization is given and the Personnel Department then implements the final plan. Normally such a cycle requires one week for final decision making.

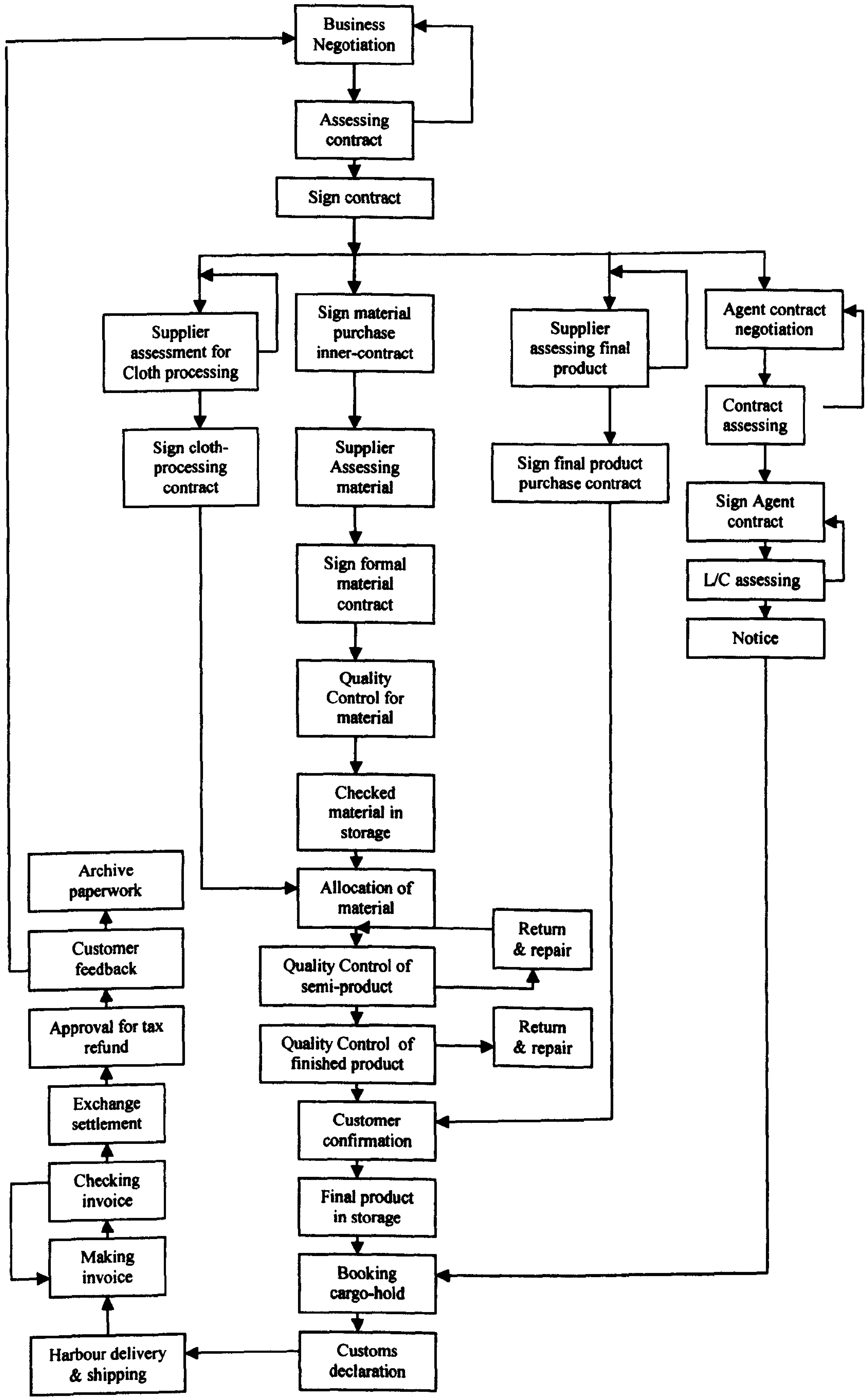
Figure 4.12 Decision-making processes for the change of welfare regulation in LTG



The second example is about selling the Phoenix Garments Factory. From the original proposal of selling to the final decision, it takes at least one year and needs to pass through five processes: (1) Verification of the selling decision and conditions (this verification requires 6 months); (2) broad of Directors' resolution (requires one month); (3) authorization of AICSA (requires 1-2 month) (4) evaluation by the Professional Group (this group constitutes professional experts that are relevant to the project, such as accountants and lawyers. Their evaluation requires 2-3 month.); (5) competitive bidding (1 month).

Communication procedures and routine processes in LTG are formalized by rules and documentations. Take how business activities are conducted, as an example; Figure 4.13 reveals detailed procedures and orders involved as requirements for completing a business deal. Paperwork is heavily used for information flows. However, communication between divisional managers is both formal and informal with telephone calls, pop-in visits and face-to-face talks as part of their routine processes. Formal operational meetings as well as Party meetings are all held on a regular basis for both horizontal and vertical communication across middle line management and divisional heads. Senior management is very much engaged in all kinds of meetings for both organisational management issues and State administrative matters. Tight control from AICSA also requires frequent reports from the senior management of LTG. The vice general manager says, they are always busy in meetings with AICSA as this is not only part of their duties but also they need to maintain good relations with their ultimate 'boss'.

Figure 4.13 Chart of Procedures of Business Activities



The systems of LTG are still changing as it is still in a process of market transformation. As a market-oriented SOE, LTG is further diversifying its product range across industries and continues to construct better management capacity suitable to operate in a dynamic changing environment. The market economy requires efficiency and competitiveness, which is a big challenge for SOEs that have operated under a planned economy over such a long period of time. Structural change, ideological shift and institutional transformation to a free market are very demanding for them. As China is still evolving its ownership patterns, it generates chain reactions for further changes in the configuration of organisations. Ownership is a practical issue at the current stage. As the Director of Planning, Mr. Liu says,

"The central State authority will continue to reform ownership equity and stock equity, as these are two main issues in state-owned enterprises restructuring. We all know there will be changes coming soon, but we don't know how it will be. This worries us. These changes will require management innovation and new systems, but we don't have the professional knowledge for it. We are in the middle situation where the old systems are eliminated and new ones are not formed completely yet. At both top and middle management, we don't know how to change management to achieve what is expected after the ownership is further diversified. It is a significant difference in comparison with western public companies, as state-owned enterprises issue three types of stock to insure state ownership protection – State shares, Legal Corporate shares, and General shares. The total shares of LTG are 106 million, but only 30 million general shares are in public circulation for purchase. There are 70 million State shares and 6 million Legal Corporate shares that make up 66% of the total are not released for public purchase by the government, which insures the security of the State ownership. Although we have changed in many aspects in structure and management, the reality is that we are not a complete market company yet. We are still seeking for the best practice for state-owned enterprises."

To summarise the management system of LTG; it is officially called a '3+4' model, which functions as an institutionalized mechanism for management control between headquarters and its subsidiaries. The '3' refers to three rights of headquarters, and the '4' refers to the four management functions the headquarters exercises to place control over all subsidiaries company. The three powers are: (1)

strategic decision-making; (2) the right of personnel appointments; and (3) the right of financial returns.

The four management functions of LTG headquarters are (I) the function of setting budgets and planning. The headquarters exercises control over the budget approval process, with inspection and auditing of transactions of finance as well as the inspection of planning progress in subordinate divisions; (II) the function of approval of subordinate companies' strategies. All the subordinate divisions must have their strategic planning processes approved; (III) the function of supervision of the subordinate divisions; and (IV) the function of managing ownership issues – it constitutes the relevant body for the registration of ownership of the subsidiary companies as well as for the ownership of equity.

The headquarters of LTG exerts direct control over its subsidiaries through this '3+4' model. Under this model, official institutions are established and operational behaviours are formalized at different hierarchical levels, which facilitate concordant and harmonious management between the headquarters and the subsidiary companies. Compared to other three types of ownership - COE, POE and FJV - in our case studies, the structure and systems of SOE are the most sophisticated form of formally institutionalized bureaucracy. Strategic decision-making in such systems tends to be affected by upper authority rather than by market demands. Despite management autonomy and ownership diversity, middle management is still tightly controlled through a culture that reflects the continuing dominance of the Party and centralised state ownership.

4.2.4 Staff

The key staff in LTG are located in the top administrative departments of headquarters as well as in the middle line of management of the core division of LTIEI. There are about 30 staff at corporate headquarters which include 8 directors/managers who are each in charge of departments. These departments are - Personnel, Planning, Supply, General Manager Office, Finance, Auditing, Party Committee, and International Trading. There is the general manager, four vice general managers, and eight directors that make up the senior management team. A distinct feature about the background of these senior managers is that more than one half of them are from the military. Among our 7 interviewees, four have a military background – Vice General Manager, Mr. Li; the Party Secretary, Mr. Qi; Director of

Planning, Mr. Liu, and Divisional Manager, Mr. Chen, all held a military ranking above "Captain" before being transferred to LTG. This is a significant and common feature in all state-owned enterprises because a military long-term education ensures accordance with the attitudes of the Communist Party. In China, the Communist Party, economic power and the military are united in one body. As a rule, those from a military background are transferred to either government agencies/administration or to state owned enterprises.

There are about 190 employees in the core subsidiary company - LTIEI, including 41 management staff with an average age of 36. Seventy-eight percent of management staff have university degrees usually in foreign languages, international trading and finance. The management staff of LTIEI are mostly promoted from capable people experienced in international trading. The general manager in LTIEI, Mr. Fan Xiaoyuan is an example of this kind of person. He is an entrepreneur with a background in foreign trading and was working overseas for four years, giving him abundant business experience. His appointment is an indication of the growing market-orientation of SOEs.

However, none of these two groups of managers has a qualification in management education. New graduates recruited since 1998 do not have this qualification. This is a problem as the restructuring of management systems requires key staff to understand global management methods if it is to improve efficiency and innovation. Human resource management is a new concept in SOEs and conventional state bureaucracy personnel policies still dominates the methods of managing labour. Despite reforms, old ideas and working practices still prevail with a continuing focus on hierarchy, job description and bureaucratic routines and procedures. Take the recruitment system, for an instance. To quote what Mr. Liu, Director of Planning says,

"*The recruitment system is backward in LTG although it is explicitly established for market-orientation. We have all the policies and criterion for market recruitment and the selection of capable talents. But they are only policies in wording and not implemented by management. It is an inevitable problem as well as a cultural tradition of SOEs. There is an underlying way of doing things in SOEs, especially in personnel issues. LTG has not opened-up recruitment after autonomy was delegated to the enterprise in 1994. Before this delegation, the Ministry of Foreign Trade and Economy Committee (MFTEC) was responsible for both appointments and recruitment for all SOEs. After enterprise autonomy was introduced, self-recruitment* *was authorized to be the responsibility of LTG, but we still rarely have open recruitment, because the upper authorities continue to make recommendations to appointments. Moreover, inside arrangements for filling vacancies also often happen in LTG.*

Generally speaking, most of the staff in LTG have personal relations with someone in either senior management or in the upper authorities of government. Sometimes, there is waiting list for vacancies from employees with personal contacts. However, the people who fill these vacancies often don't have the required qualifications for the posts, but they are assigned on the basis of personal connections. For example, I feel I need an assistant with an MBA degree, but the person who has been assigned to my office is a personal contact of the General Manager, has an irrelevant qualification, and that does not help me in the way I expect. Furthermore, even though we have open recruitment policies on the talent market, selection is not done by a scientifically-designed system, but is personally controlled by managers. So the candidates who have personal connections will be selected regardless of their formal qualifications and capability.

Because hierarchical authority is an unshakable force and culture in LTG, you cannot challenge this practice. This tradition generates problems in our management capacity, because the quality of staff is not adequate. This results in failure or poor performance in the execution of management plans. That is why the plan is always right but the results are often not achieved."

Recruitment in LTG seems to be based entirely on personal contacts without fair competition and scientific selection. Open recruitment is rarely adopted due to the tradition and culture of LTG, although a market-focused business requires selection on the basis of meritocratic capabilities. Such a pattern of personal contacts also results in a process which means that sanctions on employees are hardly implemented due to personal ties that are deeply embedded among government officers, senior managers, and lower levels of staff. Those who make mistakes can always be excused from punishment through personal relations. It is the culture of SOEs. Mr. Qi, the company Party Secretary, comments on this problem:

"*Because of the poor quality and qualification of management staff, the execution of rules and regulations cannot be carried out completely. There is always a broken sequence between the processes of decision-making and implementation. Frequent deviations in execution commonly happen. The staff in the functional* *departments are often inert and inactive. They have a passive attitude to work and only when their leaders push them will they move forward a bit. Some of the new graduates being recruited are capable of talking but incapable of acting. They are not motivated and stimulated at work, and they lack a responsive attitude and crisis awareness. They have no ambition in pursuing their careers."*

Mr. Chen, Manager of the International Co-operation Department, says:

"The implementation of ISO9001:2000 systems is not going very smoothly in LTG. We all know that this is because of the poor quality of management staff, as they don't have a full understanding of what it is and how it should be implemented. Take the planning department as example; a lot of planning controls and management are carried out by this department, but the director of planning doesn't have management knowledge – all he has is loyalty to headquarters. I am sure the director doesn't know what ISO9001:2000 stands for, but he is the person who is in charge of its implementation. Although relevant training is provided to the management staff, they don't pay too much attention to it.

The problem for SOEs is how to deal with competition on the market, and talent management is a key part of competition. How to retain capable talent and how to motivate talent is a big challenge for an SOE. The new mechanism of talent management will challenge the existing culture of SOE. Since 1994, senior management has made no new appointments. It is like an organism without fresh blood. The people being hired in the enterprise in the past ten years have all been through personal connections with ties to provincial authorities and top management. Many of them are the children of these officials and political leaders. They are hired because of their contacts not for qualification. I worry about this enterprise because it will die in the absence of talent in the future. I describe LTG as a 'diabetic without awareness'. I am a diabetic, but I have awareness of diabetes so I am taking proper treatment and improving my condition. But a 'diabetic without awareness' is dangerous as it is a chronic disease but if you don't realise it and still think of yourself as a normal person, the day of the total collapse will happen sooner or later."

Personnel management in state-owned enterprises seems to be a major problem due to their culture. There is no explicit staff development policy and there is a lack of a proper motivation mechanism. Training is supposed to be an effective way to improve the quality of staff and skills of a profession, but they are not well developed in a systematic mechanism in LTG, but operate on a random basis. Staff awareness of the importance of training is not established and so that they don't pay too much attention to training courses when these are offered to them. Absence and carelessness are common among staff. The control and planning of training is poor, as there is no analysis and evaluation of what training is needed. It simply happens whenever there is an issue arising from the demand of work or the higher authorities. There is also no assessment of the effects of training. Mr. Liu, Director of Planning admitted that this is a major weakness in LTG, but he doesn't know how to improve it. Regardless of the low qualifications of the administrative staff, the key personnel are located in the main business of garments export and import (LTIEI) which consists of specialists in international trading. They are the core competence of the company which create the profits for the whole enterprise. Over the past twenty years through its monopoly in foreign trading, LTG has hired a large number of professionals in international trading with profound experience and skills. This is the core competence of LTG and it is still the backbone of the enterprise today. However, the main issue for human resource management is how to maintain this core staff by rewards and other means of motivation. Although rewards have been enhanced by market reforms, these are still below the expectations of employees. The Secretary of the Board of Directors, and Manager of LTIEI, Mr. Ma Yu comments:

"The main means for rewarding specialists in LTIEI is the bonus system. This is based on profits which is 30% for individuals and 70% for the company. But it is still not a fair percentage for individual rewards. We create all the gains but we only get a small percentage of bonus. No one owns a percent of this company. That is why a lot of capable staff have left to set-up their own companies or work for other private companies for better rewards. They become competitors to LTG. I am not very happy about the rewards but because I am not an ambitious person I still stay. However, I don't know about tomorrow.

Sanctions are controlled by bonuses as well. People that do no achieve their sales don't get bonuses. There is no other punishment method for poor performance. Generally speaking, the reward and sanction mechanism is not fair for everyone. However, as we are still evolving these in the process of reform, there will be many changes in the near future. But we don't know what kind of changes these will be. To be honest, I don't know where my future will be as the enterprise is in the middle of *transformation. The enterprise tomorrow will be determined by the political Provincial Authority and our future is hanging in the doubt.*"

State enterprises are particularly distinctive in the ways they recruit staff. The influence of a personal relations culture is more powerful in state-owned enterprises than in other types of ownership, '*overriding market demands and rules*'. Such a difference between the state enterprise case and the other types of enterprise reveal that political power and hierarchical political authority are much greater in state-owned corporations.

4.2.5 Style

Leadership is a central feature of organisational performance. The style of managers can be divided into two catalogues – one is that of the senior managers including the general manager and vice general managers at corporate headquarters. The other is that of key managers in the main business of LTG.

The General Manager and vice general managers have the most influential impact on the style of management. Thanks to their military background, their leadership style is mostly based on 'Loyalty' and 'Orders'. 'Caution' and 'Correctness' are the main ideas guiding the fundamental style of management in LTG. Risk taking is avoided in the enterprise as a whole. Mr. Chen, Manager of the International Co-operation Department, says:

"*From the Provincial authorities to the top of management in LTG, they all have preference for 'No-Mistakes' rather than 'High-performance'. Because they are more bureaucrats than entrepreneurs; 'no-mistakes' secure their positions. Whereas 'high-performance' requires both high risk-taking and high capability to handle risks. If they fail to achieve, this will lead to their dismissal from their power positions. The safe way is to sustain the stability and avoid risking their careers, so they can retain a good personal record when they move to the next higher position. What can you expect from this kind of boss in an enterprise? To follow this style and approach is also safe for us. Otherwise they will think we are trouble makers, and sooner or later we will be eliminated from their sight. This is the common reality of state-owned enterprises. The leader, like Zhang Riming of Haier is an exceptional case, that is why there is only one Haier in China.* "

This common reality deeply affects the style of management in state-owned enterprises and it destroys ambitions and entrepreneurial willingness among employees. It also restricts the innovation and entrepreneurial development and explains why staff motivation is low in LTG. Mr. Ma, Manager of LTIEI, emphasizes:

"The guiding line for our business development is directed by steady growth, and not a hasty rush to the market. We are gradually evolving from structural change, but not significantly innovative in management and technology. Textile manufacturing is a 'setting sun' industry in China; its future will be in the inner areas of China. The demands of the international market on China's products is low-price garments, not high-tech branded clothing. Our exports completely rely on outsourced manufacturing orders from foreign countries, such as the USA, Europe and Japan. We don't have our own branded products, because the creation of brands requires heavy and long-term investment. But the top management emphasis is on current profits rather than long-term investment, as it is a crucial requirement of AICSA. Top managers spend most of their time with the higher authorities. As I know, our general manager has to drive four hours to Shenyang three times a week for meetings and reports. They are not like us; they are more bureaucratic than enterprise managers."

Obviously the government authorities and top managers in LTG are favourable to immediate performance in annual profitability rather thinking risks in long term investment. They are more driven by political considerations and the rules of administrative bureaucracy. Future prospects for the development of LTG are more related to political demands than market opportunities. Ms Du Lili, Manager of Property Management Department, comments on the style of leadership as:

"One of the significant styles of the management we feel is 'Authority', which represents absolute ownership in a State-owned enterprise. The other style is about their dual-roles in management. Top managers are guardians for the state assets and they are afraid of losses as this is their responsibility. In decision-making, they are cautious in order to avoid risking state assets. The general manager lacks boldness in business development. But we understand his dual-role, as he is not only the manager of the enterprise, but he also plays the role of being an official bureaucrat. He is at the top and difficult to approach. His office is monitored by CCTV, so he can see who is coming to visit him and won't open the door if it is a person he doesn't want to talk to. We usually report to the relevant vice general manager or Party Secretary, who are more approachable. However, work relations are very formal and we don't have close relations with subordinates and workmates."

Compared to this "Bureaucratic" and "Authoritarian" style of management, leadership in the main business – LTIEI – is quiet different in terms of orientation and focus. These operational managers are directly responsible for achieving profitable goals, and their style is completely pragmatic and task-oriented. They pay less attention to maintaining personal relations with political leaders and put more effort into their own business development. Management autonomy is delegated to them and the achievement of profit targets is more persuasive. Horizontal co-ordination and teamwork are usually adopted for specific task achievement. Informal communications are often used for information flows within and between subsidiaries. Reports and approvals for authorization pass through the relevant Vice General Manager to the General Manager, with only two spans of control involved in the hierarchy of authority.

Work styles differ in the administrative offices and the operational divisions. Both are open style, but the administrative offices are more relaxing and less busy, and work hours are in a routine schedule. But the operational subsidiaries are extremely busy with long working hours, even at weekends. The work tensions are much greater in these operating units. As the Manager, Mr. Ma says,

"*We need to learn from western companies in terms of human resource management. We need to have a pragmatic training system as well as an annual vacation system. We work so many extra hours for the company and with no personal vacation, we are stressed. We are very much pressured by targets.*"

These different orientations underlining different levels of management are the cause for sharp contrasts in management style. Top management under state ownership is the least market-oriented of all the four case studies. This diversity of style among management levels within LTG creates tensions and hinders management development. It reflects the contrasting approaches of "State-Planning" and "Market-Oriented" approaches that will become sources of greater internal conflict as further market reforms are introduced within State-Owned Enterprises.

4.2.6 Shared values

The most important management ideas guiding LTG's values are '*Honesty and Faithfulness*'; '*Professional and Pragmatic*'; '*Frontier Spirit and Innovation*'. These are elaborated in documents and constantly emphasized in meetings. 'Honesty and Faithfulness' are stressed in business operations and are built into the company's reputation. 'Professional and Pragmatic' styles of working are embodied in attitudes and ways of doing things. It emphasizes the goal of profitability and underlines the importance of professional teams in business success. 'Frontier Spirit and Innovation' result from market reforms. These values are continuously stressed among employees to facilitate company restructuring and managerial evolution.

The key spiritual values deeply imbued in the whole enterprise, particularly at the management level, are '*Loyalty and Consistency*' with the Communist Party, the central authority. It is an inviolable principle and a prerequisite above the business orientation of LTG. Without this premise, everything is meaningless and irrespective. Party meetings are held in routinely and they are as many as business operation meetings. Ad hoc activities assigned from the Central Committee of the Communist Party reinforce the education of 'Loyalty and Consistency' on a frequent basis and they constitute a core part of LTG's enterprise activities.

For example, in order to comply with recent Party commands on the reinforcement of a new central spiritual theme – the implementation of 'Three Representatives' from the 16th People's Congress in 2005, new activities on 'Maintaining Progressive Ideas of the Party' were enforced in state-owned enterprises. An Ad Hoc Leading Group on this topic was established in LTG. The whole activity is intensified in three phrases, from 22nd July to the end of October 2005. In the first 4 week phrase, besides sessional meetings, Party members are required to spend at least 20 hours reading "Party Statutes", "Reports of the 16th People Congress" and "the Special Edition for Maintaining Progressive Ideas". In addition there has to be 8 hours discussion. Key Party members in leadership groups are required to do 28 hours reading in addition to 12 hours discussion. The second phrase of this political education is for five weeks in terms of the analysis of the first phrase of study. Sixteen meetings are held on topics, analyzing employees' opinions. This means one-and-half day each week is taken up with Party meetings. The third phrase is for three weeks to rectify and to improve attitudes and behaviour. After this period of intensive political education, there is another 12 months for improving behaviour in relation to the routine work of enterprise management. This is a distinctive difference in the pattern of management in state-owned enterprises by comparison with private or foreign owned enterprises. State enterprises spend a great deal of time and effort in such political activities and their senior managers are heavily engaged in party education so they cannot concentrate on business operations the whole time.

Such constantly imposed Party education moulds employees' values and this inevitably impacts on management philosophies and behaviours. It further explains the style of management in LTG. The core shared values of 'Loyalty and Orders', 'Steadiness and rightness', and 'Authority and hierarchy' are derived from the legitimate authority of the Communist Party as well as the company's bureaucratic culture. Bearing in mind market values that require entrepreneurship and risk, there is an inevitable conflict of cultures within the enterprise as a whole. This is why the interviews reflected confusion about the future direction of the enterprise. They have no clear idea of what kind of culture the enterprise should have. LTG lacks the necessary construction of a unified organisational culture because of the conflict between Party values and the demands of a market economy.

State-owned enterprise reforms have long been restricted by socialist ideology. Because state ownership is directly conjunct to the state administration and the Communist Party's political systems, it means economic reforms need to be compatible with existing political systems; i.e. socialist ideals. In order to secure such concordance, key managers are mainly selected from the military and constant education of socialist ideas is enforced among top managers. This strong political and socialist culture significantly distinguishes state-owned enterprises with the other three types of ownership enterprises, privately-owned enterprise, foreign joint-venture and collective-owned enterprise. However, free market competition requires effective management with 'market ideals' other than 'socialist ideals'. This is the essential contradiction within state-owned enterprises.

4.2.7 Skills

Because of its 20 years in a monopoly position in the textile export and import business, LTG has established solid foundation in terms of its resources, business networks, staff, and capital assets; particularly the backbone of LTG's competence is the key staff in the export and import business. They create profit and actualize the market value for the company's growth. They are trained and brought up by LTG, experienced and skilful in profound business practices. The overseas markets are the main strength of LTG in which they have established a reliable network of wholesalers and suppliers in the past 20 years. As the Vice General Manager comments:

"The core competence of our company is having a group of experienced staff who work at the frontier of our main business. They are very skilful and knowledgeable in export and import business; they develop extensive clients' network in international markets, which are the main sources for sales."

And the company Party Secretary comments:

"We have an experienced professional team in international business. They are so skilful that they instinctively know what the best price clients can offer when they come to negotiation. Not only do they know formal rules in international business, but also they possess an understanding of unwritten rules. Such experiences give them ability to deal with changes and uncertainties that emerge from both domestic and overseas markets. They handle all orders and contracts from overseas' clients and the company' survival relies on them. This is our core competitiveness."

Due to their high capabilities in price-negotiation, not only can they get the best price from foreign clients but also they can transfer the trading risk to outsourced manufacturers. To minimise the risk, most time they only pay the outsourcing factory when the order is completed. Therefore when any contingent situation occurs in the process of manufacturing, LTG always has the upper hand over business partners because they withhold the payment. Such key skills of trading staff give the company a fast track to enhance LTG's negotiation power and ensure its competitive advantage in price. The key staff in this international business are essential and they have a different style of management. They pay less attention to relationships with senior managers due to the delegation of full autonomy in terms of responsibility for profit and loss. They are task-oriented and profit-driven. They only report to the vice general manager and there is no hierarchical span of control within their structure of operations. This is an institutional innovation in SOE; a highly bureaucratic organisation that has diversified its methods of management delegation at the subsidiary level to meet the market-driven economy. The vice general manager, Mr. Li Xiao, who is in charge of international business, still behaves like a military captain, and shows an upright and righteous leadership style in the interview. In fact, due to his rigorous and long military training, the majority of senior managers demonstrate their loyalty to the enterprise. Despite their lack of entrepreneurial attributes, the quality of this trait gives trust and support to those operational managers who work at the frontier of the market place. As one interviewee, Mr. Chen, divisional manager of International Co-operation Department, comments on the vice general manager;

"I have a chance to leave this enterprise for better material rewards, but I feel a commitment to my leader as he always supports me. I can't let him down since he gives me his full trust and takes responsibility for my work. I have to work hard to prove myself, to show that he doesn't trust the wrong person, and also I need to demonstrate to others that I deserve such trust. It is something worth working for."

The general manager plays the dual role of being an entrepreneur and a bureaucrat. He has to balance these two roles, as the enterprise requires an entrepreneur to actualise market value and the government administration requires a bureaucrat with whom to communicate. However, as he has been promoted from the operational core, he fully understands how the business should be managed and what managers need. Therefore, two types of culture co-exist in LTG to satisfy both market and state needs.

As reforms in China are a system change, it is a very complex process. State-owned enterprises' reforms play a leading role in this systematic transformation to a market economy. Leadership is an especially vital factor for the successful adjustment of a state-owned enterprise into the market economy. Independent management autonomy in business enterprises is the most significant change compared to the former socialist command model. Ownership diversity and involvement in market competition have diluted the old ideology of the planned economy, generating entrepreneurship and institutional innovation in management. This is a demanding task for the leaders of state-owned enterprises. The dual roles they must fill shape a special management pattern that is distinct from that in other types of enterprise ownership.

LTG has, particularly as a state-owned enterprise, some special advantages that the other types of ownership enterprise do not have. For instance, it has privileged access to the essential factors of production – capital, land and labour. The capital market in China is still not open to foreign investors and the major banks, dominating the capital market are state-owned banks that favour state-owned enterprises over other types of enterprise. As interviewees in LTG mention,

"We have sufficient funds to run the enterprise, and we give increasing profits to the Government each year. We can always get loans at any time from the bank when

we need more cash flow. The Bank's managers chase us to lend us money. The availability of sufficient capital is our strength."

LTG has never worried about a shortage of capital for investment and growth; it is just a matter of whether managers can do it without high risks and mistakes, so that their positions and power can be secured.

State-owned enterprises also have access to free land to build factories and offices. The Liaoning Times Mansion has a fixed asset value of RMB 6 billion (US$ 73 million) for LTG based on free land and a bank loan. Xiongyue Dyeing Fabric Manufactory was a state owned company and went bankrupt in 1996. LTG has invested RMB 40 million (US$ 4.8 million) in purchasing 95% of this dyeing factory, re-organising it for a diversified manufacturing chain. This subsidiary company, after the injection of a large investment in technology and production capability, has become profitable dyeing materials for garments. It also provides technological support for materials selection for international trading, as it gives more strength and advantage to the trading group in bargaining and negotiating power outsourcing orders. LTG's Research & Development centre uses up-to-date technology and has a group of engineers working on the maintenance of stitching machines, sewing machines and needle detection machines. A group of technicians use graphic software for designing logo and patterns. They deal with special technical requirements from clients and conduct research on market trends and demands. They are the innovation centre for technology and manufacturing methods.

4.3 Concluding Remarks:

State-owned enterprises in China are tightly controlled by a veiled power – the Communist Party. The Communist Party and administrative authorities are powerful agencies in China which can provide many concessions and favours for state-owned enterprises. Issues associated with government-controlled resources are very demanding for other types of enterprise. Founded in the past and with economies of scale and cheap access to resources state-owned enterprises have great competitive advantages. However, their current competences are not enough for long-term sustainability as businesses in the emerging market economy require a strong entrepreneurial culture and the injection of new human resources for long term development. State-owned enterprises have to solve the cultural conflicts that operate within its management, building a corporate entrepreneurial culture is one of future challenges.

The emergence of a private economy with market reforms is challenging communist political control and creating a dilemma for the Party – economy or polity? It endeavours to seek a balance in 'market socialism' between socialist ideals and market forces. State-owned enterprises are foremost in the experiment in this ideological transition from a planned to a market-driven economy. This confusion affects motivation and morale as well as the ability of this enterprise to develop long term strategies and vision. Ownership of the enterprise remains state-controlled but without radical change in its political culture and administrative processes, it is unable to adapt flexibility to market changing demands. Despite regulatory concessions and access to finance, state-owned enterprises are characterized by ineffective management and a nepotistic culture. Innovation in operating systems and entrepreneurship in managing change are challenges for state-owned enterprises in China. How to reform the administrative system of state control and how to further diversify ownership remain controversial to the Communist Party. Scarcity of guiding theories on creating a *socialist market economy* obstructs the pace of reforms in state-owned enterprises and creates uncertainties in the future vision of market socialism. Our case study suggests there are many issues to be resolved in relation to party control and intervention if state-owned enterprises are to adapt to the changing demands of market forces.

CHPATER FIVE:

Case Study (2): The Collective-Owned Enterprise

Shenyang Liming Anna Clothing Co., Ltd.

Introduction

The economy in China comprising both state sector and private sectors is characteristic of evolutionary reforms. Collective-owned enterprises (COEs), derived from the state sector, are undergoing bold reforms in privatization. Due to the complex history of collective-owned enterprises, their management models are significantly different when compared to those for state-owned enterprises and privately-owned enterprises. They are neither purely privately-owned nor wholly owned by the state. The collective-owned enterprise is the type of business which is owned by its employees and governed by local authorities. They are regarded as a component of the state sector but secondary to state-owned enterprises. It is a result of the decentralisation of political authority from central government to local government levels since 1979. Economic reforms have changed the composition of traditional collective-owned enterprises since privatization has become incorporated within them.

Collective ownership creates a hybrid management infrastructure with mixed values and culture, both market and socialist. Rarely have there been studies of collective-owned enterprises which combine both private owner's management control with direct state participation and administration. The collective-owned enterprise in this case study, as an emerging form of business venture, and demonstrates this type of hybrid management model reflecting the mixture of market values and socialist ideals, engendered from these different ownership properties. The privatization and marketisation of the collective-owned enterprise in our research started in 2003.

5.1 Background of SLAC

Shenyang Liming Anna Clothing Co. Ltd. (SLAC) was set up in 2003 through a merger between 'Shenyang Liming Garments Co., Ltd.' (SLG), a collective-owned enterprise in the state sector and 'Anna Fashion Company' (AFC), a privately-owned enterprise in the private sector. 'Shenyang Liming Garments Co., Ltd.' (SLG) was listed on the Shanghai stock market in 1999, but claimed bankruptcy in 2001 due to poor performance and heavy losses. Following reforms of privatisation, 'Anna Fashion', a privately-owned trading company in Shenyang, bought 51 percent of the shares, becoming the major shareholder in 2002. This new venture was renamed 'The *Shenyang Liming Anna Clothing Co., Ltd.*' (SLAC) in 2003. It currently has 600 employees and a fixed asset value of US$ 2.5 million in equipment and buildings. This allows for an annual production capacity of one million garments. As a professional garments company, it integrates manufacturing, marketing, retailing, and export & import functions. Its product range covers women and men's suits, shirts and trousers for causal wear, fashion clothes, jeans and snowsuits. Its main markets for sales comprise domestic cities and overseas countries, such as Japan, South Korea, Europe and the USA. SLAC owns two patented trademarks: "Anna Lee" for woman's fashion clothes, and "Yawenshi" for men's suits and shirts. These brands are only for the domestic market and account for only a minor portion of all profits. Its major profits are from manufacturing and processing garments for foreign brands. The annual value of the exports of SLAC has increased over the years due to increasing orders from overseas clients. (Figure 5.1)

Figure 5.1 Value of exports of SLAC for overseas sales 2002-2005 (Thousand $US)

Year	2002	2003	2004	2005
Value of Exports	9,000	13,600	20,000	30,000

Shenyang Liming Garments Co., Ltd. (SLG) – a collectively-owned enterprise in the state sector – before the merger, had a period of rapid growth from 1994 to 1999. But this declined due to many weaknesses including the local government's administration system and the quality of enterprise management. Shenyang Liming Garments was initially established in 1956 as a small collective-ownership workshop with some basic sewing machines and with eight employees producing uniforms. Its collective ownership was directly headed by the Residence Administrative Office[257] and administrated by Shenyang local government. In 1984, the enterprise had developed into a medium size corporation with 800 employees and RMB 9 million

[257] The Residence Administrative Office is also called "Jie Dao Administrative Office" which is the junior level of local government administration.

(US$ 1.1 million) value of fixed assets. But in common with collectively-owned enterprises in the state sector, its debt ratio had reached 90%. Following gradual reforms in the state sector, market elements were injected into the enterprise, which resulted in ownership diversification and institutional restructuring. For example, in 1990, SLG implemented its first reform experiment by joint-venturing with a Japanese company in both marketing and manufacturing. Nevertheless the Shenyang Liming Garments still held majority share ownership in this business venture. As an outcome of this venture, Japanese technology, management concepts and capital became involved in Shenyang Liming Garments and a new brand – 'Lifu' with Japanese technology was launched. Since SLG completed its first reform with foreign technology and capital, profitable rewards from the market as well as brand cognition from customers encouraged Shenyang Liming Garments to seize on further expansion and to venture with foreign technology and overseas markets. The new venture with a private company in 2002 has transformed this collectively-owned enterprise into a different management system. This mixed collective ownership in both bureaucratic and entrepreneurial forms gives this collectively-owned enterprise distinct features in comparison with state-owned enterprise and privately-owned enterprises. Its collective relations and ownership composition are described in the following chart (Figure 5.2). The president is the private owner from Shenyang Anna Fashion, which owns 51% of the shares in this new venture; and the General Manager is appointed by the local Government Department. This department, the Provincial Bureau of Textile Industry, represents the collective ownership – all employees retained from Shenyang Liming Garments, that still owns 49% of the shares.

Figure 5.2 Ownership Structure of the Collective Owned Enterprise (SLAC)

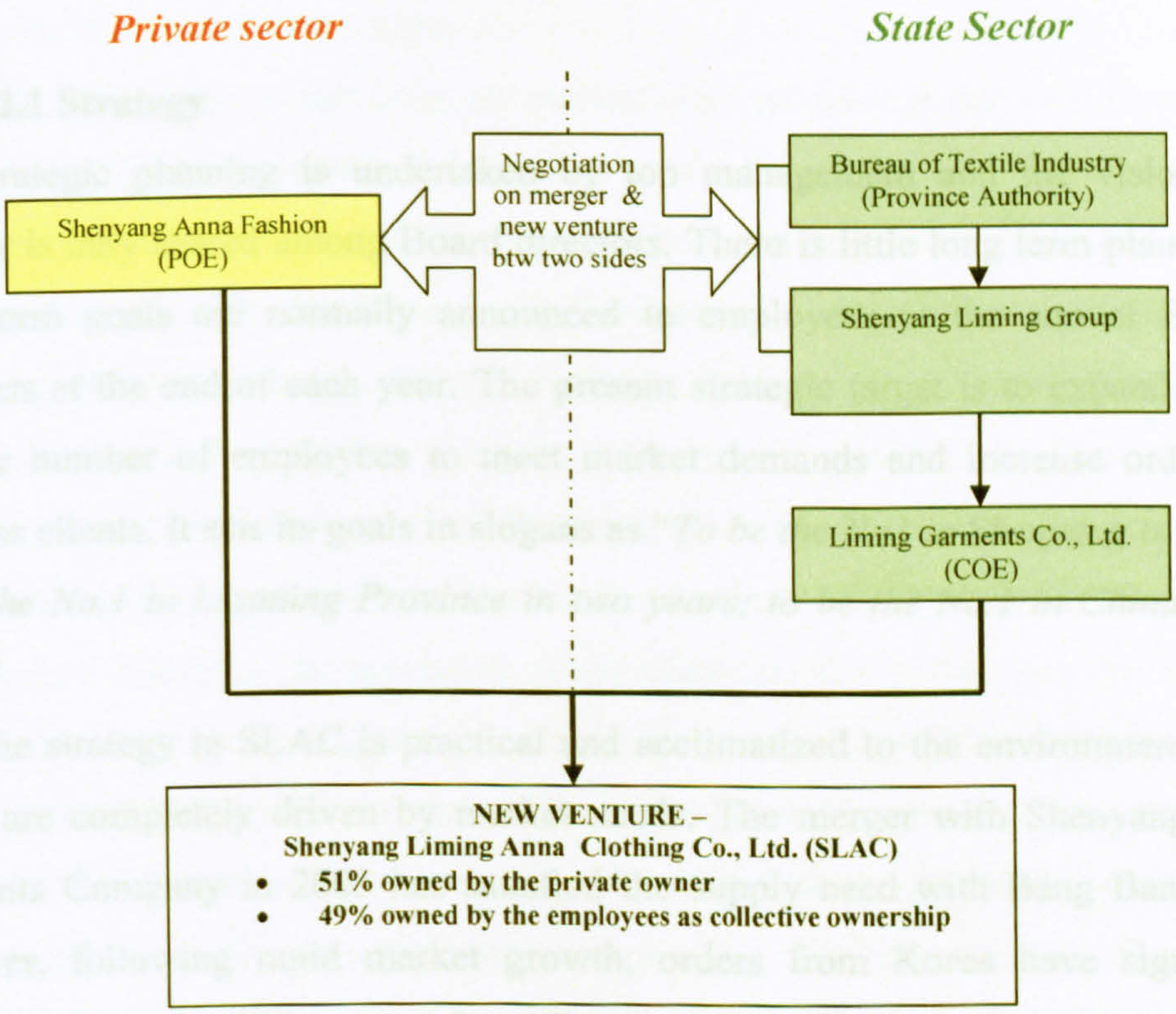
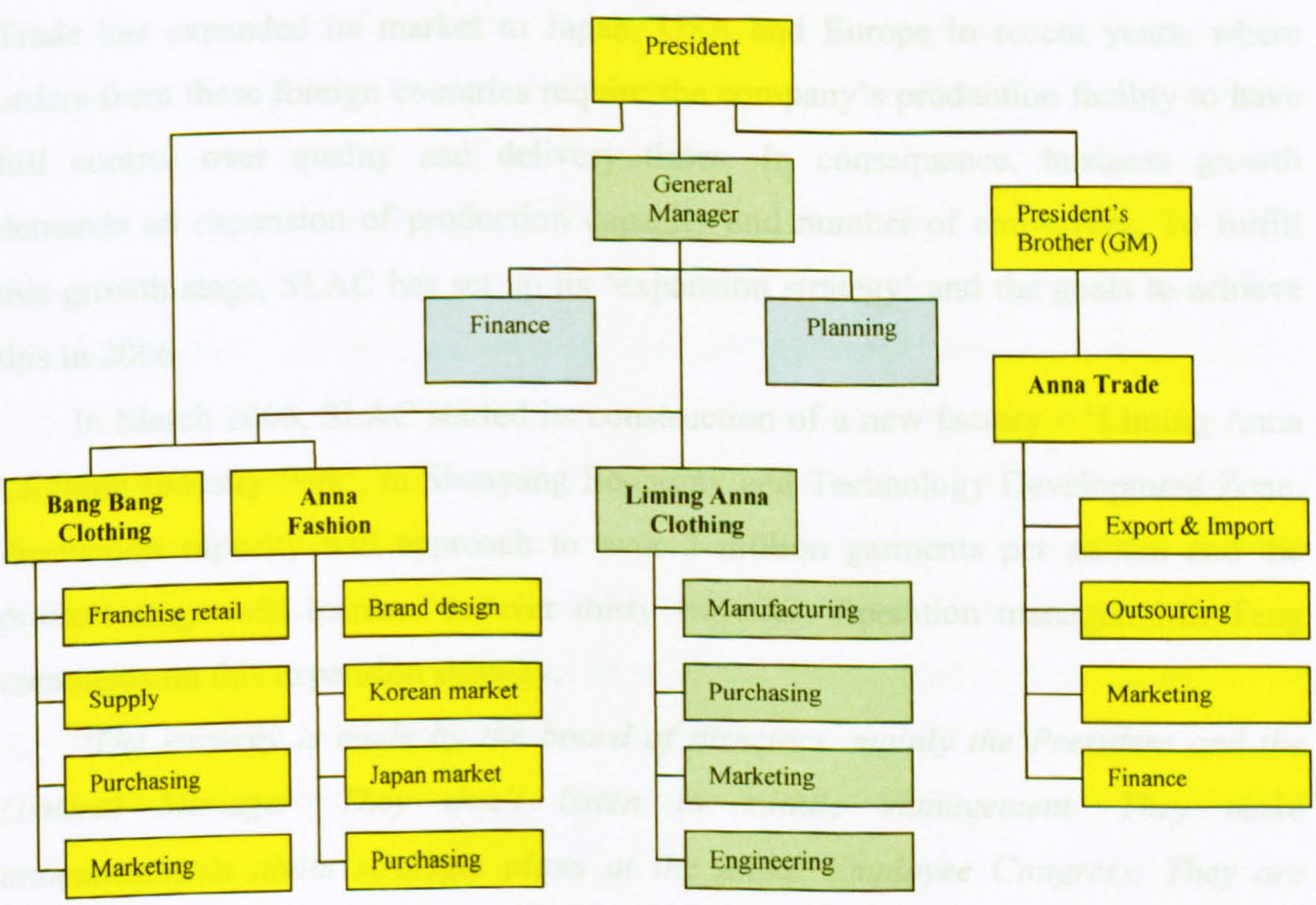


Figure 5.3 Formal Organizational Chart of SLAC



5.2 McKinsey 7-S framework analysis:

5.2.1 Strategy

Strategic planning is undertaken by top management and the vision of the strategy is only shared among Board directors. There is little long term planning, but short term goals are normally announced to employees at the annual Employee Congress at the end of each year. The present strategic target is to expand facilities and the number of employees to meet market demands and increase orders from overseas clients. It sets its goals in slogans as "*To be the No1 in Shenyang in one year; to be the No.1 in Liaoning Province in two years; to be the No.1 in China in three years.*"

The strategy in SLAC is practical and acclimatized to the environment change, which are completely driven by market needs. The merger with Shenyang Liming Garments Company in 2003 has satisfied the supply need with Bang Bang Korea. However, following rapid market growth, orders from Korea have significantly increased from 1 million to 1.8 million garments in two years. Presently, the production capacity in Liming Anna Company is only one million and extra orders are out-contracted to other factories in different locations. Further growth in Anna Trade has expanded its market to Japan, USA and Europe in recent years, where orders from these foreign countries require the company's production facility to have full control over quality and delivery times. In consequence, business growth demands an expansion of production capacity and number of employees. To fulfill this growth stage, SLAC has set up its 'expansion strategy' and the goals to achieve this in 2006.

In March 2006, SLAC started its construction of a new factory – 'Liming Anna Clothing Industry Park', in Shenyang Economy and Technology Development Zone. Production capacity will approach to over 2 million garments per annum and the product range will increase to over thirty varieties. Operation manager, Mr. Tang comments on this expansion strategy,

"*The strategy is made by the board of directors, mainly the President and the General Manager. They don't listen to middle management. They make announcements about strategic plans at the annul Employee Congress. They are going to invest about RMB 50 million (US$ 6 million) in a new factory in Sheyang Economy and Technology Development Zone.*"

Ms Gong, Marketing Manager who is in charge of domestic sales and marketing development for two brands, says,

"The marketing in our domestic market aims to develop our own brand image. We have patented two brands, "Anna Lee" and "Yawenshi" in 2004. Every year we look into 'popular colour'; 'cloth material'; and 'fashion style'; three key factors in clothing design. For marketing communication channels, we annually attend 'Clothing Exhibition' and 'Recent Fashion Release' in Beijing, Shanghai and Guangzhou to keep up-to-date with the latest trends and fashion elements for our designs. Our General Manager and President often travel to European countries and bring back updated fashion information for us. They tell us what we should design and what we should do for marketing in the Chinese market. Normally we copy some famous foreign brands' designed from their 'Recent Fashion Release' and make some minor changes in line with our own craft. Our main cloth materials are imported from Italy and our design is European style. Our brand design is always at the leading edge of fashion in the domestic market. Anna Lee and Yawenshi are distributed to Shopping Malls and Department Stores in Shenyang, Beijing and Dalian. We plan to build up the image of our brands before we open our own brand shop and make franchise sales.

I have worked in the clothing industry for 20 years, and know that brand value can last for a long time. Only manufacturing for other brands will give us no future. Our old brand, "Liming" is a good example, as it has been so many years after Liming Group went bankrupt, people still recognise this brand for its quality reputation and never forget its history. It is the main reason why Anna Fashion bought Liming's ownership share. We still use its name, because our consumers recognise this name and still have trust in the credibility of this enterprise."

It is obvious that SLAC has set its 'expansion strategy' on both overseas and domestic markets. Significant investment has been made into corporate expansion in terms of economies of scale. Construction of high value branding image requires heavy investment and takes a long time to give a visible profit return. However, the domestic market is aimed for such long term investment. The main sources of profit are presently from overseas orders, but they are used to build up production branding in the domestic market.

In general, of the four types of enterprises in our case studies, both the collective-owned enterprise and privately-owned enterprise hold an aggressive strategy in expansion and growth, which benefits from the entrepreneurial vision of their private owners. It is the state-owned enterprise that has the most conservative growth strategy when it involves heavy investment – despite it has the easiest access to finance resources.

5.2.2 Structure

SLAC is managed as a group corporation under the President in charge of a Board of Directors. Four relatively independent companies constitute the main business functions in the organisation (Figure 5.3). Final decisions are taken by the Board of Directors and these are administrated by the President, in conjunction with the General Manager. 'Liming Anna Clothing' is the production base for Anna Fashion, providing one million garments per annum. It comprises the core competence of Anna Fashion. The management of "Liming Anna Clothing" is relevantly independent and its daily operation is under the control of the General Manager, Mr. Liang and the Vice General Manager, Mr. Fan, who are both appointed by the Local Textile Authority, which are the representatives of the collective ownership. The number of employees in this division is approximately four hundred. The management staff are about 30 to 40 people. All the production tasks and orders come from Anna Fashion, which are mainly for manufacturing Korean "Bang Bang" branded clothes. Only a minority is for "Anna Lee". These two companies, 'Liming Anna Clothing' and 'Anna Fashion' have close horizontal working relationships and communicate on a daily basis between managers and supervisors at an operational level. Bang Bang Clothing has up to 45% of market share in the Korean jeans sector. Many famous Korean movie stars are representatives for this brand. Since Anna Fashion is the exclusive supplier for the "Bang Bang" brand, it has given Anna Fashion rapid growth.

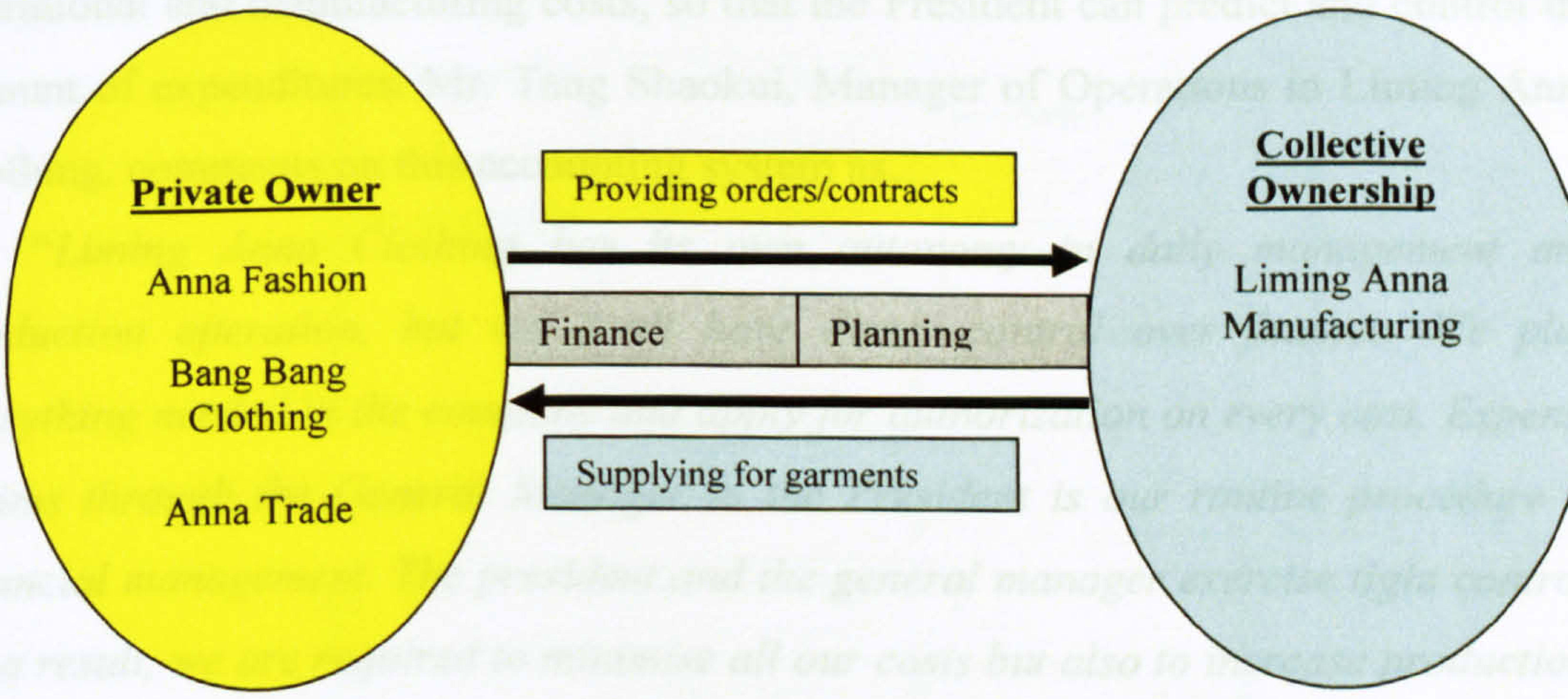
'Anna Trade' focuses on garments trading. It is completely independent of the other three divisions as it has its own accounting system and is only responsible to the President. It is not involved with Anna Fashion and Bang Bang Clothing, and has no co-operation with Liming Anna Clothing. It has its own overseas clients and places orders with its own contracted outsourcing factories. It seldom communicates with other divisions at the operational level. The Manager is a member of the board of directors merely involved in final decision making and the corporate strategic development of the whole company.

These four branches separately operate with their own range of responsibilities and with autonomy. However, there is frequent communication and co-operation between Anna Fashion, Liming Anna Clothing and Bang Bang Clothing. As the General Manager of SLAC, Mr. Liang comments;

"As remained in the form of collective ownership, we retain independent management in our factories, although daily operations are totally controlled by me and the vice general manager. We report to the President, the private owner, for key decisions. All the orders come from Anna Fashion and Bang Bang Clothing, and we plan our production based on their command of orders. Particularly we have close working relationships with Anna Fashion, as our managers and supervisors keep in daily communications with them for delivery and quality issues. Sometimes Bang Bang will bring together Quality Control staff with Anna Fashion staff for sample verification and quality approval. But we don't have any work relations with 'Anna Trade'."

Government reforms are bringing into gradual privatization of collective ownership. The reality of this case study is a business venture with a split ownership; private and collective-owned. The merger of a private company with a collective-owned company has created shared benefits for both parties. Shenyang Liming Garments (SLG) needs orders to keep its factory operating and Anna Fashion Company (AFC) requires a manufacturing base to reduce its cost and for quality control. Land and capital are two essential production factors that private owners lack in China. The collective-owned enterprise in the state sector offers these. However, private owners are prone to encroaching upon the collective property ownership and this gives birth to increasing tension and disputes in management, as in this case study. To sum up structural relationship, a barbell structure illustrates in figure 5.4 - a split weight emphasis in two functions of the organisation; one on marketing & trading and the other on manufacturing. Flexibility of management is showed at one end (top management) but extremely constrained at the other (production base). Such 'barbell' structure reveals separate entrenchments of dual-type of ownership – private owners and collective ownership.

Figure 5.4 Barbell Structure of SLAC



5.2.3 Systems

Within this layout of organisational configuration, management systems and processes are schemed to accomplish goals. In this business, the most significant systems are finance control; total quality control; and overall everyday evaluation. Financial systems are designed and used by the President as the key method to control management and costs. Total quality control has been taken from Japanese quality management and redesigned in line with the company's own needs and situation. The Japanese 'Kaizen' cost approach is also used as a complementary part of total quality control. Overall everyday evaluation has been taken from the Haier company, a collective-owned (public holding) enterprise that is enthusiastically endorsed by the government. The approach of overall everyday evaluation refers to detailed daily control. An assessment form is required to be completed each day by each production unit, so that every day's work is examined to ensure that daily production meets both quantity and quality standards.

There is a centralised accounts office to which the three main divisions must report all their expenditures. Expense claims are submitted every Friday with approval granted during the following week. Alternatively questions may be asked of the division to justify their expenditures. The President supervises all cost claims and gives sole authorization for approval. This tight control on finances is also reflected in the purchasing of raw materials. The President directly controls all purchases of major raw materials that are required by Anna Fashion. Bang Bang Clothing is in charge of the imported accessory materials from Korea. They supply the needs of the Liming

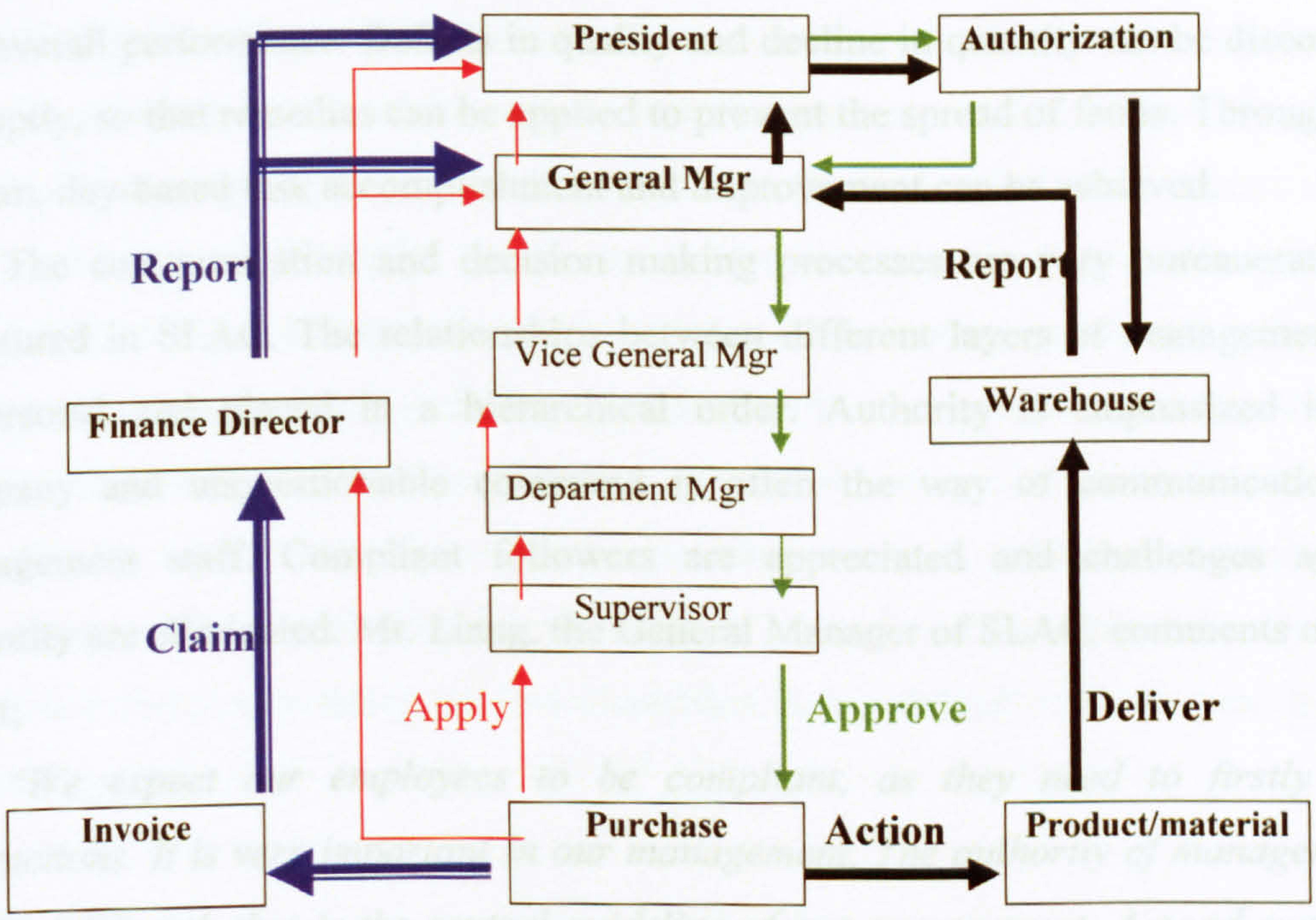
Anna Clothing. Budget planning is required on both a monthly and an annual basis for operational and manufacturing costs, so that the President can predict and control the amount of expenditures. Mr. Tang Shaokui, Manager of Operations in Liming Anna Clothing, comments on this accounting system as,

"*Liming Anna Clothing has its own autonomy in daily management and production operation, but we don't have direct control over finance. We plan everything needed in the company and apply for authorization on every cost. Expense claims through the General Manager to the President is our routine procedure in financial management. The president and the general manager exercise tight control. As a result, we are required to minimise all our costs but also to increase production. Strict cost control is the main issue in our financial management.*"

Ms Gong, Marketing Manager, mentions the accounting procedures involved in daily management;

"*The accountancy procedures in our company are quite complex. Every purchase has to go through two authorizations. For instance, we need to firstly send the proposal for what we are going to purchase to both the Finance director and the vice general manager. They then submit our application to the General Manager. The General Manager reviews the application and then sends them to the President for her final authorization. When the application is approved from the President, we can make our purchases. But an invoice for purchase is required to go through the same processes again for final review. Moreover, the product or material being purchased needs to go through the warehouse procedures and receipt of stock needs to be submitted to the same processes one more time. It is a complicated procedure we must follow. The President and the General Manager need to supervise every expense regardless of its amount.*" (See Figure 5.5)

Figure 5.5 Decision-Making Processes in the Financial Control System in SLAC



The quality control system is formalised by stipulated processes and procedures that are carried out by Liming Anna Clothing. It is a powerful tool to control the quality of product and places various tasks in place and in good order through different levels of management to first line production. Not only does it insure the output of production meets expected standards in order to satisfy the customers' needs. But also cost control is integrated into this system as another valuable aspect of the quality control system. This system is illustrated at two levels; one is the management chart that outlines how this system works in the company structure. The other is to demonstrate what kind of processes and detailed procedures are involved in this system, as well as showing how different functional departments follow procedures to work together as a whole. The quality control system provides the standards for the division of work, and stipulates work relations between departments. It sets the processes in order to produce the expected outcome in a predictable manner. Labour and capital as inputs are organised and processed in the system and high-quality products, as outputs, are produced to meet market needs. Such effective systems are important generators for organisational efficiency and profitability.

The system of overall everyday evaluation is applied in daily management. Based on the results of daily evaluation, control is placed tightly over unit production and overall performance. Defects in quality and decline in quantity can be discovered promptly, so that remedies can be applied to prevent the spread of faults. Through this system, day-based task accomplishment and improvement can be achieved.

The communication and decision making processes are very bureaucratically structured in SLAC. The relationships between different layers of management are impersonal and placed in a hierarchical order. Authority is emphasized in the company and unquestionable command is often the way of communication by management staff. Compliant followers are appreciated and challenges against authority are eliminated. Mr. Liang, the General Manager of SLAC, comments on this point;

"*We expect our employees to be compliant, as they need to firstly obey instructions. It is very important in our management. The authority of managers can not be infringed, that is the central guideline of our management. A good employee has to be a good listener and follower. I believe effective management is based on the premise of authority.*"

However, when the general manager is asked about the weakness of management, he continues,

"*The capability of execution is a weak point in our management as our objectives are often not achieved completely as to what we plan. The implementation of commands always deviates from my expectation. Although I constantly check the procedures of work, the capability of employees to carrying out tasks is still very low.*"

Job specifications for each position and for each department are regularised in a very detailed way. The company also sets many principles to guide what the employee should do and what they should not, in order to avoid mistakes in their jobs and to insure job efficiency. The total quality control system, Japanese just-in-time management method and Kaizen cost control and F. W. Tylor Scientific Management methods are all implemented. These insure the smooth operation of the bureaucracy. But on the other hand, it often generates low performance with low motivation as well as a low rate of innovation and creativity.

The systems of SLAC show some common characteristics of machine bureaucracy. It has very formalized procedures in the operating level and a proliferation of rules, regulations throughout the organisation, which it totally relies on employees complying and obeying as the core of the system. The decision-making is prone to follow the formal chain of authority in this collective-owned enterprise, so that the interests of the private owner and the interests of the collectivity can be clarified according to their respectively owned share division. The control of the private owner considerably ramps up while the representatives of collective ownership intended to entrench their control over collective assets and retain their management independence is declining. This is unlike the case study of the privately-owned enterprise with its organic entrepreneurial structure and its systems that are very flexible without formal rules and regulations but with tasks by informal norms and the owner's control. The involvement of collective ownership from the state sector is a factor accounting for this distinction as formalized rules are prominent in the state sector.

5.2.4 Staff

The future growth of SLAC relies on the talents of its key staff, mainly from two divisions – Anna Fashion and Liming Anna Clothing which are respectively managed by the President and the General Manager. The Board of directors, as the final decision-making group, includes five people - the President, the General Manager, the Vice General Manager, Finance Director and the manager of Anna Trading Company. These form the top management team, which makes all the final decisions about strategy. The general manager and the vice general manager are local government appointments – as representatives of collective ownership – and the other three are from the private company. Although the constitution of the company stipulates that all decisions require the signature of the General Manager, the President is still the final decision maker. The General Manager is also the connection with the Textile Industry Bureau, which handles reporting and communicating with local government.

The key personnel in the operational core in SLAC are divided into two specialisms - manufacturing and marketing. The manufacturing group is led by the Vice General Manager, and covers the majority of employees; approximately 600 in total, including 150 managerial staff (supervisors, managers and directors). The marketing group is led by the President, and includes three divisions: domestic, international and Bang Bang clothing, and has a total of 160 employees. The level of education in the manufacturing group is relatively low; 70% of staff have no higher than college qualifications and only 30% have graduate degrees. The marketing group is better qualified with graduates forming the majority of staff.

Formal recruitment is undertaken once a year for management staff, whereas recruitment occurs all year for production workers as there is high labour turnover. The Company sets ten selection criteria for formal recruitment. These are:

(1) Professional attitude to work

Being loyal and having a positive attitude to work.

(2) Learning potential

Expertise and experience are no longer necessary prerequisites, but learning potential and a capacity for training is important.

(3) Morality and ethical standards

Morality and ethical standards are regarded as essential traits for all employees. A person without such qualities will harm the enterprise regardless of how high capable and talented they are.

(4) Ability to communicate, and to handle change, and solve problems and be capable of making quick decisions.

A manager in the enterprise has to communicate with bosses, colleagues, subordinates, as well as to negotiate with business clients and state officials.

(5) Willingness to innovate

Science and technology are developing rapidly nowadays. An enterprise needs to continuously progress through constant learning and innovation, otherwise staying still means falling behind. Therefore an improving enterprise requires management staff with high learning willingness and capacity to develop talent.

(6) Collective spirit

One person's power is limited but collective power is mighty. An outstanding manager should be able to co-ordinate in teamwork and use collective talents to carry out tasks. He should not make arbitrary decisions based on personal preferences.

(7) Health and fitness

Good health is a basic element for a competent manager. A manager should be energetic and dynamic to carry out tasks efficiently.

(8) Self-understanding

Understanding personal goals and capabilities is important for a manager. Self-understanding encourages intuition for better management work.

(10) Adaptability

A manager should have the ability to accommodate to different environments and get along with others.

These selection criteria are used in the formal recruitment of management staff. However, as the Manager of Operation mentions,

"The President appoints his own trusted fellows, who are relatives and friends, to important positions, such as in the Finance Office and the Marketing Department. Even the Dining Hall is managed by his uncle and his dog also gets fed there. Although we have formal regulations, these do not apply to the President; she is privileged."

The Personnel Manager, Ms Zhang comments on personnel management as,

"We have no human resource management and still follow old conventions in personnel management. The main content of our work is in relation to contracts and recruitment. We do not have reward and motivation mechanisms to manage. But if employees make mistakes in production that causes losses they will be fined with a penalty. However, if it relates to a finance issue, Finance Department is responsible for such things."

The Marketing Manager comments about recruitment as,

"It is always difficult to find very capable staff. We recruit new graduates every year, but they lack work experience and most are practically inept and they make blunders at work. Take the design work as an example; the new graduates from the Clothing University can design nice drawings by computer software, but their skills cannot be used in making samples and for manufacturing. Most capable candidates think the salaries here are too low, so we invest in new graduates and train them to become skilful. However, when they become capable through training and gain experience, they often leave for better opportunities and pay. You know that the pay for staff in the garments industry is quite low, so we can not retain talents. The problem in SLAC is that we lack capable managers and technicians."

Training programmes are well designed in SLAC. These cover a wide range of management issues and methods taken from successful case companies and western management theories. These programmes are to breakdown the old socialist planning ideology and create a new market-oriented mentality. They aim to improve innovation and enterprise in the company. Training is also aimed to facilitate the implementation of institutional change, as SLAC still has traditional management practices based on detailed regulations and rules that sustain a hierarchical, bureaucratic culture. Through self-management and training, the motivation of employees can be altered from '*make me work*' to '*I want to work*'; and from '*managed employee*' to '*self-managed employee*'; as well as '*ask me to perform well*' to '*I want to perform well*'. From 2004 to 2006, training has been systematically intensified for the implementation of total quality control and overall everyday evaluation systems in order to restructure business processes and rebuild enterprise management. This is in response to reform policies in the state sector. In consequence, the efficiency of production has improved, which is evidenced in its production capacity that has increased every year and costs of production reduced.

Bonuses and sanctions are stipulated in employees' contracts. The bonuses are very low in amount and limited to only two subjects: 'full attendance bonuses – RMB 60 per month' ($US 7) and 'lunch subsidiary RMB 100 per month ($US 12)'. But sanctions are applied for such things as days off, absenteeism, mistakes in production and unachieved targets. Performance evaluation is directly related to overall everyday evaluation assessment. Because of low material rewards, the motivation of staff is low. Interviewees at all operational levels (including the vice general manager) complained about the poor salary conditions and the "*no-reward rewards*", as they do not regard 'full-attendance-bonus' and 'lunch subsidy' as rewards. Personnel management has no staff development plans. As the Vice General Manager mentions about training;

"*We have many training courses for learning new management theories but these are not very applicable to our practical work. Theory seems too abstract to us. We benefit from some, such as Haier's management concepts and these are adopted by us. We are currently working on the objective of 'Restructuring Business Processes and Rebuilding Enterprise Management'. However, what we can learn from training is not much; our work still depends on our own expertise and experience.*"

The Manager of the Operations Department says:

"*I always keep all the training materials, so I can read them later as they are hard to understand at the first time. I think they are useful but we are too busy to have time to learn the knowledge. Less staff and more work is our situation. The production tasks are very demanding each year, particularly as delivery times are always very tight. We often have to work over time. Two Sundays off in each month is the pattern in SLAC and we get no extra pay for extra hours. Working longer hours becomes our obligation.*"

The staff policy and training of this collectively-owned enterprise emphasise management skills and market ideas. The enterprise demands change, innovation and creativity and the recruitment of staff and training is designed to develop this culture. Nevertheless, such demands conflict with existing systems and structure as staff are de-motivated because of low rewards. There is no development planning for staff and training is not designed to meet individual needs.

5.2.5 Style

The management style in SLAC is a mixture of that of the private entrepreneur and the state bureaucrat. The private entrepreneur operates informally and flexibly while the state bureaucrat prefers hierarchy and control. Such characteristics are mixed together in this company and form a unique leadership pattern, characteristic of COEs. The President, Ms Li Ying, who determines final decision-making, is an entrepreneur driven by profit maximization. Her style of management stresses dictatorship and absolute authority. The employee must listen and obey her commands whether it is wrong or right. Her way of control focuses on financial management; whether it is minor or major issue, it must be approved by her. The General Manager, Mr. Liang – a local government appointment – is a typical state bureaucrat with a political focus and a very cautious approach in what he says in the interview. He is more concerned with the security of his own position than about the situation of his employees. He emphasizes the importance of authority in management and shows a very strong preference for hierarchical orders in organisational processes. He expects employees to be good listeners rather than independent individuals with their own opinions. Mr. Liang describes his own style of management as;

"Authority is the centre of our management. I can't see how management can be implemented if employees do not listen to you. They must listen first and do what we ask. We set rules and procedures that employees must obey. It is how our systems work. I need to solve conflicts that emerge and work with both the President and our Local Government Textile Bureau to ensure smooth management and to develop strategy for the future of this company. I believe every process of employees' work needs to be checked to insure that they do it correctly. If the processes are right, then the results will be right. As a leader in the company, I must stress that compliance with the leader is the most important criteria in examining our employees' loyalty and commitment."

Operations Manager, Mr. Tang comments on Mr. Liang's style as;

"He is not an expert in the garments business and he has no idea about how manufacturing works. He is appointed by the local government authorities for this venture. He is a bureaucrat rather than a manager. He completely relies on the vice general manager for the management of manufacturing. But he is the only connection with the President in reporting what is going on here and he is involved in final decision-making. He attends all board meetings at headquarters and frequently communicates with the State Textile Bureau for meetings and reports. He is normally in his office two days a week to listen to reports from the vice general manager. This is the major content of his work. The joint venture with Anna Fashion has saved us from bankruptcy, so we appreciate our jobs more than ever. Even though work conditions have got worse, we still have a deep commitment to this enterprise since we have been working here for over 20 years. The new style of management in this type of ownership treats employees as capitalists, exploiting cheap labour. But we have to survive, so we try to accommodate to this new style."

Marketing Manager, Ms Gong comments on the President's style as;

"Our leader is very arbitrary and dictatorial. We must fully listen and do what she asks. Well, actually we can't express our own opinions as that would offend her authority. She won't accept your ideas anyway. So we already get used to following concordantly instead of thinking independently. We have no right of speaking, no source of information, and no independent thinking. When we have better performance, we won't receive any material reward and only verbal praise. But when there is any mistake, a penalty will be given. To perform better is what we are expected to do and it is regarded as our obligation. This is our management style. (A helpless smile appeared on her face when she stated this.) But I like this enterprise. I like my work very much. I have worked here for over 20 years and I don't want to leave, so I have to be adaptive to the management style here."

Nevertheless, at Vice General Manager level, the style of management is significantly different from that of the top decision makers. The Vice General Manager, Mr. Fan is a pragmatic and approachable person, promoted from the core operation level. He is in charge of manufacturing and routine management. He focuses on daily operations and keeps close communication with staff. Face-to-face and telephone conversations are his most common methods of communication, though paperwork and reports are also used for following-up formal procedures and documentary processes. The Technology and Finance Departments are the two most important functions for Mr. Fan. He thinks technology is the backbone of innovation and the key for the productive factory, and that finance is the centre of the enterprise. He works with technicians to improve production methods in order to reduce costs. The implementation of quality control systems is directly managed under his supervision. He does not believe in rule-of-thumb management and says;

"*We have learned a lot about advanced management practices, such as Haier's unique management system and Japanese just-in-time management. The methods are good but they only work when they fit into our own situation. The theory is too abstract for the practice and most are non-applicable for the real life scenario. The theorists are masters in talk but they do not know how to do it by hand. We do not know how to talk but we know how to do it in good hands.*"

Mr. Peng, Manager of Production, comments on the style of leadership as;

"*We have seldom communication with the General Manager and rarely see the President. But they give management autonomy to the Vice General Manager. He is the person who is in charge of daily management here. He is not only a practical leader, but also an expert in production and technology. He always gives appraisal to our performance and solves problems immediately. He talks to employees in person when they make mistakes and we know he is trying to help us. His office is open and welcome for any pop-ins and questions. Unlike the general manager and the president who are hard to reach, he is close to us. We like his style, as he is very supportive of our work. Among top management, he is the only leader who really cares for us. He has both quality and capability.*"

The Manager of the Technology Department, Mr. Gao also comments on the leadership style;

"*The key in our management mechanism is to do with what the leader tells us. Compliance to the leader, no-mistake, good quality and low rejection rate are emphasised in daily management. We don't have contact with the General Manager and the President; they are far away from us. We work under direct supervision of the Vice General Manager. He is a democratic leader and is willing to accept different opinions. He encourages us to discuss problems and find solutions in teams. We have very harmonious working relations. He creates a friendly work climate for us.*"

The personal impression in SLAC is one word – "Busy"! In the offices, everyone is busy, running around the building with phone lines ringing all the time. The Operations Manager, Mr. Tang says;

"We only have one day off in two weeks due to work pressures. We often work over weekends, and when there are urgent orders we have to stay late at night. But these extra hours are not paid for. As management staff, we have better working conditions compared to first line workers. A large number of our workers are lowly educated labourers from the countryside – they are farmers with temporary contracts. They are paid very low pieces rate. In order to gain enough for monthly living costs, these temporary workers have to work at nights and weekends. We have a very high turnover rate of them. The company relies on exploiting employees to earn maximum profits. The state ownership just gives us space for survival but it does not allow us a better life than survival."

The management style in COE is "mixed" and combines the dictatorship exploitation of the private owner, and the bureaucracy and dogmas of state management. It makes the worst case in terms of employment working conditions and treatment in comparison with the other three types of ownership in our case studies – state-owned enterprise, privately-owned enterprise and foreign joint-venture. As such it has none of the positive features of state management (e.g. employee welfare and equality) nor the ethics and flexibility of entrepreneurial management. Instead, it emphasises dictatorship, authority and bureaucracy. Capital accumulation through ruthless cost minimisation is most strongly demonstrated in this form of business venture. It is evidenced in this case study of a collective-owned enterprise that private ownership and collective ownership in a joint form gives rise to capitalist exploitation and the absence of business ethics. The venture purposes of the two owner parties and their entrenched control over resources seem to be the reasons for this outcome. Seeking opportunities for growth is the aim of the private owner, while survival in the market is how the collectively-owned enterprise existed because of its lack of market networking and incentives. Its state-owned background gives this collectively-owned enterprise advantages in land and production resources, which is what the private owner needed. The private owner regards the collective assets as resources to be exploitable and usurped. Therefore, direct control and bureaucracy are often resisted by the private owner while intervention of state governance is frequently involved to protect the collective interests. Implicit or explicit hostility has emerged between the private owner and the representatives of collective ownership. The private owner is reluctant to hand in profit to the local authorities but attempts to use it for further expansion. Privatisation as an inevitable trend of reforms is an echo surrounding China. Implicitly, the opportunity to buy out the collective ownership at a good price could be possible in the near future, which leaves the temptation to the private owner to plan for such a possibility. This joint venture generates unsolvable conflicts such as – 'speculation over collective production resources'; 'ambiguity in ownership property'; and 'hostility between diversified owners'. The only solution seems to be either sole private-ownership or full state-controlled ownership.

5.2.6 Shared values

SLAC is a collective employee venture in ownership with a hybrid model in management style. Although a collective owned venture, the company management is a mixture of four types - private, collective, state and joint venture. The President represents the values of private ownership; the General Manager those of the state ownership style; the vice general manager, collective-ownership values, and the Bang Bang Korea those of a joint venture partnership. As a consequence, values, beliefs and organisational culture are complex among both owners and employees.

The president is purely market driven and emphasizes profit maximization and cost control. She believes in capitalism and practises the atrocious exploitation of employees. Her financial control strategy is against employees' legal welfare and work conditions. She is an authoritarian and believes in tight management controls. However, she is highly sensitive to capturing market opportunities. As an ambitious entrepreneur, she is a big gambler, willing to take high risks that give expectations of high profit returns. She and her followers have an aggressive approach to market development. They move fast to respond to market trends as in any market-driven enterprise. Since 2002, they have grown from a small trading company with about 100 hundred staff to a company with 600 employees and a manufacturing capacity of one million garments in three years. Further expansion plans will grow the company to an enterprise with 1800 employee in a new industrial park with production capacity of two million garments. It will become the biggest garments manufacturing base in Liaoning Province within 2 years.

As a result of market reforms, SLAC is a new venture with combined collective ownership connecting the private and state sectors. To a certain extent pure market-driven forces in the private sector exert direct influence over state enterprises and pushes them into pure market competition. The emerging market economy is not only demanding organisational restructuring, more crucially, it is challenging management attitudes in changing from a socialist to a capitalist regime. People have to discard their belief in a planned economy and accept the ideas of a market economy. Such changes in ideology generate confusion and question employees' beliefs, particularly for those who are deeply involved in planning mechanisms, such as enterprises in the state sector. This is why the people in state-owned enterprises often have been slow to react to market changes because their confusion blocks their ability to identify market opportunities. Private enterprises, on the other hand, are the outcome of the market economy. They grow from the market gaps of a socialist planned economy, which were regarded as a revival of capitalism that had to be suppressed in the old regimes of the 1950s and1960s. Hence private enterprises have a capitalist nature and market characteristics. The market environment to them is like water to fish, they can freely swim in it. Any business consisting of private and state ownership produces shared values in recognising the nature of market orientation, but it gives rise to conflicts in organisational culture and management philosophy.

The General Manager has the role of representative of collective ownership as well as the role of guardian of collective assets for the local government. He reports to local government authorities, the Textile Industry Bureau, on SLAC management and financial matters. He is neither an entrepreneur nor a manager, but a bureaucrat. He represents government policy in relation to the strategy and management of the company. But he gives full autonomy and responsibility of management to the Vice General Manager and takes a detached supervisory role for the management of SLAC. He works at the top of the strategic level of the business with the private owner and acts as an important connection to the State agency that exercises inspection over the collective property.

The Vice General Manager works directly and closely with the operational core and first line workers. He is an amiable leader, truly representing the collective values – employees' interests. He is an expert in technology and production and always gives support to his employees. In this collective venture, he shares equalitarian values with his employees and his democratic style of management is different from that of top management. Although he has no right to change the rules of the company, he tries to create an easy work climate for his employees. Loyalty and diligence are shared values in his environment. Despite his different beliefs and opinions with the top management, he often tells his staff to work hard to improve themselves and they need to survive in the market. As the company slogan announces, "*If you do not work hard today, you will have to look hard for work tomorrow.*"

Bang Bang's partnership in both supply and franchise sales gives SLAC the opportunity to expand their scale and to closely learn from its successful Korean partner. As Bang Bang Korea emphasizes quality of products and sets high standards for inspection of samples and delivery times. Quality control becomes a main theme and focus on SLAC's management. Every interviewee in the company brings forward this emphasis on quality control. They all believe that quality is the life blood of the product. The implementation of total quality control and overall control evaluation systems is well practised by management and first line workers, although they have to follow petty procedures and processes.

In order to understand market forces and to be fit for financial control on costs and efficiencies, an education programme about "Market-Related-Wages" and "Market Chain Management" has been implemented to change the old ideology of "fixed wages" in the state sector. This re-education is built into learning and training processes and is designed as part of management development. The old standard was to pay workers on a daily basis and employees normally believed that the full amount of wages should be given when their work was done. However, employees seldom asked '*why do I get my wages?*'

Market-related wages that have been implemented in SLAC has re-evaluated the amount of pay to employees in line with market objectives and the reality of market conditions. The company slogan is "Work effectively and Get paid clearly!" It stresses that employee's salaries come from the orders they produce, which is determined by whether they can turn orders into quality products that the customers are satisfied with. The new standards on salaries changes the responsibility of employees from 'the accomplishment of tasks for the boss' as in old approach, to 'for the market benefit and client satisfaction' in a market economy. It is the clients who really pay the employees' wages. It is a market chain relationship which includes relations with clients and market relations with profit. The employee should be part of this chain and be responsible for customer relations and producing quality products. Everyone's wages are determined by these market mechanisms. The new standards for pay break down the old functional management and turns the functions of organisation into processes, with all business activities regarded as customer delivery processes. It transforms outside market pressures into internal market pressures to stimulate the employee's self-awareness of their market value.

In order to cope with new systems and processes, new concept and continuous improvement, SLAC is prone to gradually foster a learning culture in the enterprise by introducing regular training and assessment processes. It uses the Party advocacy of the 16th People Congress: "*To form a people-learning and life-learning society in order to facilitate all-round development of the people*" as a company slogan to encourage the growth of the learning culture. It proposes six learning objectives for all staff as follows:

(1) Systematic thinking, so that people can see the whole picture instead of pieces. With systematic thinking, we will know how the piece of work in our hands can contribute to the organisation, which gives us understanding on what we can do better to make the whole system better.

(2) Self-improvement, leading to better work performance for the good of self, company and society.

(3) Improving employee psychologies to cope with the new business environment.

(4) Encouraging collective consciousness for team work and cooperation.

(5) Encouraging emotional and social intelligence alongside technical skills.

"*Learning how to learn*" is the education theme. "*Concepts decide behaviour; ideas decide solutions; innovation decides development*"' are promoted as values for employees. Management education in 2006 advocates three objectives: (1) to improve the quality of middle management by staff selection and performance appraisal; (2) to develop a central core of management with a spiritual belief in the enterprise; (3) to establish market-focused values among managers.

These continuous learning programmes are in concordance with Central Government policies and political decisions. This pattern of intense training and education demonstrates a typical approach of collective-owned enterprises which distinguishes them from purely entrepreneurial firms that lack systematic training schemes.

Although all training and education tend to equalise values and cultural beliefs in COE's, conflicts are still inevitable. The major conflicts in SLAC amongst owners as well as employees are represented in the following paradoxes:

(1) Individual Values vs. Collective Values

The private owner tends to maximise profit values by all means. Although the enterprise is based on collective ownership, the private owner regards the enterprise as her own as she is the majority share holder. This individual value is against collective values as she tries to keep all the profits and to retain these in the enterprise for further growth instead of sharing them with the employees and the local government. Such disputes in profit-sharing emerge in this enterprise as it grows compared to the stable status of the past. In addition to this profit-sharing problem, she controls the financial system to avoid tax payments and to evade fees that should be paid to the government. It is a big conflict in this venture as the local government is a victim in both ways, either profit loss or tax loss. Two key elements in SLAC - Finance and Marketing - are still directly controlled by the Private Owner. This conflict may evolve into a fatal problem if the local government continuous to receive no profits. The expansion of the new factory temporarily leaves this dispute to later discussion as future higher profits may solve this problem. The General Manager mentions that the local government provides land for the new factory building but still counts for only 49% of collective ownership. The government expects a profitable future from this further expansion in the venture.

(2) Legal vs. Non-Legal

A further conflict between individual and collective values refers to appropriate ways for getting things done. The market legal infrastructure is still not completed so there are still ways of avoiding rules and illegal behaviour is not punished by legal processes. The emergence of private enterprises was initially the outcome of a non-legitimate environment consisting of market gaps. These generate non-legitimate ways in business operations. Because of a prevalent social culture in favour of trust and personal relationships, private entrepreneurs tend to ignore legitimacy in business and instead, try to find '*cheap*' and '*short-cut*' ways to success. They strongly believe that the informal power of relationships is greater than legal and contractual processes. Such values direct their behaviour to manage their businesses in non-legitimate ways, which may contravene the legal frameworks.

Take the construction work for the new factory as an example. The President is trying to evade the legal procedures for this project as these involve paying various fees. The bid for hiring a professional construction company seems to be too expensive for her as she would prefer to use another cheaper construction company from the countryside that she personally knows. When the project was stopped by the local authority because of its illegal operation, she attempts to use personal connections in the government agency to help her to avoid legal regulations. Although employees and the local government disagree with her approach, she controls the finances of the company and owns the majority shares. Conflicts and complaints are inevitable but she still dominates the enterprise for the final decision making.

(3) Capitalist vs. Socialist

The private owner is capitalist, driven by market forces and capitalism, compared to the collective ownership governed by the local government still with its socialist ideology. Lack of concern with human relations is an obvious feature of capitalist enterprises at their early stage. The staff are treated as 'economic men' in Shenyang Liming Anna Clothing in the market economy, instead of 'master of the factory' as in the collective enterprise in the socialist economy. In order to maximize profits, the conditions for employees are seriously reduced to a minimum level.

The collective enterprise in the past provided such welfare services as nursery houses for female employees who had children; subsidies for free meals in the dinning hall; holidays and sick-off-days with pay. Extra hours at work were paid at the legal rate. Moreover, employees also enjoyed annual bonuses, and the assignment of welfare house and medical insurance. The employees in the former company were treated as if they were part of a big collective family with equality and democracy as the key values of belief under socialism. However, welfare and a non-profit orientation as socialist values in the past also caused inefficiencies and non-competitiveness.

Today, Shenyang Liming Anna Clothing is now dominated by private ownership under the market economy, and these welfares and benefits for employees are mostly eliminated. Moreover, they have to work longer hours and only get two days off every month. Employees are unpaid for extra days and hours. Salary for staff is fixed at a minimum rate, for example, RMB1,000 (US$ 121) for supervisors, RMB1,500 (US$ 181) for managers, RMB3,000 (US$ 363) for vice general manager and RMB 5,000 (US$ 605) for general manager; and no bonuses are given. No pay is given for days-off for illness and no compensation is given for medical treatment. The countryside labourers are temporary and no contracts are issued to them, which means they have no security and no insurance cover. They can be fired at any point and receive no pay.

As Mr. Tang, manager of Operations mentions, some fired employees have reported SLAC to the State Labour Inspection Department on several occasions for breach of labour rights, but nothing happened in the end. Such poor conditions for shop-floor workers in the garments production factories are common, not only in SLAC. The company is more powerful than individuals and it has strong relations with officials in local governments. Such actions by SLAC means that it will not be punished legally. There is no trade union or any employee association to represent labour rights and protect their interests. Employees who want to stay employed keep silent and do not complain about such treatment as they need their jobs to survive. In the North-eastern heavy industrial cities, there are a large number of laid-off employees from bankrupted state-owned enterprises and collective-owned enterprises, and they are normally low-skilled and older labourers. Marketisation is a shock wave to them and they are struggling to find a job again.

Although the culture in SLAC is mixed with both socialist and capitalist values, as market reforms deepen, the capitalism values are becoming dominant in driving the enterprise. It demonstrates some characteristics of primary capitalist accumulation. As Karl Marx (1974)[258] said about 'Capital',

"The bourgeoisie, as its rises, wants and uses the power of the state to 'regulate' wages, i.e., to force them within the limits suitable for surplus-value making, to lengthen the working-day and to keep the labourer himself in the normal degree of dependence. This is an essential element of the so-called primitive accumulation."

"But if the labourers could live on air they could not be bought at any price. The zero of their cost is therefore a limit in a mathematical sense, always beyond reach, although we can always approximate more and more nearly to it. The constant tendency of capital is to force the cost of labour backwards this zero."

"The capitalists become bold when there is proper profit. They can take risk for 50% profit; they can override all laws for 100% profit; they can commit crime for 300% profit and even regardless of the danger of hanging."

In the case of SLAC, conflicts in shared values and changes in culture are inevitably taking place in the transition to market socialism. It reflects the outcome of ownership diversification and illustrates one scenario of mixed ownership experiments in the socialist market. Nevertheless, it forms the most complex case comprising of mixed values and styles, and particularly reflects the diversified interests of shareholders and hostile attitudes in management control, when compared

[258] Marx, K. (1974) *Capital – a critical analysis of capitalist production, volume I*, Progress Publisher, Moscow, p689 and p562.

to the other three types of enterprise ownership; the state-owned enterprise, privately-owned enterprise and foreign joint-venture in our case studies.

5.2.7 Skills

SLAC is a large-scale collectively-owned enterprise crossing both state and private sectors formed on a solid middle management team with professional training and qualification in garments manufacturing and domestic marketing. The middle management staff are very experienced and skilful in practice since they have worked in the garments industry for over 15 to 20 years and they have been brought up alongside the growth of the Chinese textile industry. They have practical knowledge and expertise about the technology and traditional crafts required in textile manufacturing. Loyalty and diligence are their strengths; commitment to the work and the collective make them a valuable human asset for the Company. New systems and processes are being implemented and executed by this key staff that form the core for insuring quality and on time delivery. Without guarantees of quality control, products cannot be sold, customers will not order, and in consequence businesses will fail. They are the backbone of the business and of marketing.

The Manager of the Technology Department comments, "*The Technology Department is the dragon head of the whole factory, as every department of manufacturing requires our technological guidance. Every order from clients need to come to us first to verify whether we can meet the standard and define the requirements of quality control. Innovation in technology is for better techniques and methods of production and to carry out cost control and efficiency improvements.*"

The Marketing Manager, Ms Gong, "*Our Marketing Department focuses on domestic market development for our own brand, Anna Lee. This department combines many functions, such as Design, Sales, Retail, Distribution, Promotion and Advertisement. The marketing work is done by experienced staff as new graduates we hire are not experienced and have no skills in this area. The staff in our department require multi-talents who know all the functions of marketing and understand the traditional craft techniques in clothing and who have management capability. New graduates from the school are required to have extensive training before they can be adequate for their jobs. However, because of low pay in the textile industry, they often "hop their jobs" after they gain qualification. Our company has no effective management to retain young people.* "

Due to the absence of human resource management, the company lacks a motivation mechanism to attract capable talents through recruitment. The absence of a proper reward system generates low motivation among staff. The objective of management is to improve employees' motivation but the reality is far from this goal. As the complexity of technology progresses and the number of employees increases, the human resource management will be a major issue for SLAC in the future. An increase in wages and improvements in work conditions will be the demands of labourers.

The President, Ms Li Ying is a strong female entrepreneur. She started her own business by selling clothes in 1990's. Marketisation has provided her with huge opportunities and an environment for rapid growth. She has developed her own clothing business in the domestic market and taken opportunities with Korean companies for outsourcing and supply in the late 1990s. By 2001, she became an exclusive supplier for Bang Bang Korea Company. She is the person who gets the business and contracts for the enterprise. Her capability in business development is vital for the future development of the enterprise. As a private entrepreneur, she has pure market incentives and her strong sense of capitalism is exerted as a belief value in the management of SLAC through her direct control. Profit maximization and cost minimization is her main objective of management.

The General Manager has the responsibility for setting up formal management systems and to institutionalizing the whole enterprise management. As a leader from a SOE, he has implemented formal bureaucratic management systems. These consist of formal procedures and processes in different systems, detailed job specifications and hierarchical orders from top to down. This is the management pattern of SLAC, which demonstrates the significant features of scientific management in the early 1920's during the age of Lenin's Industrial Revolution in Russia. Such a formal structure is not common in private enterprises such as the privately-owned enterprise in our case study, as most of them are informal, entrepreneurial with a family style.

5.3 Concluding Remarks:

SLAC, as a collective-owned enterprise, has the combined characteristics of both private and state organizations in terms of structure and systems. Machine bureaucracy and hierarchy is the foundation of SLAC while closed and formal rules are highly stressed. Unlike the state-owned enterprise case study, this collective-owned enterprise is headed and navigated by a private entrepreneur, not a state bureaucrat, to the extent to which state participation is limited at protecting its interests rather than managing them. It leaves a 'vacant space' so in this type of ownership, labour law, social responsibility and business ethics are neglected. Despite the involvement of the private entrepreneur, this collective-owned enterprise focuses entirely on low-cost, standardised high volume production at the low-end of the value chain. Basically, it offers cheap sub-contracting services to foreign companies. As a direct impact of market socialism, two forms of ownership – private and collective – create a buddy system that offers benefits to two separate interest groups. Conflicts and tensions between these two owner groups are intense, reflecting how their merger has enmeshed two types of ownership in a dialectic and antipathic relationship. Property ownership is a main focus of change in the transformation to a market economy, and this inevitably affects managerial behaviour and organisational processes. This collectively-owned enterprise illustrates many of these tensions. Ownership clarification seems to be a better solution than ownership diversification in this case.

CHAPTER SIX:

Case Study (3): The Entrepreneurial Venture

Dalian Dali Cashmere Product Co., Ltd.

Introduction

One of the striking features of China's economic reforms, transforming from a command to a socialist-market economy, is the rise of the private sector. Rapid growth of privately-owned enterprise has become a driving force for the Chinese economy as well as a dominant ownership mode in the country. Private enterprises are organized in a very informal way because of how the domestic private sector emerged from its history; in the shadow of the state economy. This informality has given entrepreneurs great flexibility to respond to an uncertain business environment composed of unclear and rapidly changing government policies, taxes, and regulations. But it also hampers their ability to raise capital, reward managers and employees. Due to lack of management skills and professional managers, private enterprises tend to be stuck in a framework of legal, financial, and governance structures that they have outgrown in terms of the size and complexity of their businesses.

In private enterprises, entrepreneurs are the spirit of the organization as they start up their enterprises and take the direct and central supervision for management. They make all the decisions and take all the risks for their business ventures. Their success or failure determines the fate of their whole enterprises. As Schlevogt (2001)[259] has suggested, the private Chinese organizational model tends to be very centralized with an informal structure and strong entrepreneurship that emphases enterprise networks and traditional cultural values. These distinguish them from state-owned enterprises and collective-owned enterprises. The privately-owned enterprise in this case study demonstrates such distinctive characteristics as it is a typical entrepreneurial organisation outgrowing from economic reforms in the recent decade.

6.1 Background of Dali

Dalian Dali Cashmere Product Co., Ltd. is a typical entrepreneurial company. It was founded in 1995 by Mr. Zhu Li with start-up capital of only RMB 20,000

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[259] Schlevogt, K. A. (2001) 'The Distinctive Structure of Chinese Private Enterprises: State versus Private Sector', *Asia Pacific Business Review*, 7 (3), Spring 2001, pp.1-33.

($2,500). Within ten years (1995-2005), it has grown to be a company with 200 employees, and total assets of RMB 50 million (USD$ 6million). It manufactures cashmere knitwear and combines all its functions - raw material purchasing, manufacturing, marketing, retailing on a single site. The company is equipped with advanced computer technology and has 220 production machines. These include auto computing transverse knitwear machines and 7G-18G manual transverse knitwear machines, manufactured in Japan and Korea. The factory has an annual production capacity to produce 150 thousand pieces of knitwear and over 20 tons of cashmere yarns.

Its famous brand of cashmere sweater – 'LiaoNanWang' ('the King of Liaonan') is particularly well-known in Dalian city, as well as nationwide. It was one of China's pioneering companies in building its brand value in the early 1990s, along with its competitors, 'Erdos' and 'Kingdeer'. Besides its cashmere products, Dali has also diversified its product range into silk knitwear and various natural blend fibres to meet the demands of the Japanese market. These products are now also exported to the USA, Japan, Korea and Europe. Overseas sales have been rapidly increasing since 2000 and since 2005, account for more than 50% of the company's total sales.

Mr. Zhu, the owner and general manager, is a typical entrepreneur with a self-confident, open minded and risk-taking approach to the market. In interviews, he tells the story of how he started his business[260]. At the time he had a secure job working in a large-scale, state-owned cashmere factory, Guoxing Cashmere Company, in the Dalian Economic Development Zone, working as a deputy manager. In the early 1990s, a job in a state-owned enterprise would be something to be proud of, as it offered guaranteed life-long-security. However, the person who can survive in a state-owned enterprise, has to be a good listener, follower and respect seniority, regardless of personal competence. The cultures of state-owned enterprises' do not reward performance based on personal ability. Instead, there is an old saying in China that, "The gun will shoot the bird that shows off"; that is, the person who demonstrates personal competence would be regarded as a threat to senior management and be rejected. Mr. Zhu was a victim of this. He had faced up to a decision; either to tolerate this work situation, or leave the security of a state-owned enterprise for a position that would be high risk. He decided to become an entrepreneur; to take high risks and to

[260] The interviews with Mr Zhu Li were recorded for the archives of primary data.

make more money. He believed that life should be one of personal success and achievement rather than oppressed by the procedures of a state-owned enterprise.

He started his business in 1995 using all his savings - RMB20,000 ($2,500USD). He used credit to rent a store to sell his cashmere sweaters and to purchase raw materials. His personal relationships and the business network that he had built in his previous job played a crucial role at this start-up stage. Without personal trust he enjoyed, he couldn't have obtained credit. His friends gave him loans for his initial capital. Since then, he has always been committed to building up long-term credibility and personal reputation as the basis for his business development. The second stage in the growth of his business was the establishment of manufacturing workshop in 1997. As a technical expert in production, he was knowledgeable about raw materials and knitting technology and this gave him an advantage in setting up his own factory. Through personal contacts in banks and friends, he obtained loans to extend his retail business to manufacturing. Before 2000, the domestic market was his focus and the exclusive source of his profit. 1997 to 2000 was particularly important for Dali's domestic market growth, which established his competence in aspects of technology, equipment, skills and staff. Following the wider openness of the economic environment and WTO membership, Mr. Zhu began to focus on overseas markets as new growth areas for his entrepreneurial company. During the period 2000 to 2005, Dali rapidly expanded its sales by between 80% and 100% per annum. (Figure 6.1)

Figure 6.1 Annual sales and respective portion of domestic and overseas markets of Dali Cashmere

Year	Annual Sales (Million Yuan RMB)	Portion of domestic market (Percentage)	Portion of overseas market (Percentage)
2000	6-7	100%	-
2001	7-8	10-20%	80-90%
2002	10	10-20%	80-90%
2003	20	20%	80%
2004	28	35%	65%
2005	32	50%	50%
Total	105		

One of the features for Dali's growth, is that Mr. Zhu always heavily reinvests the company's earnings into the expansion of his company's manufacturing facilities. (Figure 6.2) Increasing production capability is his strategic focus in business development. When asked for the reason of his success, he says there are two reasons:

"*I should say that the open environment – the free market, provides me with great opportunities to develop my own business. In early 90s, I saw increasing demand for high-class cashmere products but the supply was low. During this period, having a cashmere sweater was a wish for almost everyone. As the market was booming, there were too many opportunities, but it depended on whether you could step out of old ideas. The planned economy and regime had locked people's mind for too long, the economic reform was subversive to most people who were born and brought up under the planned socialist economy. In the late 80s and early 90s, those who started their own private individual businesses were most likely forced into it because of their situation. For example, those with criminal records and the unemployed couldn't find jobs in state-owned enterprises or even in collectively-owned enterprises, and so they have to do some individual business or trade to survive. In people's minds, jobs in SOEs were the preferred choice with respectable social status. Private businesses were discriminated by the society. That is why the quality of the first entrepreneurs was poor with low education. There is an old saying in China 'The hero grows in the times of disorder'. I think the creation of the open market and the high demand for cashmere products were major reasons for my success today. I just did the right things at the right time.*

As for me personally, I believe that if you can cope with the hardest of hardships, you can rise in society. Hard work and the ability to endure hardships are important to my success. I reinvest my profits in technology and business expansion, not in pleasure-seeking. As the motto of my company says, 'excellence is created from bit by bit', 'Ideas determine the path of development and the calibre of people determines the quality of the products'."

Figure 6.2 Major investment and fixed assets in 10 years of Dali Cashmere
(Exclude the stocks of cashmere products and raw materials)

Year	Investment (RMB Yuan)	Purposes of investment
1996	20 thousand (US$ 2.4 thousand)	Starting capital (registration of an individual company)
1998	1 million (US$ 120 thousand)	Basic computer-controlled knitting machines
1999	10 million (US$ 1.2 million)	Constructing factory building
2001	3 million (US$ 363 thousand)	Increase 30 manual knitting machines
2002-2004	15 million (US$ 1.8 million)	Equipping factory building and office (IT systems/ERP, computers, elevators, conditioners, etc.)
2005	5 million (US$ 605 thousand)	Increase equipments/machines to 220 (Auto-computing knitting machines and manual machines)
Total	**34.2 million (US$ 4.1 million)**	

Within ten years, Mr. Zhu has gradually and constantly reinvested profits in increasing his company's technological competence. Despite the fact he knows little of management theory and has no idea about such terms as 'strategy' and 'structure', his actions demonstrate unconscious strategic thinking and planning. This case study attempts to unwrap the management processes and examine these by using the McKinsey 7s framework.

6.2 McKinsey 7-S framework analysis:

6.2.1 Strategy

When Mr. Zhu is asked about the business strategy, he is confused. He asks for further explanation of this term. After a few minutes, he says;

"I don't have any strategy or ambitious goals in my business development. I just do what I think is right, following my instinct and rule of thumb, doing work with a down-to-earth style. Firstly I never thought I would have achieved what I have today when I started 10 years ago. Secondly, I have never been satisfied with what I have achieved in each year. I don't have long term objectives like market share, or to build a mansion, or how much profit to make, or to compare myself with others. Maybe it explains my weakness, no planning or explicit goals. I am working step by step. When

I saw the opportunity for cashmere products, with my expertise in raw material and cloth making technology, I decided to become an entrepreneur. But I didn't think anything more than being a retailer. But as my business went well, I thought if I could open a manufacturing facility, it would be more profitable and I would have more control on market supply. Then I borrowed loans and with my profits, I set up a workshop with only 20 hand machines. The market has continually grown and so I have been naturally expanding the scale of production to meet this increasing demand. Actually I have no strategy or plan for my business, but I do look back for what I have done in each year and compare that to the market demand. However, the outcome has never satisfied me, as I always think I can do better. So, I have been trying to improve myself by expanding the level of production and quality control. Our objectives are focused on each customer order, each batch of production, every season of sales, and each step of work. 'Excellence is created from bit by bit' is at the core of my guiding principle."

He is not pretentious and arrogant in his speaking. He talks as a dedicated and focused entrepreneur. He takes risks and he is always looking for new market opportunities. He is committed to steady business growth, constantly investing in technology to improve his volume and quality of production. His strategy is no strategy!

As the motto hanging on his wall states, '*The idea creates fortune, and the wise person sails the boat with the help of the current.*' He understands how important it is to use other peoples' resources to achieve his objectives. That is why he could set up his business almost from nothing. He gives the impression of honesty and integrity and through this he gains other people's trust. Relationships are an important resource for doing business in China, and even more important for entrepreneurship. Not only did he rely on personal credit at the start-up stage of his business, but also he drew upon bank loans to expand it. All this required the use of personal relationships and networks, as the bank system in socialist China didn't support private businesses in a formal sense. Without maximising the use of his personal relationships, he wouldn't acquire the necessary capital for business growth. But the business was structured on a very informal basis and through his personal integrity he was able to fund his strategies for growth.

In the second stage of business growth he built up the core competences of his company. Technology and quality were the focus of his mind, and the need to identify market needs. Due to the rapid speed of market transition, and political uncertainties in China it was difficult for him to have an explicit strategy and business plan. He had to respond swiftly to market changes and trends in the business environment.

In the third stage of his growth, he developed a strategic alliance with a Japanese company in 2003 that gives him market opportunities to expand his business. This business relationship with a foreign company gives him tax advantages. According to '*The Rules for implementation of Income Tax Law for Foreign Enterprises and Foreign Invested Enterprises*' (The State Council Decree, 1991, No. 85)[261], clause Seventy-Five, foreign joint-ventures in manufacturing can enjoy 'two-year total exemption and three-year half reduction in corporation tax'. The two-year exemption starts from the date of making profits. Moreover, in line with clause 80, when the gains from a foreign partner are reinvested in China or in the expansion of production and technology, the reinvested capital can enjoy the full refund of corporation tax. Further, on the grounds of '*The Notice of Income Tax Policy on Purchasing Home-made Equipment for Foreign Enterprises and Foreign Invested Enterprises' by the Ministry of Finance and National Bureau of Taxation* (Finance 2005, No. 74)[262], the foreign joint venture can enjoy the tax refunds and offsets on the tax paid on the amount of capital used for purchasing home-made equipment. Based on the annual sales Dali made in 2005 (Figure 6.1), it has saved RMB 1.28 million (US$ 155 thousand) in terms of taxation because of this joint venture strategy in just one year. As Dali is constantly expanding its scale of production, these refunds and offsets on home-made equipment facilitate business growth.

The Japanese partner is responsible for the Japanese market and is signed as an exclusive agent. Japan is a large consumer market for cashmere products, and is vital for Dali's future growth. Following the setting-up of this strategic alliance in 2003, Dali has developed a second line product –women's silk wear to meet Japanese customers' demand. Mr. Zhu also regards this strategic alliance as a route to international markets since, in response to WTO, he knows there will be the cancellation of tariffs and quotas on cashmere products. Dali's business strategy is implicit and emergent, responding to market opportunities as they arise.

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261 http://www.chinatax.gov.cn/view.jsp?code=200309241006262333 (Accessed 2nd May 2006)

262 http://www.chinatax.gov.cn/view.jsp?code=200510121519356588 (Accessed 2nd May 2006)

Strategy is decided by only one person – Mr. Zhu. All other employees in middle management have little idea about the company's goals and future development. Five managers, respectively from sales, marketing, production, finance, and office, are interviewed and asked about the company's strategy, but no one has any idea about it. They think it is the owner's responsibility and they simply focus on their own, present-day objectives. Among the five interviewees, with questions that do not relate to their own responsibilities, they reply, 'don't know' or 'it is the owner's responsibility'. They don't contribute to their company's business decision-making. This is entirety focuses upon the ideas and inclinations of Mr. Zhu.

6.2.2 Structure

Structure in Dali is almost non-existent. When I ask for a chart of the company's structure, Mr. Zhu tells me to wait for his office director to show me. But in a later interview with this office director, Mr. Ding, he says that they don't have such a document. Not even documents for HR policies, management procedures, or company regulations. As he says:

"I have been told to write these papers since last year, but I have been too busy to get it done. This work requires me to sit down but I have been so busy so unfortunately we still don't have it today. I know that formal management structures are important for us and that is what we lack, but it is not easy to set this up because of the nature of this company. You know, it is the way small privately owned companies operate. I would prefer to have a normal structure and procedure in management, which would make things more predictable. However, it is not what we can decide really. Maybe in the future we will formalize our management as the company becomes bigger."

During the second interview with Mr. Zhu, I ask him to describe the number of departments they have, the relationships they have with each other, and major responsibilities in each of them. According to his description, I draw an organisational chart. However, he says that some departments are only a wish for the future. In figure 6.3, these future plans are indicated in a broken-line. An exploration of the relationship between the owner and the functional departments, reveals the owner retains total control over all functions of his organisation. He is the centre and the totality of management. The Vice general manager and office director are like "two hands" of the owner, which help him to manage the company, but report to him for all decisions, and they are under his direct control. In the interviews, the vice general manager, Ms Xu and office director, Mr. Ding both say that they need to report to the owner for every decision. The owner expresses his management style by stating his belief that if each process is navigated well, then the result will not go wrong. For him, giving autonomy to employees generates risk in the company's management. So in reality, Dali's organisational structure is as identified in figure 6.4. Basically it is NOT a structure but a pattern of dependency upon Mr. Zhu.

Figure 6.3 The "Supposed" Structure of the Dali Company

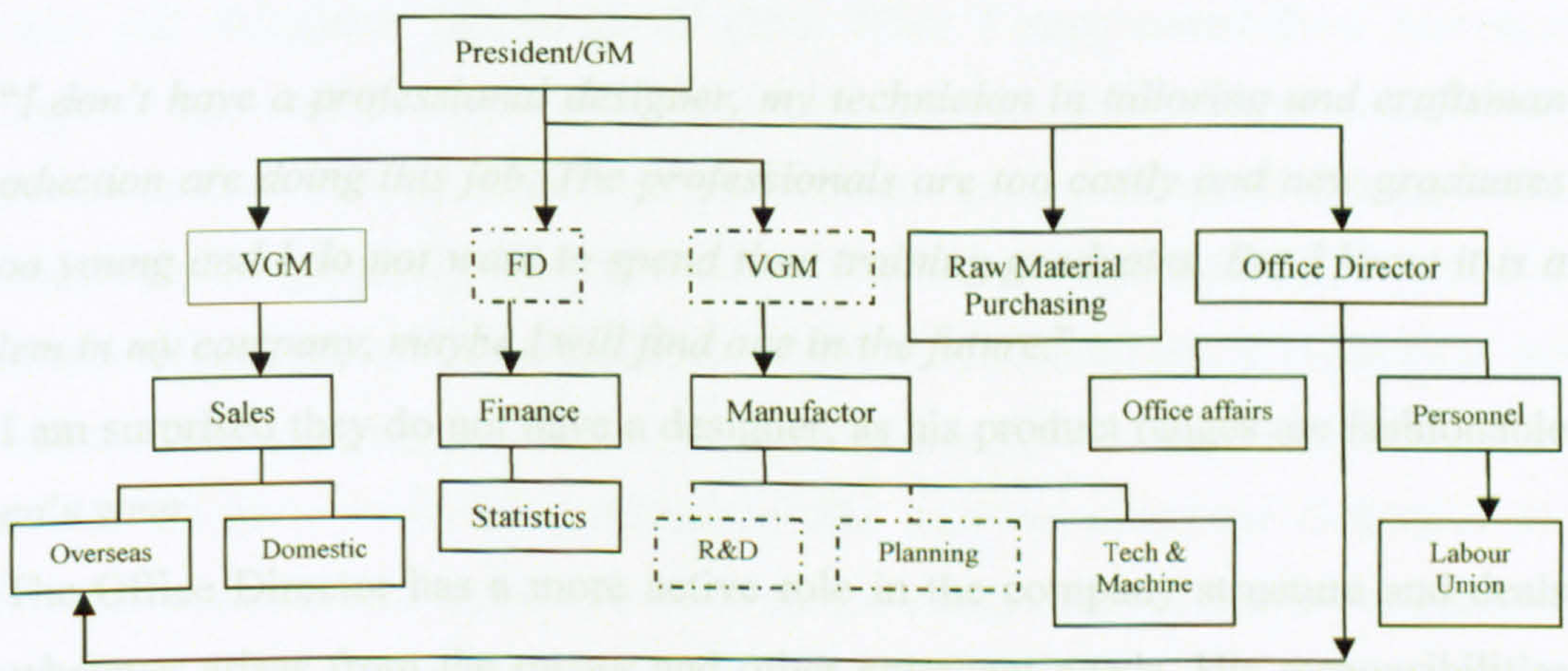
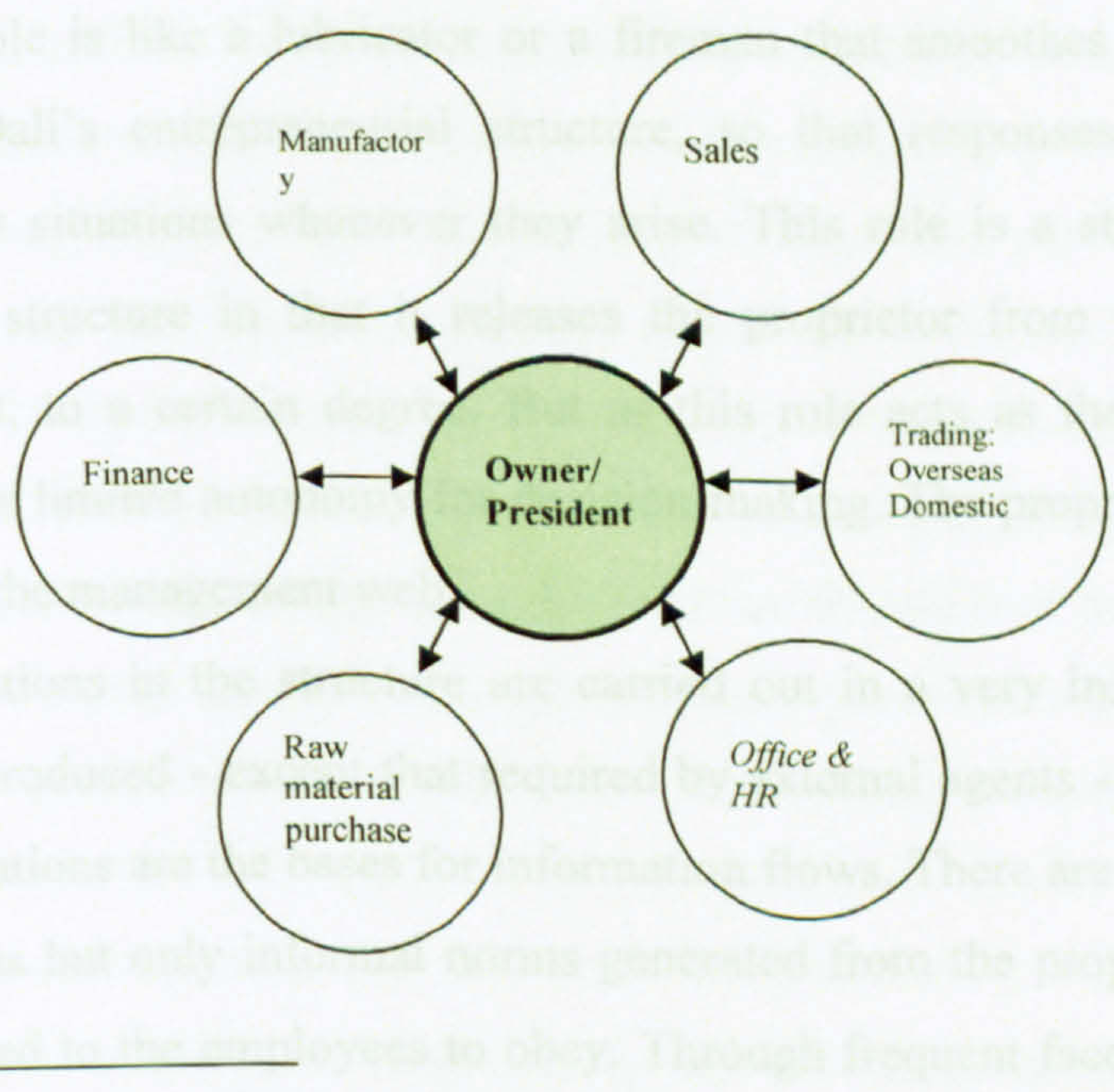


Figure 6.4 The Reality of the Dali Structure[263]



[263] Goffee, R. and Scase, R. (1995), *Corporate realities – the dynamics of large and small organisations*, Routledge, London, p9.

Job' specialisation in this structure remains very unclear and individual responsibilities are unclear and not defined. Except for the accountant from the finance department, the other three interviewees, respectively from office administration, marketing and sales departments, take on multifunctional duties and play flexible roles in meeting diverse needs as they might arise in the organisation. The vice general manager who is in charge of the sales department is also a manager in manufacturing, but she was transferred to sales when there was a shortage of staff.

Take the designer as an example. During field research in Dali's company, I call the owner and ask for an interview with the designer in his company. Mr. Zhu tells me that,

"*I don't have a professional designer, my technician in tailoring and craftsman in production are doing this job. The professionals are too costly and new graduates are too young and I do not want to spend time training graduates. But I know it is a problem in my company, maybe I will find one in the future.*"

I am surprised they do not have a designer, as his product ranges are fashionable women's wear.

The Office Director has a more active role in the company structure and deals with whatever arises from the owner and other emergent needs. His responsibilities are very broad - such as government requirements for annual reports and renewals, public relations, personnel issues, and trading affairs and particularly with overseas business. His role is like a lubricator or a fireman that smoothes and enhances the flexibility of Dali's entrepreneurial structure, so that responses can be swift to changes or new situations whenever they arise. This role is a strength in such an entrepreneurial structure in that it releases the proprietor from total management control; at least, to a certain degree. But as this role acts as the extension of the proprietor, it has limited autonomy for decision-making. The proprietor is very much at the centre of the management web.

Work relations in the structure are carried out in a very informal way. Little paper work is produced - except that required by external agents - and more face-to-face communications are the bases for information flows. There are no written rules to guide employees but only informal norms generated from the proprietor's principles that are conveyed to the employees to obey. Through frequent face-to-face meetings, verbal communications, and mottos, the proprietor passes his unwritten rules to the employees. By regularly checking on each working process, he "corrects the wrong" and "encourages the right" in line with his criteria to make sure his ideas are being fully implemented. Despite the owner's total control, informality and high flexibility are still the major characteristics of the Dali entrepreneurial company. In the interview, the proprietor explains why he cannot delegate autonomy to managers. As he says,

"I would be glad to delegate responsibilities to other managers. But the thing is that no one in the business is capable of having these. Their ways of thinking and ways of doing things are not beneficial to this company. They don't treat this company as their own in the way I do. More importantly, no one is competent enough to make important decisions. For example, I had a vice general manager, Mr. Qu. I gave him full delegation in charge of sales. What I experienced from him was cheating and mistakes. Because the cashmere sweaters are for seasonal sales, stocks are divided into two classes in accordance with their quality and fashion design. The first category are high quality and fashionable. The second class is for those that have quality defects and that are out of fashion and which need to be sold at a discount. Mr. Qu sold the first category of stock at a big discount for his own benefit. Another example is the current marketing manager. She says we need new brochures for marketing promotion. So I ask her to show me the design. Her design is not creative at all, but just adding bits from the old brochures. I also find out there is still a large storage of old brochures still remaining.

I keep direct control on every procedure to make sure each step is done properly so that the final result meets my expectations. I always believe that if the procedures are right, the outcome will be right. Sometimes I really feel very tired and exhausted, because everything depends upon me. Money is important for an enterprise, but capable staff is the most important asset. I would like to invest an extra RMB 300 thousand (US$ 36 thousand) every year for recruiting better talent for my company, but the reality is that I cannot find good people. The problem for my company is not a shortage of capital but a shortage of capable talent. When I look back, I realise that I predicted some trends in business development, but unfortunately my good ideas can't be implemented by only my two hands. I don't have enough people to achieve all my plans.

I know reliable statistics are very important for making the right decisions. I cannot always judge everything subjectively. My enterprise needs effective systems and mechanisms to manage these data scientifically. I need to have formal *management processes. These are important for the enterprise and we need to gradually build these up in the near future. I am aware of this, but the changes need to take place gradually."*

6.2.3 Systems

Within a minimal skeleton of the structure, the systems of direct control are informal and highly flexibility. Communications are carried in a very informal way with little paperwork involved. The telephone and face-to-face contacts are the means of daily communication. Regular meetings take place on a weekly or fortnight basis to review the week and to plan for the following week. These meetings between the proprietor and management staff are when verbal reports are presented and problems arising are discussed for solutions and approval. The proprietor is the centre of decision-making and has direct and total control over every procedure. He emphasizes the importance of supervising the procedures when I ask him whether his management focus is on results or on process control. To quote what he says,

"This is my frequent emphasis in my meetings with my management staff: the correct procedures must lead to the right results; the wrong procedures that lead to the right results are a contingency; the wrong procedures that lead to the wrong results are an inevitability."

Hierarchy is low in this system and the proprietor is the sole authority for all working procedures. He gives a very interesting and visual description of how his organisation operates. As he says,

"This organisation is like the human body and functions like a transmutative kingkom. This organism has only one brain which is me, and other employees are the different organs of this body. These organs work together to create the metabolism to be alive. In this sense, every part is important and need to play its own function. They must stay in their own roles and listen to the commands coming from the brain. They cannot be disturbed. For example, the assistants work as my two hands and they have to do what the brain tells them to do. They fulfill the function of being hands and not of being the brains. If they begin to think, they might slap the face when the brain commands them to achieve things. All the organs must be in order and listen to the brain's instructions otherwise the whole organism will breakdown. An enterprise should also act as a transmutative kingkom. When the different parts are assembled, the transmutable kingkom-toy can change into different things; for example, an auto

car or a gun, or a tank. The people in an enterprise should act like the assembly parts of a kingkom, in which they can become cars when they are at work and become tanks when they are at home. I can be a car at times and also change to a brain when the situation requires. The enterprise should be able to change into different shapes through combining and reforming these parts, in order to meet the changing demands of the market. Sometimes I feel like a 'hemiplegia'; my brain has many ideas but the body cannot move or run as fast as what the brain wants."

Day-to-day work is managed through informal communication, face-to-face decision-making and flexible systems. We can also understand how the informal system operates within Dali's company through interviewees with managers in the four major divisions: central office; sales & manufacturing; marketing; and finance. The central office combines many functions (personnel, international trading, public relations, e.g.) and consists of four employees under one director's control. There is no job specialization in this department and it has access to all the other functional departments for mutual coordination and flexible teamwork. The office is just aside of the main entrance and it is open plan. Telephone and verbal conversations are the sole means of communication among staff and between them and proprietor. The Office Director often goes to the proprietor for reporting and gaining approval on a daily basis. To quote Mr. Ding, the Office Director;

"*I worked in a large state-owned enterprise for many years before I came here, so I know the distinct difference in the two types of organisations. In the state-owned enterprise, an approval required many layers of hierarchical processes to pass through, such as from supervisor to manager, and vice general manager to general manager. There was hardly any face-to-face communication, but many boundaries between departments, lack of flexibility and much paperwork. But in this private company, flexibility is supreme, the systems are very flexible. Only one person makes the decisions and there is only one procedure to follow – that stated by the owner. I report everything to him and he decides everything. No written rules or formal processes exist in this company; the systems are open and flexible. Work relationships between employees are very friendly. Harmony is emphasized by the owner in this enterprise.*"

The Labour Union is also the responsibility of the Office Director, but it only exists in order to meet a government requirement. It has no powers to represent employees. Its only duty is to arrange infrequently some social activities for employees. The company accountant comments on the Labour Union as:

"It is too far from us. I didn't perceive any benefit from it when I worked in the state own enterprise. It is even more so in this private enterprise."

"I was appointed by the owner to take charge of the labour union, but it is just a title, no responsibility. The only thing it does is to arrange some social activities, like a dinner or a party for the employees, maybe once a year, which requires the approval and a budget from the proprietor. There are no scheduled activities in the union, and it does not speak for employees rights." Mr. Ding comments, the Office Director.

When I ask Ms Jia, the Marketing Manager, about labour union, she says: *"I have no idea about it."*

The finance department is controlled directly by the proprietor. Weekly and monthly reports are produced for the proprietor and annual financial plans are prepared. Financial controls are operated by the computing systems and reports are produced for the State Tax Bureau. The accountant, Ms Liang, says,

"There are four employees in the finance department, three accountants and one trainee. There is not much lateral coordination with other departments and our planning is made mostly based on the previous year's statistics. Plans for sales and manufacturing are prepared and reported to Mr. Zhu. We mediate some financial issues, such as sales targets, production budgets, etc. between sales and manufacturing, or other departments. All final decisions are made by Mr. Zhu. The work and management in this department is not very complicated as the principle areas of the business are specialised in two main fields – manufacturing and sales."

The marketing and sales departments are responsible for developing and managing production and distribution. There are two major distribution channels for cashmere sweaters. One is the sales agents and wholesalers in different cities, and the other is the local retail stores. Two systems with different terms and conditions apply to these two channels. Only a small team is required for completing these tasks. Morning and evening reporting meetings are the communication mechanisms in this department. Some paper work is produced in terms of marketing plans, but verbal communications are the main means of getting things done.

The Sales department is managed by Ms Xu, a vice general manager, who also supervises marketing. Because she has worked in manufacturing as a supervisor for many years, she knows production procedures and this gives her an advantage in managing the sales department in conjunction with the manufacturing planning. She has introduced quality control checks and cost controls. This is important in cashmere production because of the expensive price of raw material. Mr. Zhu personally supervises both manufacturing and raw material purchasing. In the interview, Ms Xu mentions both advantages and problems in both the sales and manufacturing systems;

"*We combine purchasing, manufacturing and sales & marketing together, which gives us competitive advantage in controlling all the procedures in this business to minimise our production and marketing costs. This integrated control process also gives us great flexibility in deciding the profit margin and discount ranges offered to our dealers. We have invested millions in technology and advanced manufacturing equipment, which allows us to produce a broader range of styles and varieties as well as to reduce labour costs. But we still have problems in our sales system that is the conflict between stock management and the delivery to both retailers and dealers. This causes a problem in stock and delivery in that some products in high demand can be out of stock, and some in low demand are largely overstocked. This balance is hard to manage as it is not totally controlled by us. We have to depend on retailers and dealers to keep us updated on what is sold every week. Most of the time, they don't keep daily updates, or they order goods on the assumption they can be returned when they do not sell. There are also regional differences in the demand for varieties of stock. For example, in Dalian, the sales for cashmere trousers are very popular, but we are out of stock. Whereas the dealer in Qingdao, has very low demand in such trousers, has stockpiling. But we won't know until he reports to us. We are not efficient in solving this issue, but we are in the process of improving as we increase the number of delivery staff and improve our communication with these distributors.*

In the manufacturing system, there is a conflict in scheduling production for overseas and domestic markets. These demands are difficult to balance, as both the domestic and overseas markets are important to us. But when there is an order from an overseas buyer, it is always according to a tight delivery schedule. A solution is to manage the switch of focus between domestic sales and overseas sales in different seasons. For example, we plan to get orders from the international market by the summer when there is little demand in the domestic market, while the main production focus in the winter is for national sales. Moreover, we have built up an outsourcing *system for international orders, by which some reliable subcontracting factories are selected for production."*

6.2.4 Staff

The Owner, Mr. Zhu says: *"In ten years development of this business, the people in my company have come and gone, but the total quality of my employees has improved. I believe the quality of people is very important for getting work done."*

The total number of employees in Dali's company is about 150-200 with the majority first-line workers with low education (middle school to high school) and sales and delivery staff. There are also 50 part-time seasonal sales, production and delivery workers. The key personnel are about 20 managerial staff, who are college graduates with expertise in foreign trading, English language, marketing and finance. Besides, there are about 6 experienced technicians in cashmere production technological processes.

The company training programme is informal and random, and depends on the needs of the work process. New workers in production are trained by their supervisors on the factory floor. The training programmes are only offered to management staff when the proprietor thinks there is a need, or when a special task requires it, such as when foreign trading requires an understanding of contract conditions and procedures. However, the proprietor often takes relevant managers to visit other efficient factories or more advanced companies, so they can gain experience from their competitors. The accountant, Ms Liang said:

"I benefited a lot from a visit to an advanced factory in Hong Kong. We saw how the modernised procedures are operating and learnt the techniques of advanced production management. We appreciate and feel excited about such learning experience, which open our eyes to something new and what we have never seen in our lives."

Ms Xu, vice general manager, also made the same point:

"Mr. Zhu often arranges for our key staff to visit other efficient companies on a regular basis. We have learnt about their advanced management philosophy, efficient methods, various new styles in design, production techniques and even how they decorate the outside of retail stores. These field visits have impressed us very much. Particularly, I remember once we visited a big textile spinning factory in Beijing. I have never seen such a large scale of spinning production. I was shaken up. By

learning from these different advanced enterprises, we know where we are and how much difference there is between us and those modern corporations. We are motivated to work harder in the practice."

There is no clear or written policy for staff development. Firing policy is simply on the basis of whether or not the owner thinks the employee is doing a good job. Promotion criteria do not exist in either a verbal or written form. Mr. Ding, the office director tells that:

"*We don't know promotion criteria and I don't think there is any chance to get promoted. In this private company, the matter is of how much responsibility you can take and how much pay you can get. But the salary depends on the boss's preference, and so does the year-end bonus.*"

Ms Liang, the accountant says the same point: "*we all listen to our boss, and the boss decides everything.*"

It is the same situation with the reward system. The subjective and discretionary judgment exercised by the proprietor is the only criteria for material rewards; there are no written rules or guidelines. The only guaranteed rewards are in the signed contract and are the monthly salary and the social & labour insurance that are legally required by the government. The year-end bonus is used by the proprietor to keep control over his employees and gain their commitment to the company. However, it generates insecurities for employees as well.

In addition to the reward system there is the spiritual and moral methods the owner uses to motivate his employees, such as 'weekly exemplar' or 'monthly paragon' and 'progressive individual'. Mr. Zhu tends to stress the importance of ethics and morals for his employees to create devotion, loyalty and honesty. This is so that less material rewards need to be used but more commitment and output can be gained.

Mr. Zhu emphasises he is urgently in need of highly skilled management talent for his company. To do this he will need to change his present entrepreneurial approach that does not retain able people because of the absence of an effective human resource management system. A formal system is required and he needs to delegate more responsibilities if he is to retain highly skilled talent. His insistence on total control over management procedures is against human resource retention. On the one hand, he describes himself as the only brain of the organism and that his managers are his hands that just to do what he tells them. On the other hand, he feels that he needs highly skilled and independent talents to share his responsibilities and work, so that he can delegate autonomy to them. This thinking reveals a paradox in his mind. As the company is growing to the limits of his ability to exercise total control, this is making him recognise the need to recruit skilled staff to share his responsibilities. His company is reaching a bottle neck in its growth, which is blocking its further potential to expand. He may come to realise that although an entrepreneur requires one brain; a larger business requires a think tank.

6.2.5 Style

Mr. Zhu is a typical entrepreneur with charisma. His explicit leadership style is to manage people by heart and affection, not by rules. This informal leadership is built on top of his unassailable authority. He demonstrates a hybrid leadership style in his management. He is democratic, amiable and gracious, he always consults employee's opinions and he is a good listener. He always explains when he rejects the opinions of a manager. He is caring to his employees and works as hard as his staff. Nevertheless, he is also an authoritarian with more-or-less arbitrary decision-making. He does not allow others to challenge his authority. For instance, he has rejected the idea of a board of directors and controls the whole company on his own. In the interview, when asked about the ownership status of his company which is set up as a limited company, and which should have a board of directors involved in decision-making, he says,

"*This company is completely mine, and I have sorted them (the board of directors) out by giving them enough money to go away. I am the person who makes all the decisions. I do not like others to be involved in the decisions, and tell me how to do things.*"

He has total control over all strategic decisions; his authority is uncontestable. His professional expertise in cashmere-spinning technology and his knowledge of cashmere raw material makes him venerated among his employees. The Vice General Manager, Office Director and Accountant all refer to this background of expertise with respect in their interviews. This also contributes to his successful establishment of his business and its rapid expansion. The raw cashmere material is a very rare resource that not every business can have easy access to it. However, his networks in access to raw material resources and his knowledge in this field guarantee his success. It is the reason he still directly controls the two areas of raw material purchasing and manufacturing in person, and which are not allocated to others.

All his employees share the same perceptions about his style. Besides his authoritarian nature, his leadership is a mixture of supportive, participative and achievement-oriented approaches. As the Office Director comments,

"*He is a democratic leader with affinity, he is amiable and always discussing and consulting with us. He explains the reasons for his decisions and asks you for mutual consent. He has a wise strategic view on things and he is a resolute man when he comes to a decision.*"

His Marketing Manager, Ms Jia says,

"*His personality is very prompt and decisive. He cares for us and participate with us in our work. He can democratically discuss with us and you can feel his affinity.*"

The Finance Accountant, Ms Liang comments,

"*He is a leader who does things with religious care. His style is decent with justice, generosity and patience. He cares for his employees. I still remember that he treated us to a nice dinner as a welcome when we came back from the New Year holiday. He gives us a warm feeling.*"

The Vice General manager, Ms Xu comments,

"*Mr. Zhu knows how to put people to good use; he knows how to develop people's talent. He is an expert in spinning technology. He is good for getting things on hand quickly and he employs the right people for doing things he can't do.*"

The owner manages people by his heart and not by rules. Once they had an urgent order from an overseas client. As the delivery time approached, they were still much behind the schedule. He asked his employees to work at nights and at weekends. He also works as late as his employees and leaves the company as the last person. He constantly says 'thank you' to his employees for their hard work, which normally is very rare for a Chinese boss to do. Although the work makes them exhausted their hearts are happy and content, because what they do is highly appreciated by their boss and their boss works as hard as they do. Furthermore, he demonstrates his care for his employees respecting to Chinese traditions, such as attention to traditional holidays, and he always gives small gifts to his employees to keep them happy.

A family atmosphere is successfully cultivated by his leadership style. His emphasis on this type of business culture incarnates the importance of his authority as the father of this family. He can be an affable father because his authority is secured.

Moreover, this family culture also enforces the informality of the business and reinforces his employees' dependency on him.

6.2.6 Shared values

The significant meaning and guiding concepts that Dali enterprise imbues in its employees can be revealed from various mottos and creeds that are hanging on the walls in the buildings. Some of these are as follows: (Appendix 6 Photos of case studies 3)[264]

'Excellence is created bit by bit'

'The idea determines the path of development and the calibre of people determines the quality of product'
'The idea creates fortune, the Wiseman sails the boat with the help of the current.'

'Please watch your thinking, it will influence your behaviour,
Please watch your behaviour, it will influence your habit,
Please watch your habit, it will influence your character,
Please watch your character, it will influence your fate.'

'FAMILY' – A big Chinese character hanging on the wall in Mr. Zhu's office, which demonstrates he runs the company as a big family.

These statements illustrate the management philosophies that Mr. Zhu emphasises as important and valuable for all members of the company. To cultivate the family culture, he shows his democracy, consideration and respect to employees. The work climate is friendly and harmonious with little hierarchy, making employees feel psychologically comfortable. He tries to share the attitudes of his employees by educating them to have the right values so they cooperate and comply with his direction and decisions. He is the centre of a power culture and imposes total control throughout the whole organisation. This is similar to how Handy (1993) [265] describes a power culture.

"*It depends on a central power source with rays of influence form the central figure throughout the organisation. Control is exercised from centre by the selection of key individuals. There are few rules and procedures, and little bureaucracy.*"

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[264] These guiding mottos are photographed from the site of Dali Cashmere in August 2005, attached as appendix 6 Photos of case studies (3).
[265] Handy, C. B. (1993), *Understanding Organisation*, 4th Ed., Penguim, London, p23.

But also the business prides itself on having a learning culture. This is strongly promoted in the company by Mr. Zhu. He frequently arranges field-visits to advanced companies nationwide and actively joins industry associations, in order to find ideas for continuous improvement. He constantly educates his employees and stresses the importance of learning and improving their working practices. As Mr. Ding, one of the interviewees says,

"*We are in a period of improvement. There are many things in the company that need to be improved, and we are working on that, such as quality, formalization, and advancement in management techniques. We will get it gradually, it takes time, but we are processing.*"

Such a learning culture has led to innovations in the quality control system and marketing, but the management structure has not yet been altered.

6.2.7 Skills

Alongside China's rapidly growing economy, Dali Cashmere Company has successfully exploited opportunities in the cashmere market place. Within ten years, it has developed its own featured capabilities and skills in the market. These core competences in Dali enterprise are analyzed in terms of: leadership, business reputation and networked resources, and technology and machanisation.

The leadership is the most important competence in this entrepreneurial business, as everything depends on the proprietor's preference and capability. As a successful entrepreneur, Mr. Zhu demonstrates his high capability, charisma and wisdom. He is the determining factor for the fate of this organisation and his strong leadership is an incontrollable competitiveness. His entrepreneurial qualities definitely account for the strength of the business. The strategic focus and intuitive vision and sensitivity allow him to find opportunities in the market. His flexible and informal structure with quick decision-making processes allows him to swiftly respond to market trends. As he describes himself, he can change to any form and be adaptive to any situation when he needs to. He possesses such strengths that are lacking in large, formal enterprises. His talent in thinking, decision-making and charisma of personality, these qualities enable him to be a successful leader. Equally, this strength could turn to become a weakness when his business grows to a certain big size, whereby these capabilities cannot be used for total control. His entrepreneurial style will start to limit his potential for further business growth and development.

Business reputation and personal network for access to raw resources are a special strength in Dali company. In ten years, Mr. Zhu has intentionally built up his business reputation by always honouring contracts, and guaranteeing refunds and product returns. As he states,

"Sometime the contract is not for profit purposes but for future strategic alliances. Other businessmen may not do business that creates losses but I will do this for getting market share. It is my long term vision. I am not only a profit-driven person. ... ... I consider the social responsibility of my company, such as donations to the poor and public road maintenance, as I have such capability now. We are part of society and I feel I should do something for others."

He says his reputation and personal credibility for the long term is more important to him than short term profit gain. Cashmere raw materials are a scarce and expensive resource and there is hardly sufficient supply. Thanks to his previous work in the State-owned company, he has established his own resource network, and this has benefited him when he set up his own business. The other competence that helps his company's growth is the technology and mechinasation that Mr. Zhu has heavily invested in. This strength enables his company to produce 150,000 cashmere sweaters a year. This facilitates his growth not only in the domestic market but also allows him to rapidly expand in overseas markets at the time of China's accession to WTO. His intention is to develop the company from one based on labour intensive low technology to one operating with high technology.

In the view of the core competences Dali possesses, Mr. Zhu's entrepreneurial traits play a critical role in its primary success. However, these will limit further business growth unless he delegates and develop management competences among his staff. He needs to shift the company's dependence from a brain to a think tank.

6.3 Concluding Remarks:

The emergence of private ownership is of major significance in market socialism. It forms a stimulating force not only to contribute to China's economy growth but also to restructuring the economy. This privately-owned enterprise is characterized by its flexibility, organic systems and entrepreneurial culture. In a turbulent and changing marketplace, it is not surprising that such entrepreneurs often emerge as a new class of plutocrats and business magnates. Their entrepreneurial traits and ingenuity lead to their exploring and securing business opportunities. Privately-owned enterprises are a sharp contrast to state-owned enterprises in every organisational dimension. But this often raises future challenges for the further growth of privately-owned enterprises as an owner dependency management structure needs to shift to a delegacy system with appropriate control mechanisms. Through seeking a balance between delegation and control, successful start-ups can grow into large businesses.

Supportive government policies for privately-owned enterprises to access capital and finance sources will further promote the growth of the non-state, privately-owned sector. Non-discriminative treatment should be guaranteed to the non-state-sector in terms of prices structures and the availability of goods and services provided by industries including traffic and transportation costs, energy, basic telecommunications and other factors for production. This privately-owned will continue to grow and enter the fields once monopolized by the state-owned sector.

CHAPTER SEVEN:

Case Study (4): The Foreign Joint-Venture

Sunfed Group U.S.A. Dalian Sunfed Fashion Co., Ltd.

Sunfed
BY HÉLÈNE ZHOU

Introduction

State-owned enterprises (SOE), collective-owned enterprises (COE), privately-owned enterprises (POE) and foreign joint-ventures (FJV) are four types of ownership evolving from economic reforms and management change in China. These enterprises demonstrate distinctive characteristics in terms of their leadership style, strategy, structure and management systems. Studying each of these different types of ownership provides a better understanding of the dynamics of emerging enterprise practices in the context of Chinese market socialism.

Foreign joint-ventures are the outcome of foreign direct investment in China and have been a significant factor in the growth of China's market economy. At an early stage of market reforms, because of government encouragement, sino-foreign joint-ventures were the dominant option for companies' entry into the Chinese economy. However, since 1997, wholly foreign-owned enterprises have become the preferential choice mainly because of foreign frustration with joint ventures with Chinese partners; particularly, after WTO accession, and as China has become a more market-driven country. (Yan and Warner, 2001)[266] As government controls in some of industrial sectors are relaxed, the formation of wholly foreign-owned enterprises seems to be a favourite mode by foreign companies. Davidson (1987)[267] pinpoints the factors that determine foreign joint-ventures' performance as individual personalities, organisational cultures, administrative style and management philosophy. These factors are often combined as the 'One Bed, Different Dreams' symptom (Vanhonacker, 1997)[268]. Moreover, the 'veto-power' of Chinese partners in joint ventures is often a hindrance for foreign partners in their strategic decision-making

[266] Yan, D. and Warner, M. (2001), "Sino-foreign joint ventures versus wholly foreign owned enterprises in the People's Republic of China', The Judge Institute of Management Studies, Cambridge. *Working Paper*, No.11, Oct2001, p31.
[267] Davison, W. H. (1987), 'Creating and Managing Joint Ventures in China: Motivation and Management of Political Risk'. *California Management Review*, XXVII (4), Summer1987, pp44-58.
[268] Vanhonacker, Wilfried (1997), 'Entering China: An Unconventional Approach'. *Harvard Business Review*, XII (2), Mar/Apr1997, pp19-32.

(China Joint Venturer, 1996b)[269]. All these lead Foreign Joint Ventures to take 'go-it-alone' strategies for running businesses in China.

Nonetheless, Sutter (2000)[270] argues that,

"*Wholly foreign-owned enterprise has its disadvantages in several areas. First, in sectors like consumer goods and high-technology hardware, Chinese firms are relatively stronger. In the absence of suitable Chinese partners, a wholly foreign-owned enterprise can be handicapped in the competition by a lack of effective connections to handle governmental work. Having a competent Chinese partner may be useful in developing applications for the local market for the high-tech companies.*"

Knowledge of local governmental issues, culture and market, is critical to both Chinese and foreign investors in China, albeit with different emphasises in different areas. Sino-foreign joint-ventures overcome economic and political hurdles, and achieve sales volume more rapidly. (Davidson, 1987)[271] Child (1998b)[272] points out that wholly foreign-owned enterprises have relatively lower profitability when compared to sino-foreign joint-ventures. However, after China's accession to World Trade Organisation, both types of venture have benefited from market reforms as the business environment has become more market-driven. Many foreign firms' localization programmes have been accelerated due to these reforms. The call to transfer management from expatriates to local managers echoes across China (Gamble, 2000)[273]. More and more studies reveal that the management practices of these joint ventures have adopted a hybrid model in combining characteristics of western management and Chinese cultural and human resource features. "*The rapid localisation has become the mantra of many foreign invested enterprises in China*" (Melvin, 1997)[274]

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269 China Joint Venturer (1995b), 'Do You Need a Partner in China?' *China Joint Venturer*, 2 (2), Oct1995, pp3-5.

270 Sutter, K. M. (2000), 'Investors' growing pains', *The China Business Review*, 27 (6), Nov/Dec2000, pp14-21.

271 Davidson, William H (1987), 'Creating & Managing Joint Ventures in China'. *California Management Review*, XXIX (4), Summer1987, pp78.

272 Child, J. (1998b), 'PRC investment control: exploring the myths', *China Direct Investor*, Aug1998, pp10-15.

273 Gamble, J. (2000), 'Localizing management in foreign-invested enterprises in China: practical, cultural, and strategic perspectives', *International Journal of Human Resource Management*, 11 (5), Oct2000, pp. 883-903.

274 Melvin, S. (1997), 'Passing the Torch', *The China Business Review*, 23 (3), 1997, p.32.

In this case study of a sino-foreign joint-venture, the form of ownership is a joint venture in capital investment rather than management participation. This case is examined as an example of full localisation in the management of foreign joint-venture enterprises. As Davidson (1987) mentions, the performance of sino-foreign joint-ventures depend greatly on qualitative factors such as individual personalities, organisational cultures, administrative style and management philosophy. As disappointments are not unusual with foreign management participation, this case of full localisation without foreigners' direct participation may provide a different approach. In this mode of foreign investment venture, an entire 'Fit-in Strategy' is maximised through trust-based operational and strategic autonomy. The expatriate managers in this venture, the president and general manager, are overseas Chinese who were born and brought up in China but emigrated to the United States. They have adopted advanced western management approaches through overseas higher education and a deep understanding of foreign culture by living in the West. However, they also have a full understanding of Chinese culture and market as they have lived and worked in China during their working careers. They have both an understanding of the western style and Chinese business practices. The characteristics of such joint ventures emerging under market socialism reflect how economic reforms and environmental changes shape management practices and how they find the best way to fit in with local market requirements. A review of the literature shows there are few studies of this type of emerging venture and in particular, with this type of expatriate-owned management.

7.1 Background of Dalian Sunfed Fashion Company

Dalian Sunfed Fashion Co., Ltd. (DSF) is an American-Chinese joint venture. In 1997, Sunfed Group U.S. invested US$ 30,000 capital with its Chinese partner, Mr. Li, an overseas Chinese, who brought into this venture US$ 36,000 capital to set up a joint venture company in the clothing business. The America investment accounted for 45% of total start-up capital and the Chinese party 55% with an agreement that full management autonomy is assigned to the President, Mr. Li and that the profit is divided 45: 55 on an annual basis. The company's Annual Report is required to be submitted to the Sunfed Group US as a formal method of communicating business performance. The American investment in this company is based on trust as it had been in auto parts trading business with Mr. Li for many years. Mr. Li and his wife, the General Manager of DSF, have both Chinese and Canadian nationality. Prior to this venture, they lived in Canada and America for years and they engaged in auto parts trading business and traveled between China and America.

This joint venture has specialist expertise in the clothing business as Mr. Li's sister-in-law is a fashion designer who is a graduate from a French fashion college with several awards for designing women's clothes. Mr. Li and his wife are professional business people with high qualifications (Mr. Li has a MBA and his wife a PhD) in business management. They identified an opportunity in the clothing industry - a gap for value-added products – branded clothes. The America partner had little know-how about the Chinese clothing industry but he saw the unprecedented potential of the Chinese market. Thus, Mr. Li and his American partner decided to invest together through a 'capital venture mode' with full management autonomy assigned to the Chinese partner and the interests of the American investment protected by a legal contract. This venture company, Dalian Sunfed Fashion (DSF) is positioned in the clothing business with a target market of professional women and with a strategic focus on brand building.

In this research, six management staff were interviewed including the President, the General Manager, the Designer and three departmental managers in marketing technology, and HR. The president Mr. Li stated in his interview:

"The American investor injected capital into this ventured business and his interests are guaranteed by a legal treaty in addition to personal trust and confidence in me. We all know that the Chinese market is filled with opportunities; it is just a matter of how you can catch and secure them. You can earn a fortune from the growth of the market economy if you know on which side your bread is buttered. Foreigners see the opportunities but they don't know how to secure them and they don't have know-how in local practices. China has the most complex business environment with a discrete market infrastructure. The legal framework in this market is not the same as in the West and the absence of market laws is a matter of fact. Personal relationships and business networks and nepotism are key values of the business culture. The Americans understand these dynamics and complexity and regard them as the highest risks that can cause failure for their investment in China. I can minimise this risk by offering capital venture with them and taking full responsibility for management practices in China as I know them like the back of my hand. But to do this I need to have full autonomy in management for effective flexibility and control.

The opportunity cost is high for exploring the Chinese market. The investment from America is not only important in sharing the high economic cost but also the American venture adds brand value. In addition, a foreign joint venture company can enjoy tax holidays and benefits and gain supportive policies from the government."

Affiliated with the Sunfed Group in the U.S., Dalian Sunfed Fashion (DSF) has established a brand reputation in Dalian for its sophisticated style and fine craftsmanship. In 1999, DSF has been conferred the "Famous Trademark" by the Provincial Government. By combining the latest European fashion trends with elegant classics, the Sunfed line appeals to professional working women. The brand has become very popular in Dalian and it has consecutively made the top list in recent Dalian International Fashion Exhibitions from 2003 to 2005. It was awarded the "BEST OF TEN" ladies fashion in the ninth, tenth and eleventh Dalian International Fashion Festivals with its excellent styles and high sales.[275]

As a distinctive professional women's wear company, the DSF collection is outstanding with its fresh and bright looking, unique design and long lasting style. It breaks through the boundary between "professional" and "informal"; professional but stylish. Its design is based on the "oriental female"; in particular, temperament, complexion and figure. Having merged with European's simple and clear fashion concepts, a perfect combination of eastern and western fashion culture enables it to demonstrate the natural elegance of the cultivated modern metropolitan Asian female. The culture underpinning this brand is well defined in company stories and tales. The meaning of brand is delivered to all salesmen through constant training programmes. This well-established branding culture is a distinctive feature which differentiates it from other types of enterprises studied in this research. The state-owned enterprise, the collectively-owned enterprise and the privately-owned enterprise lack clear cultural content and brand definition in the marketing of their products.

7.2 McKinsey 7-S framework analysis:

7.2.1 Strategy

The original purpose for the establishment of this foreign joint-venture was to explore the potential and opportunities in the Chinese market that emerged from

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275 http://www.sunfed.com/aboutsunfede.htm (accessed on 20th April, 2006)

economic reforms. The American investor had little know-how about China and the clothing business, and so a 'capital venture' approach was adopted as the entry strategy into the Chinese market. A clothing business with a strong focus on branded products requires sophisticated marketing distribution and retailing, with a large scale customer-based networks. Designs for meeting local customers' fashion preferences are critical factors in product brand and demands designers possess both an understanding of Chinese culture and western fashion values. In fact, an integration of both cultural elements is essential in clothing design. The American investor did not have this expertise and resources to carry out a go-it-alone investment in China. Therefore, a full localisation approach was adopted as a 'fit-in strategy' giving full operational and strategic autonomy to the local Chinese partner.

The development strategy in DSF is explicitly stated in documents that focus on marketing and branding. The western pattern of branding enterprise is adopted in DSF as '*Marketing – Design – Manufacturing – Outsourcing*'. The president, Mr. Li is very knowledgeable about Chinese market and clothing industry. In the interview, he discussed the macro and micro economic environment for the textile and clothing industries, knowing opportunities and threats in this industrial sector, and understanding the strengths and weaknesses of his own business. As he says:

"The configuration of the clothing industry is constructed as three different types of components. First, there is the type of enterprises that outsource with a chain of subcontractors, used for manufacturing. Second, there is the export-type of enterprise which gets orders from foreign purchasers and arranges manufacturing and outsourcing for these exports. These are the types of enterprises with their own manufacturing equipment. Third, there is the type of enterprise with its own brand manufacture and which heavily invest in marketing and branding. We position ourselves so as to produce value-added products by constructing our own brand and marketing. We target the luxury consumer market as China's economic growth creates this demand. But this market is dominated by foreign brands, such as Zara, Channel, Armani, Luis Vuitton, Giorgio, which have entered the China market through franchising, retail distribution and their own flagship shops. They set up branches in China and managing brand marketing.

We aimed to establish a woman's brand to take a leading role in women's wear when we started this company. We have made this task in the past eight years, but the next goal is to create a chain of by-products such as adorning jewellery, bags, hats *and shoes in the same brand. The range of women clothes need to be diversified into different collections in our next stage of development; for instance, sports collections."*

He positions this foreign joint-venture enterprise in competition with other foreign entrants rather than domestic players, as in the branded clothing market, only a few players are indigenous firms. As the Development Report of Clothing Industry (2005)[276] indicates,

"Indigenous brands dominate these popular consumer goods markets, like cashmere sweater, men's shirt, knit underwear, suit trousers, snowsuit; but the luxury branding goods markets in women clothes and T-shirt are dominated by foreign and joint venture brands and this is a growing trend compared to last year. The demand for luxury brand goods is steadily increasing; as the luxury goods consumers in China have reached 13% of the total population and that is still growing. The total value of luxury brand goods market in China is estimated to be worth US$ 2 billion, which accounts for 3% of the world total and ranks as No. 3 country for luxury goods. It is predicted that the luxury goods market in China will continuously grow to be No. 2 in the world in the next 10 years."

The report also points out the major weaknesses of indigenous clothing enterprises are lack of advanced management knowledge and management innovation to break through conventional low-technology manufacturing and move up to high technology and value-added production.

DSF operates a western approach to branding with a deep understanding of strategic approaches to brand marketing. This is difficult to imitate by other domestic players who are much behind in their management practices. In the field of branded clothing, foreign companies have many advantages because of their expertise, advanced knowledge and long history. Comparatively, indigenous firms are weak in brand building; brand is an invisible asset which is a general term; it describes an emotional experience that businesses create for their customers.

"If a company's product is perceived to be the same as those of competitors, then consumers will be indifferent and will choose the cheapest or most accessible. Companies that are forced to compete on price rarely make satisfactory profits. If the customers perceive one brand as superior, then they will prefer it and pay more for it.

[276] *The Development Report of China Clothing Industry 2005*, by China Clothing Association, China Business Union, and China Textile Export & Import Committee, April 2006, pp. 26-51.

Brand equity is the value of these additional cash flows generated for a product because of its brand identity."(Baker, 2000:159)[277]

In its corporate strategy for 2006, DSF sets out three objectives for this year's brand updates:

(1) Developing Sunfed Brand's Culture and Characteristics

- Constant promotion and marketing of brands in a rich cultural context.

(2) Building a team of talents

- Recognizing that external business relationships and networks and interpersonal skills are the core of marketing.

(3) Improving sales performance

- Developing new markets and strengthen the international position of Sunfed brands

<u>Two objectives on operations and management</u>

(1) To establish divisions and branches nationwide.

(2) Bring three functional branches into operation:

a. Beijing Branch – enhance the operational capability of brand building

b. Shanghai Branch – focus on the R & D on product material innovation

c. Dalian Branch – reinforce top management function & improve service standard

Brands are at the heart of marketing and business strategy. Given the advanced knowledge about brand management, DSF has placed the objective of developing brand equity as the core of the company's strategic management and regarded it as a key determinant of corporate values.

'*The average British and American company is valued by the stock market at around twice net balance sheet assets. However, companies with portfolios of strong brands are valued by the stock market at four times net assets.*'(Financial Times)[278]

Strong brands can obtain good prices and high market share and offer a company avenue for further growth through line extensions and the penetration of new markets. However, investments in brand building activities do not have an immediate pay-off. Without an understanding its future potential value and with no long term vision of strategic development, many of today's Chinese companies are unwilling to invest in building brand. They cannot see such invisible value in the long run but tempted and

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[277] Baker, M. J. (2000), *Marketing management and strategy*, Palgrave Macmillan, Basingstoke, p159.
[278] 'Price to book ratio of brand name stocks', *Financial Times*, 23 November 1991, p.III.

pressured by short-term profit return. DSF's brands strategy shows a long-term focus that increases its market competitiveness. As the President says,

"We don't earn any profit from brand building but we have heavily invested in marketing and promotions of our brands. We spent about 5 million RMB in marketing and advertising activities for the first five years. The American capital inflow is a very important source for this investment. I also continue doing the auto-parts trade with them, and this income source covers our overheads. We have strong belief in the future reward of this brand investment and we know we are doing the right thing. Profit is an important measure for an enterprise performance, but building a long term strategy is more important for future growth and competitiveness."

The brand has paid off for increasing market share and profit margins after five years of investing (1997 – 2001). The profit return from this brand's sales is up by 206% since 2002. (See figure 7.1) It is growing every year following the company's successful brand strategy.

Figure 7.1 Sunfed Annual Sales: (US$ Million)[279]

Year	Main Sales	Operational income	Total	Increase %
2001	0.11	0.05	0.16	-
2002	3.48	1.48	4.96	206%
2003	4.21	1.94	6.15	24%
2004	5.32	2.66	7.98	30%
2005	8.94	3.14	12.08	51%

In relation to ownership, foreign joint-ventures have the distinctive advantage in advanced management approaches due to direct investment and learning from the West. The foreign joint venture is a form of indigenization that overcomes the shortcomings of foreigners or expatriates directly involved in management but utilises the value of foreign capital in resources. This type of localised foreign venture is dependent upon a high degree of trust and tight legal contracts. Compared to state-owned enterprises, collective-owned enterprises and privately-owned enterprises, they are the only ones positioning themselves at the top of value-added production in the clothing industry. Foreign capital is the wherewithal for the adoption of such a strategy as brand building requires constant and extensive investment for a long

[279] The main sales are obtained from National Tax Bureau, Zhongshan District Department. The operational income is from Local Tax Bureau, Zhongshan District Department.

period without immediate payoff. Financial pressure is often the ruthless reason for killing such a strategy as such investments do not have visible returns in short-term sales and profits. Faced with such elusive, long-term and intangible benefits, it is not surprising that companies and managers always drop this strategy in planning. This is the prevalent situation in China, with a deficiency of capital to fund growth in privately-owned enterprises. Even state-owned enterprises, with privileged access to financial sources, are usually driven by short-term profit returns due to performance assessment mechanisms used for managers that emphasise immediate profits. Foreign joint ventures have competitive advantage in creating high value added products through their strengths in capital, technology and advanced western management techniques.

7.2.2 Structure

The structure in DSF is especially designed to serve its strategy. It functions in two modes: through its organisational chart and its operational structure. (See Figure 7.2 & 7.3) The organisational chart reflects the joint venture and management relationships within the company. The operational structure demonstrates the customer-centred operations. One distinctive feature of DSF's organisational chart is the business relations between its U.S. and Chinese partners. The auto-parts trading is the foundation of this venture that formed the basis of trust through many years in a joint partnership. When the two parties joined in the new area of clothing business, the auto-parts trading remained the close tie between the two partners. This is handled as an exclusive business separate from the clothing investment by the President. However, auto-parts trading profit contributes to the profitability of the company. This trade was an important source of finance to support the overheads for the first five years when the clothing company received no profits from its brand building investment.

The President in Sunfed plays an overall supervisory role at a strategy-decision making level and he exerts direct operational control over the Finance Department. The General Manager acts as CEO with the General Director and Vice General Manager. These four together form the top management team. Middle management consists of managers from six functional departments; finance, personnel, marketing, design, manufactory and technology. The marketing function is the core focus of the company, with a network that covers the three major international cities in China -

Beijing, Shanghai and Dalian. The Dalian office is the company's Headquarters that controls the other two branches. The Shanghai branch is the centre for Research and Development working on new products, materials and technology innovation. The Beijing branch is responsible for brand marketing and includes advertising planning, sales distribution and promotion support. The Dalian office is the base for brand management and manufacturing supply. The main management functional departments, such as Finance, Personnel, Design and Marketing and Logistics are centralised at Headquarters in Dalian.

All the operations and management of DSF are focused on customers' needs and support services. The division of work is grouped to meet this objective and tasks are allocated to serve customers' needs. Work relationships in the marketing function are more informal and based on team work but with sales personnel given autonomy to achieve their sales targets. In other departments, such as Finance, Personnel, Technology and Manufactory, hierarchy and authority are stressed by top management. Formal rules and policies are enforced and descended from top to the lower levels. Total management control is exercised by the top managers with an emphasis on the formalisation of management and systems. Authority is stressed by the General Manager in order to ensure the implementation of commands and strategic plans. However, the marketing division has a flat hierarchy with considerable management autonomy compared to other departments so it can react quickly to external changes and customers' needs. Larry Chen, the Marketing Manager comments;

"Marketing is the main activity of the company. The product has priority in coordination, an absolute priority, and other departments must collaborate with product marketing. We have the most complex structures in other departments; the responsibilities for each job and each unit are clearly defined with given duties to carry out the objectives."

Figure 7.2 Organisational Chart of DSF

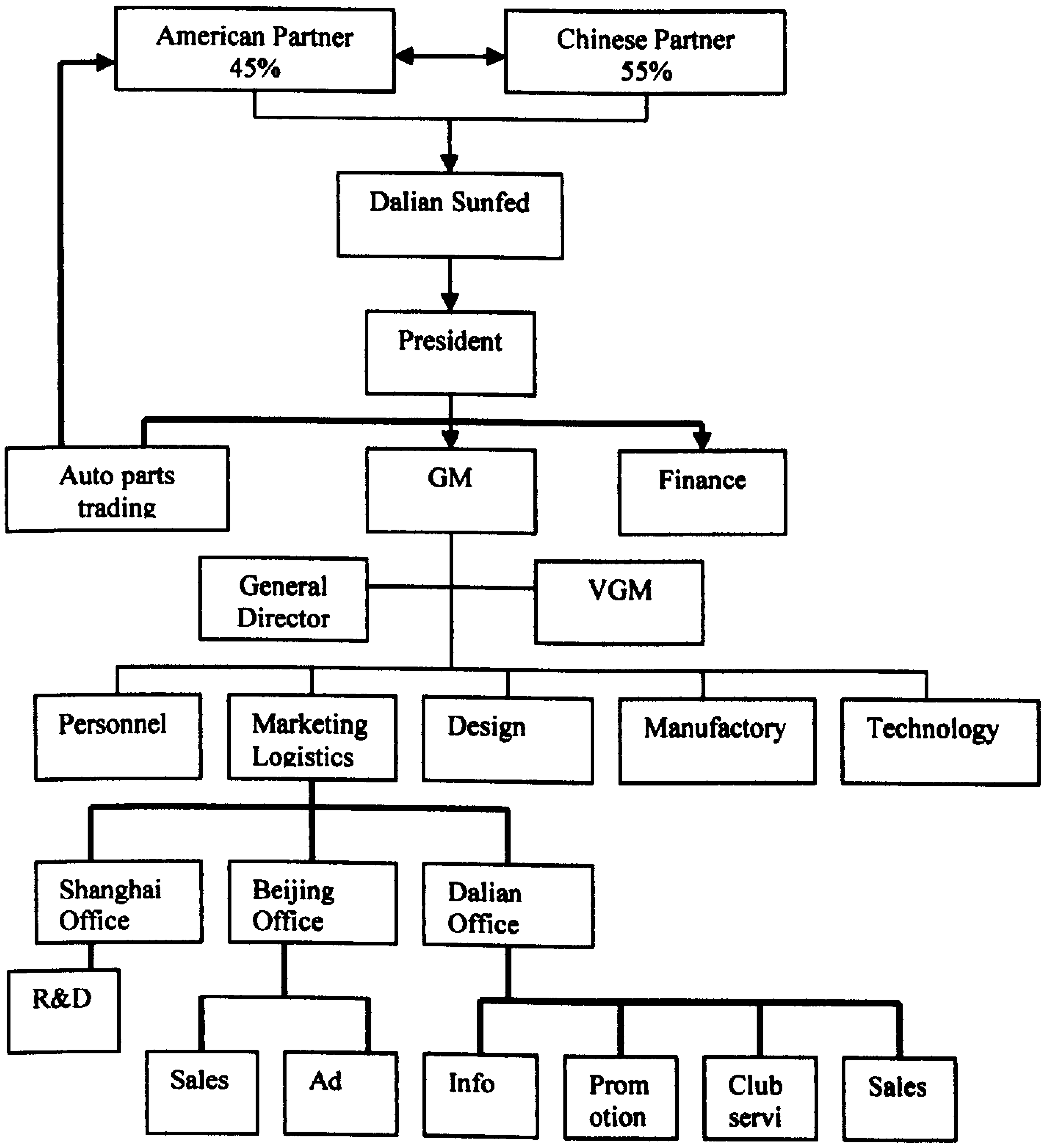
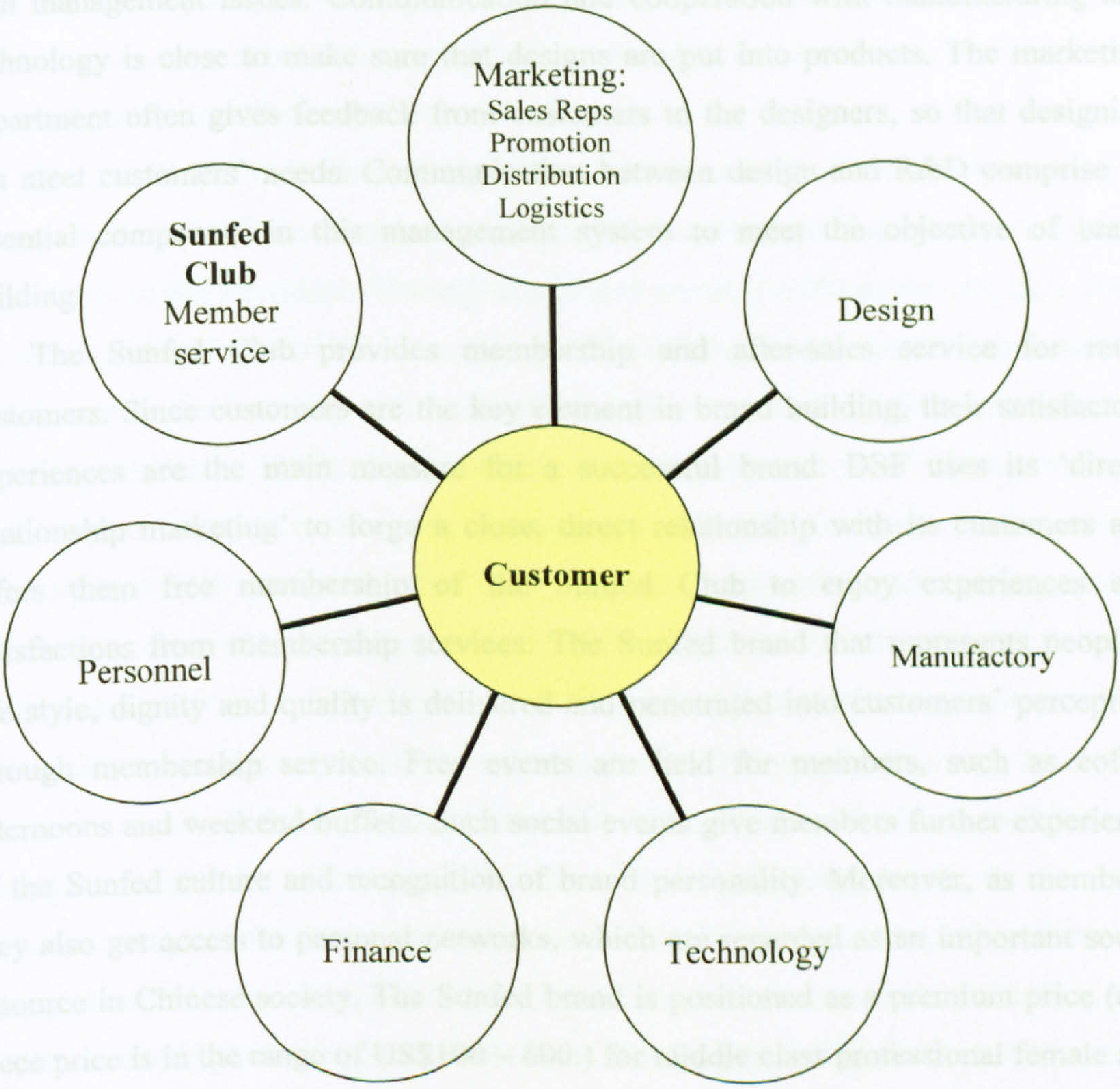


Figure 7.3 Operational Structure of DSF



7.2.3 Systems

Communications in DSF are set in hierarchical orders. Employees in each division report to their supervisors and managers. Ignoring orders is regarded as offensive behaviour. Middle managers can have direct face-to-face communication with top management. Information flows in a bureaucratic system. Paperwork and formal meetings are the dominant means of communication with top managers. Informal communication processes are pronounced between sales staff. Manufacturing is the department with strictest bureaucratic rules that standardise routine processes of production. The design department has independent operational autonomy. Creative ideas and design styles are the main output of this department. It has the least number of employees (only five) and focuses on fashion culture rather than management issues. Communication and cooperation with manufacturing and technology is close to make sure that designs are put into products. The marketing department often gives feedback from customers to the designers, so that designing can meet customers' needs. Communication between design and R&D comprise an essential component in this management system to meet the objective of brand building.

The Sunfed Club provides membership and after-sales service for retail customers. Since customers are the key element in brand building, their satisfactory experiences are the main measure for a successful brand. DSF uses its 'direct-relationship marketing' to forge a close, direct relationship with its customers and offers them free membership of the Sunfed Club to enjoy experiences and satisfactions from membership services. The Sunfed brand that represents people's life style, dignity and quality is delivered and penetrated into customers' perception through membership service. Free events are held for members, such as coffee afternoons and weekend buffets. Such social events give members further experience of the Sunfed culture and recognition of brand personality. Moreover, as members, they also get access to personal networks, which are regarded as an important social resource in Chinese society. The Sunfed brand is positioned as a premium price (e.g. piece price is in the range of US$100 – 600.) for middle class professional female and rich people. They form a valuable resource of social networks when they are organised by the company's club membership. This is important for word-of-mouth marketing. As the General Manager says,

"The Sunfed Club is an important communications tool for direct relationships with customers and getting direct feedback from them about their feelings, perceptions and preferences. I always try to attend every event, so that I can listen to what our customers' feel about our brand image and know what they want. Our product targets the segment of luxury goods which mean our customer groups are not in the mass market. They are differentiated from the mass with their own characteristics. They are not easy to satisfy because of their profession, social class, wealth and knowledge. We need to have direct communication with them in order to diffuse our brand values and so that they not only commit their brand loyalty to us but also they can tell others about us through word-of-mouth. More customers are

attracted by our Club because they can enjoy a high-class social life and get to know more people who may form a useful social network for their business. In addition, only members of Sunfed can enjoy privilege discount based on their purchases. In order to guarantee this privilege right of membership, we never have promotion and discount sales in retail stores. "

The president exerts direct management control over the finance system, and all budgets and expenditures require his approval. The Finance Department is directly responsible to the President. Through financial control, the President can then direct and adjust marketing activities at a strategic level. The planning system is an essential mechanism in the company as it has high employee involvement. Every employee in each department is involved in planning and they discuss their work with their departmental managers on a weekly and monthly basis. The Company sets targets (e.g. sales volume and stock rate) for 'macro control' and soft targets (e.g. customer satisfaction, work attitude and creativity) for 'micro control' in its planning systems. Employee creativity and participation are high through this planning process. Cost and quality control is exercised through this system. Responsibilities and division of labour are clearly defined. Personal autonomy is based on level of responsibility and management position. The annual assessment of planning targets is the most important stage in the management process. It is the key element of performance management. Middle management have a high degree of autonomy on deciding how to plan marketing activities with customers and for promoting the brand. However, conflicts between the company strategy and marketing plans are frequent. The Marketing Manager comments that the brand strategy often prohibits discount promotion in order to preserve the value of the brand whereas the hard targets on sales volume often need to be achieved through discount sales promotions. Coordination and communication between top and middle management are often set in formal and informal meetings for seeking solutions when such conflicts emerge. As brand management is a relevantly new concept in the Chinese market, education and training are often required for employees to understand brand strategy and the processes of brand building. Particularly in foreign joint-ventures, western management approaches (e.g. strategic management approach, human resource management, branding management, marketing communications approaches, etc.) are highly adopted and integrated into the organisational systems. Local employees need to have good understanding of these approaches in order to carry out their objectives.

The execution of tasks is often unsatisfactory when staff understanding of these concepts is low. It is the so called 'capability of execution'. It is a problem in all types of enterprise regardless of their ownership characteristics.

7.2.4 Staff

The total employment in DSF is about 200 people including 60 managers, supervisors and technicians which form the key personnel. The education level of key personnel in this foreign joint-venture is higher than in the other three case study companies. The President holds a MBA qualification and the General Manager has a PhD in Management. All the other management staff have either postgraduate degrees or undergraduate degrees in relevant marketing, HRM and technology subjects. Higher education qualifications are an essential requirement for key staff in DSF as their knowledge is regarded essential for brand building and the company's long term development. The US partner emphasises the importance of this. The quality of employees is related to their education and professional background, as the President emphasised in the interview:

"The quality of employees is very important in demonstrating our brand's image, as they represent the company. We try to build up a high quality team with proper courtesy and capability through training and education. The level of knowledge that employees hold determine their degree of creativity and capability. This is crucial for successful marketing communication to our customers."

Recruitment policies are based on this strategic vision of brand building. Selection criteria for staff recruitment focus on five elements, 'education', 'qualification', 'ability potential for creativity', 'open-mindedness', and 'acceptance' to the Sunfed culture. The selection process includes four procedures: written-format questionnaires; informal interviews; culture workshops and final stage of formal interviews. During these procedures, employees' intelligence quotient (IQ) and emotional quotient (EQ) are evaluated. The culture workshop is an important feature in the selection processes as it is designed as a special observation programme. Candidates are invited to this 3-day workshop to experience the Sunfed culture before the final stage of interviews take place. During these workshops, observations on candidates are recorded to examine their acceptability to the Sunfed culture. As the General Manager says, *"During workshop activities, some people get excited about the Sunfed culture and cannot wait to ask questions about it in order to know more. Some are not interested and some are confused. We observe their interests and understanding of the Sunfed brand philosophies, so that we know whether they can adopt our culture and style, and integrate into this system as a whole."*

Training programmes are an essential part of staff development planning. Written formal assessment of recruits aims to identify the specific areas that require training. Tailored training courses are thus designed to meet this need. For example, new sales staff are required to attend one month full-time, off-job training courses before they start. The courses include sales techniques, colour collections, the art of displaying clothes, retail distribution, etc., in addition to brand management training that is compulsory for all levels of employees. Managerial staff have training courses that focus on strategy and advanced management approaches. Professors from academic institutions are invited to give such theory lectures. Managers are not only sent to Beijing and Shanghai for learning, but also to France and Italy to learn about brand management, as the Sunfed brand represents a European style. The design of training in DSF shows that the constant education of employees is focused on their understanding of management knowledge, underpinning the company's brand. Due to the owners' U.S. background and their direct adoption of western management practices, the strategic vision of the company is based on high value-added product development with rich culture connation, which requires a knowledge-based staff team. Therefore, constant training including off and on-the-job, aims to close the gap between advance management practices and low skilled local managers.

Reward and sanction systems, as part of human resource management, generate motivation to drive consistent performance. In a market-focused system, rewards based on sales performance is the common approach. The criteria for reward and sanction are set in relation to hard and soft targets in the planning system. It is formularised as – "basic wages + performance wages (assessed by hard and soft targets) + annual rewards = total employees' pay". Rewards are also increased twice a year respectively in February and August. The amount of increment is dependent on an individual's performance. The frequency of their faults at work is also recorded. When these are too great employees may be transferred to other positions or dismissed.

Personnel policies for employees' treatment and welfare are fairly good in this foreign-invested enterprise. Legal contracts provide employees with cover for five types of insurance, which include housing and pensions. Extra hours at work are paid at the legitimate rate, holidays and sick-days are also covered by the standard salary. Business travel is compensated by extra subsidiaries. Employees are well treated at DSF in comparison with those in the COE and POE case studies; particularly by contrast to the COE that is ruthless to its employees. This is another example of the influence of US ownership participation.

The "soft" means of rewards reflect human relations concerns in DSF; for example, promotion opportunities for every member of staff and opportunities for studying abroad (e.g. France, Italy) are part of the whole reward system. Good working conditions are provided with personal laptops, company cars, and compensation for travel. These "soft" methods fulfill an important function in motivating staff and developing personal potential. The interviews in DSF suggested that motivation among interviewees is much higher than in the other three case companies.

As the Personnel Manager, Mr. Liu Ming comments;

"I feel the company not only meets employees' living needs, but more importantly it gives opportunities for personal development. We have convergent objectives with the company's development. We interact within this organisation as a whole, as the organisation's development depends on us, and our personal actualisation depends on the organisation."

The Marketing Manager, Mr. Larry Chen comments:

"This company has very advanced management concepts and philosophies which encourage us to learn management theories that we never looked into before. This is a company with huge potential in development and it can definitely do better as time goes on. However, much has yet to be done and more capable talents need to join us as we grow. A complete motivation system to retain highly skilled talents is in demand, although this company has been very successful in building brand image and culture with precise market position. Further development will put challenges on our human resource management. The motivation incentives are still not enough and rewards systems need to be more improved in order to fully develop personal capabilities. For instance, responsibilities that managers carry out need to relate to specified rewards, and we need to know what we can achieve and what we can do."

As the General Manger says:

"*We still need to find better solutions to motivate the middle management. Groups of employees at sales level are well motivated by specified sales-related reward mechanisms; whereas other departments, like design, technology and outsourcing that don't have direct links to retail stores and sales, require better incentives. We need a multi-designed motivation mechanism to retain capable talents. Currently this is the most challenging task for our company, as we are struggling with a shortage of capable managers. Our concepts and ideas need to be executed by capable staff, but we don't have enough of them. It is not easy to find skilled managers on the Chinese labour market. Actually we have been trying to train potential employees from internal promotion. However, re-education and training are a tough task for us.*"

7.2.5 Style

Leadership style in DSF is dichotomous. The president represents a democratic and consultative style, whereas the General Manager demonstrates an authoritative and directive role. In the Chinese sense, the president is a Confucian style leader which emphasises intellectual wisdom and courtesy, advocating knowledge education rather than an emphasis on material values. Referring to his overseas education background and expatriate experience, he is open-minded to adopt both western and Chinese philosophies, showing appreciation of advanced knowledge practices and technology regardless of country boundaries. He is a gracious and approachable person, which gives employees amiable feelings. Communication with him is much easier than with the General Manager.

The General Manager is an authority-based leader, believing in command-and-obey management. Impersonal rules and procedures are her preference as she emphasises that disciplines to regularise the employees' behaviour are necessary for effective management. She underlines this in company training programmes and that authority plays a key role in reinforcing management and the achievement of company objectives. Brand management is a new concept in the Chinese market, so its enforcement is required to push employees' acceptance of it. Because of her strong preference for authority management, conflicts often occur between the General Manager and the President. She complained in my interview that the president is too easy with employees. However, although dissensions exist, when it comes to strategic vision, they always reach consensus; if not, she accepts the final decision of the President.

The leadership style in DSF seems to be a good combination of authority and democracy as they compensate each other to form a mixed style to serve different needs of management. The General Manager regards herself as the teacher of the organisation who gives lessons to employees for their training. She has influence over employees. She is not only their manager but also their preacher of the company's culture and brand management concepts. The Personnel Manager comments on her style as:

"*The General Manager exerts great influence on the staff in terms of culture, values, management concepts and ways of doing things. She is a perfectionist in everything, so she expects high standards from us and on enterprise development. She is an entrepreneur with strong personal capabilities, which influence everyone around her. She is very authoritative in insisting on her ways of doing things. She is very directive to teach us to do new things. We respect her as she has profound knowledge and experience. She speaks fluent English and always engages in diplomatic affairs with foreigners and different countries. She has a very internationalised style and open mind.*"

The Manager of Technology comments:

"*Leadership in DSF is strong. Our president is a democratic leader, but with very cutting-edge concepts and vision. He represents the American style of management – open and creative. The Chinese general manager is an authoritative leader with a determined mind. She makes sure things get done and she is very good at creating cultural values for the enterprise. Both of them are very intellectual and knowledgeable. Their leadership is a mixed style in the company.*"

'American companies are often regarded as high profile, and are deemed as the most desirable to work for. Because the Americans are more generous and open, they tell you what to do and let you get on with it.' (Gamble, 2000)[280] Leadership in this American-Chinese joint venture seems to demonstrate a similar style – high profile, open culture, high management autonomy. DSF emphasises end-results from the middle managers while excellent achievements are expected by the top management

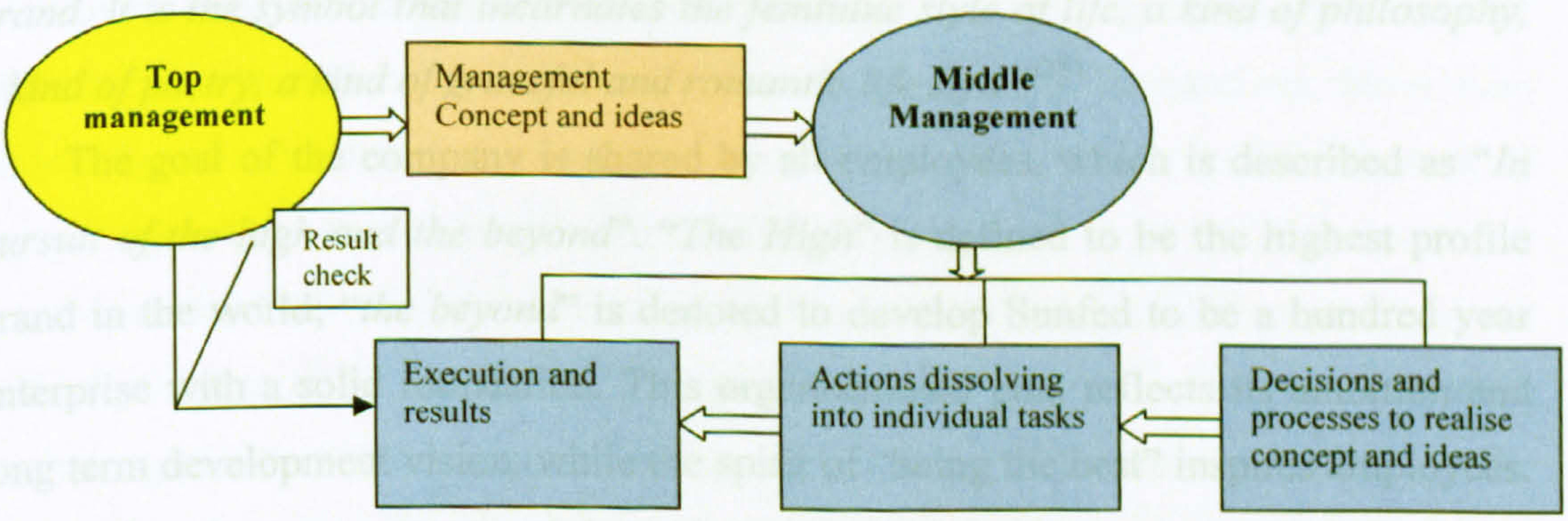
[280] Gamble, J. (2000) 'Localizing management in foreign-invested enterprises in China: practical, cultural, and strategic perspectives', *International Journal of Human Resource Management*, 11 (5), Oct2000, pp. 883-903.

as the company aims to develop high profile performance. There are great opportunities to develop personal potential, but the company also challenges the capabilities of managers who take these responsibilities. As the Marketing manager, Larry Chen comments:

"The company just tell you the objectives, the processes and decisions are left to us to determine. Although the company has taught us so much about new management concept and theories, we have to digest them by time and through practice. We feel the company should provide us with more support in process management, but actually they leave the work completely to us to make decisions, developing the tasks and responsibilities to first-line employees. The president only looks to the results, and the general manager takes a more participative role in daily operations, but she is more likely to be in a supervisory role rather than supportive."

The following figure 7.4 reflects the style of performance management in DSF which also illustrates what the local managers are expected to do.

Figure 7.4 Performance Management in DSF



The work environment is designed to high professional standards. DSF's office is located in a prestigious area, comprising wealthy people and foreigners, as this matches its brand image and market position. Its location also offers convenience to members of the Sunfed Club for its social life. The company's physical internal environment is creative and unique in terms of colour schemes and space arrangement. The Sunfed Group USA sign is the biggest logo at the front door denoting its foreign joint venture status. Coffee facilities remind the visitor of this distinction as a coffee culture is seen as symptomatic of the western life style. The clothes showroom is arranged in the lobby next to the reception, which customers can walk into. Contrasting colours and designs impress visitors and catch their attention immediately. The workplace plays Mozart and Beethoven music, which reinforces western values and enhances the work atmosphere as friendly and relaxing. Employees demonstrate proper courtesy and modest manners as a well-trained high quality team.

7.2.6 Shared values

The General Manager is the advocator and preacher for creating and enriching the Sunfed culture. She did primary research to define the Sunfed brand with both western and Chinese identification. For instance:

"Sunfed's western identity means "Bathe in the sunshine", expressing beauty, warmth and love. Sunfed Chinese translation (Si Fan) means "Repine for a secular world, a tale from 'Sinful Sen Biography' which was published by Mei Lanfang, who was the maestro of Beijing Opera. This story tells how a young Nun is attracted by an elegant boy and decides to return to the secular world. It represents women's nature and beauty and love. This cultural connotation forms the orientation of the Sunfed brand. It is the symbol that incarnates the feminine style of life, a kind of philosophy, a kind of poetry, a kind of graceful and romantic life style."[281]

The goal of the company is shared by all employees, which is described as "*In pursuit of the high and the beyond*". "*The High*" is defined to be the highest profile brand in the world; "*the beyond*" is denoted to develop Sunfed to be a hundred year enterprise with a solid foundation. This organisational goal reflects its ambition and long term development vision, while the spirit of "being the best" inspires employees. Rich cultural connotations and legend under the brand, express a prolific brand personality and value, which gives customers an emotional experience that builds the company's competitiveness in a way hard to intimate by competitors.

The general manager plays a valuable role in teaching and educating employees to the extent that her values and philosophies have changed employees' behaviour and mentality. She promotes a high profile style of quality of life, encouraging employees to pursue excellence. Knowledge is highly respected in this company and creativity and innovation in marketing and technology are a key focus in employees' education. The motto being advocated in DSF among employees is "*Excel yourself to be*

[281] '*Origin of Sunfed*', from Sunfed website, www.sunfed.com (accessed by April, 2005)

creative!" As the General Manager always tells employees; 'if you want to change your life, you come to Sunfed; this is the company that can give you the opportunity to be better and can provide you with different cultural experiences.' This is the key value in the company's culture that creates an environment to develop employees' capabilities, encouraging their creativity and innovation. An emphasis on autonomy to staff is regarded as an essential philosophy underpinning DSF's management to activate employees' potential, which is a precondition to achieve high performance in the market. The philosophy of performance management is to stress self-oriented result-driven performance. Sunfed retail stores are the main channels for sales, and this distribution network covers over 38 cities in China. Increasing sales volumes in flagship stores is the main focus of the company while developing more channels of distribution is a supplementary objective. The realisation of these objectives demands capable managers with self-motivating skills. The Sunfed culture and management philosophies are well-matched with organisational objectives and strategy.

The organizational culture in DSF is learning and knowledge-based. Learning is reinforced through constant training programmes. The willingness and exigencies to learn new things have become both formal and informal norms for staff. Every departmental manager in their interviews expressed the demand to learn new knowledge as part of their routines. It goes without saying that it is the main task of top managers to promote and enhance this learning culture.

Power in DSF is only structured in the senior management group, and its authority is stressed by the general manager. They prohibit other individuals or groups in the organisation which may challenge their power. Take the ex-manager in the Human Resource Department as an example. She was a very capable talent and did a great job in DSF, but she had been intending to form her own clan among middle managers to challenge the general manager's authority. This situation contravened the power structure in the organisation and she was inevitably fired. This sometimes generates a paradox in management, as highly skilled talents with autonomy usually make their own decisions and assign tasks to members in their groups under their own leadership. Such performance management unavoidably causes the formation of powerful individuals or group within work processes, which might become a threat to the top authority when there is dissidence. Is the shortage of capable talents in the company caused by their challenge to the power structure so they cannot be retained, or can the company really not get the right people due to the general shortage of highly skilled labour market in China? The sole authority within the power structure engenders tensions between top and middle management, which acts against the retention of capable and independent managers. This scenario is particularly common in small and medium size enterprises, where power is centralised at the top, under the control of a small group of individuals, and more importantly, while the company is structured without corporation institutions. This is evidenced in all the three other types of ownership in the case studies. It is less likely the case in the state-owned enterprise undergoing corporate institutionalisation, with subsidiaries relevantly independent of top management and their administrative relations in the form of contractual responsibilities. Governance in such large-size corporations is institutionalized and the power structure is controlled by a board of directors and supervisory board rather than by specific individuals. The underpinning problems for SOEs are retaining highly-skilled talents because of poor rewards rather than power structures.

7.2.7 Skills

The President of DSF with an MBA background and work experience in the United States has applied his management knowledge to business practice. In the interview, he demonstrated a full understanding of key management concepts and approaches. An advanced Western style of management is adopted in his company; for instance, 'brand building' marketing communications as well as management pattern, structured as 'marketing + design + manufacturing + outsourcing'. This pattern is used by Western brand-focused companies, as it prioritises the marketing and design functions as the main focus and regards manufacturing as the supply function to serve marketing and design needs. The outsourcing strategy is used in this pattern as supplementary to manufacturing in order to reduce production costs and maintain a focus on high value-added product management. 'Chinese garment factories usually concentrate on labour intensified manufacturing work and low value added products. They lack marketing and branding knowledge to design a strategic management to build up high value added product, thereof they are unable to move up to R&D based industry but cluster in the low technology and labour intensity industries.' (CTIA, 2005/2006)[282]

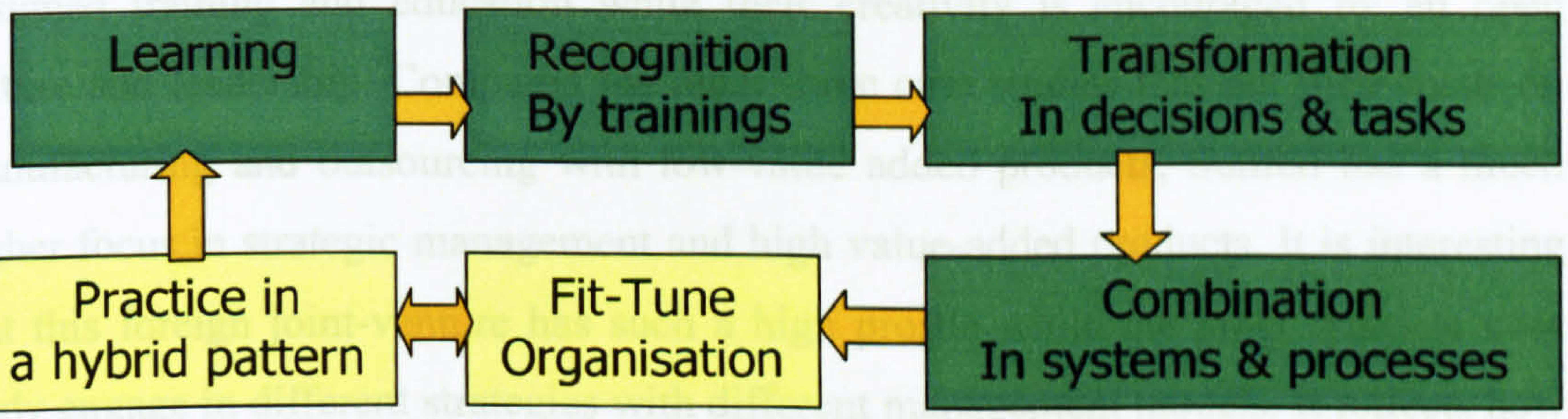
The General Manager with PhD qualification, together with a high capability in management, has enhanced the knowledge-based learning and teaching culture in DSF. As she explains, her role is more like a preacher and teacher to direct employees. They convert management concepts and theories into practice and test them in the Chinese market. This is the strength of this company. However, it is also the cause of problems in the management. As they inoculate ideas and theories in their employees, they expect them to implement these. Nevertheless they don't know precisely, themselves, what the processes should be between concept and results. Management concepts need to be converted into techniques before they can be applied to practices. It is the reason why the managers express their confusion in process management, and emphasise that they need more support from top management if they are to refine the procedures and processes in terms of how to meet their objectives. They are already aware of the problems in refining process management and one solution offered by the President and his managers is the implementation of an ERP (Enterprise Resource Planning) system. The IT software technology of ERP aims to maximise the use of all the resources in an organisation. These resources include: employees and their skills; the business processes, procedures and organisational structure; and IT systems which support the various business areas. ERP promises one database and one user interface across an entire multi-site enterprise. Taking information from every business area, ERP helps managers and employees plan, monitor and control the entire business. Improved control of resources means greater efficiency and effectiveness. ERP is a large investment for DSF, and at the time of the interviews, they were working on the selection, implementation and optimisation of software packages (e.g. BaaN, JBA, JDEdwards, Oracle, PeopleSoft, SAP, SSA), as these must be closely managed to deliver maximum benefits. The investment in ERP also places demands on skills training for staff; it is a challenging learning process for DSF in pursuit of technology innovation and management advancement.

In this case, Sunfed is going through a learning process that utilises Western management approaches in its own conditions. The adoptive process is illustrated in figure 7.5. It is similar to Deming's PDCA circle (plan, do, check, act), but figure 7.5

[282] China Textile Industry Associate (CTIA) '*China development report of Textile industry*' (2005/2006), China Textile Press, Beijing, p52.

demonstrates in a more precise level how foreign joint-ventures train local managers to carry out advanced management concepts.

Figure 7.5 Adoptive Processes for Management Theories in Enterprise Practices



The expertise of key personnel are strengthened through constant learning and training. The brand design director, Helene Zhou, is the sole person responsible for brand personality in DSF. She is a graduate from a France fashion college in 1999 and had one year study of fashion design in Japan in 1992. Her style integrates Asian and European fashion and culture, appearing as elegant but also simple. She breaks through the cultural boundaries between countries to assimilate different elite elements into a fresh European style which meets Chinese consumers' preference in pursuit of quality life style. She has gained many awards in design; for instance, a silver medal in Taegu Fashion Festival 2000 in Korea and a gold medal of 'Most Fashionable Dress Brand' in China International Fashion Week 2002. In the interview, she emphasised the importance of training for staff and that style values need to be delivered to consumers through all the marketing staff. Brand management requires a high quality team which understands both high cultural connotations underpinning the brand as well as communications techniques in marketing.

As she comments: *"Brand building is customer-centred management. We need to follow up their changes in tastes and needs, so that our foreseen ability and creativity are important in brand building, as the creation of brand value is combined by rationality and art. Design with research & development is a total activity. The colour motif, material technology and craft of clothing are all dependent on market data and scientific research. We intend to create a high value-added brand through knowledge and science. Therefore we aim to build a high quality team to achieve this* *goal through well-designed training programmes, as it is difficult to get highly-skilled staff on the labour market in China.*"

The key staff in Marketing, Technology and the R&D centre in Shanghai form the core competence in DSF. Their expertise and abilities are enhanced by well-designed training and education while their creativity is encouraged by an open culture and leadership. Compared the other three case studies that put their focus on manufacturing and outsourcing with low-value added products, Sunfed has a much higher focus in strategic management and high value-added products. It is interesting that this foreign joint-venture has such a high profile while the other types of case study engage in different strategies with different management models. It reflects how this foreign joint venture operates on the basis of very different principles (derived from its US co-ownership) than the other three types of indigenous-owned case studies.

7.3 Concluding Remarks:

Foreign investment, as a salient constitution of the Chinese economy, plays an increasing role in market transformation. Foreign joint-ventures, as one form of business venture emerging from market socialism, demands the localization and adaption of foreign investment in China's changing marketplace. DSF, a typical indigenised foreign joint-venture, with expatriate-owned management, is characterised by competitive virtues and a visionary orientation positioned in the high value-added chain of the clothing industry with brand-focused marketing. This case study suggests that a knowledge-based product portfolio and a people-focused management system are the key factors of competitiveness that distinguish foreign joint-ventures from domestic enterprises. Building 'home brands' is appealing for domestic enterprises, particularly in the clothing industry. But in the four case studies, the foreign joint-venture as the only case successfully developing brands for the Chinese market. By applying its 'learning from the West' it has implemented such practices in the Chinese marketplace through intensive staff training. Its adhocratic and professional structure in combination with formal and informal management systems provide openness and flexibility to promote personal development. The constant dissemination of knowledge through integrated training programmes generate a learning orientation to stimulate self-renewal and encourage innovation and creativity. Retaining highly-skilled managers requires an organisation to establish an environment encompassing relevant supportive systems and processes as a whole. Through this means, this foreign joint-venture is able to develop its core competences for its long-term investment strategies.

CHAPTER EIGHT:

Some Conclusions: Emerging Forms of Business Venture in China

Chapter 8 Some conclusions: emerging forms of business venture in China

Introduction

The pace of economic change in China has been extremely rapid since the start of market reforms in the 1980s. Government policies have moved markedly towards allowing market forces to influence economic activity. These policy changes have permitted a much increased role for the private sector and foreign investment (OECD, 2005)[283]. Overall, reforms have generated the emergence of four types of business venture under market socialism in China as 'state-owned enterprises', 'collective-owned enterprises', 'privately-owned enterprises' and 'foreign joint-ventures'. This thesis has explored these emerging forms of business venture and analysed the distinctive characteristics of each of them under market socialism. The organisational factors, interacting with environmental and institutional changes of economic reforms, have been studied for their impact on re-shaping management models of business venture. Case studies on these four types of enterprise draw organisational profiles for each form of ownership, to not only examine how the property of ownership is likely to impact on shaping their distinctive characteristics, creating challenges and tensions in each type of venture, but also to draw some conclusions for future trends and policy recommendations.

8.1 The four case studies: some contrasting differences

Using the McKinsey 7-S framework, as used throughout this thesis, it is possible to identify the major differences between the case studies.

8.1.1 Strategy

Even though the four cases operate in the same industry (textile and garment industry), their strategies significantly vary according to different type of ownership. The motivations that drive companies to develop, the means by which they expand and grow, and the mind-sets of those who built their operations are dissimilar due to

[283] OECD (2005), 'Economic Survey of China 2005: Policy Briefs', *Economic Outlook* No. 77, June 2005.

diverse ownership. The development strategy of the state-owned enterprise is prominently influenced by state policies and political factors. Thus, its strategy expressly reflects Party policy and political direction to the extent it may not best suit the market needs and the business itself as long as it is responsive to political demands. The state-owned enterprise has the least market-oriented strategy, resulting in the highest tension created by political demands that are of the inconsistency with market demands.

The state-owned enterprise – LTG – presented its corporate strategy in a very formal fashion, which officially documented its strategic objectives for both the short and the long term. Each stage of development is formulated for specific tasks. This forms a distinct contrast to the privately-owned enterprise, where an entrepreneur operates his small and flexible company with 'no strategy' and 'no paper rules'. No formal and explicit strategic planning is stated in this entrepreneurial company; the private owner determines the company's planning and strategy on an ad hoc basis according to how the market changes and what the customers require. Such informal strategy is never described in documents but only verbally explained by the owner in the direction of tasks for employees. Strategy can randomly change whenever the owner decides. The strategy in the privately-owned enterprise is fluid rather than fixed as in the state-owned enterprise, which demonstrates superior flexibility and freedom in planning and operation. The state-owned enterprise has utmost inflexibility and constraints in strategic change.

Due to the tension between political needs and market demands in the state-owned enterprise – LTG – conflicts existed in both the operational and corporate levels. The corporate level strategy is a reflection of the state reform objectives, which are politically driven in line with the Party's expectation and ideas of economic development. For instance, the five-guidelines for strategy planning of LTG incorporate all the government policies for the reform of state-owned enterprises. These guidelines sometimes are in contradiction with the actual situation of the market in which the enterprise operates. For example, the guideline stipulating a priority to export and import trading, whereas there is the market demand for own branding. The guideline desiring the establishment of a joint-venture with a foreign company form strategic alliance is unlikely due to both ownership constraints and political sensitivity. Because the strategic planning of LTG is not fully decided by its own senior management but mostly driven by the administration agency, AICSA, political direction is thus reinforced. Specially, strategic planning cannot be constantly adjusted in good time when the market situation changes. Such strategic change in state-owned enterprise requires a long bureaucratic process of approval from AICSA. Lack of flexibility and the absence of entrepreneurship is an evident disadvantage in state-owned enterprise compared to the other types of enterprises that can adapt quickly to changing market demands. Administration and bureaucratic processes significantly affect the management pattern of this state-owned enterprise, as the main influencing factor, distinguishing the state-owned enterprise from the other types of enterprises that operate in the same market.

Compared with the state-owned enterprise, the collective-owned enterprise – SLAC – has a more market-driven strategy and the flexibility to adopt to market changes due to less government intervention and non-centralised administration. Especially, the reforms bring into being private ownership and involvement in the collective-owned enterprise, shaping the management pattern in the form of the coexistence of both private owners and collective-owned assets. Collective ownership has gradually shifted from the state sector to the private sector alongside with the progress of economic reforms in China. (Li et al, 2004; Chao, 1998; Shirley, 1999; Chiu, 2006; Wen, 2004)[284] By 2005, collective-owned enterprises only accounted for 4% of investment in fixed assets in urban areas, compared to 65% for state-owned enterprises, 17% for privately-owned enterprises and 14% for foreign-investment enterprises.[285] The case study of SLAC is a typical example to demonstrate such transition in process. Due to the involvement of private ownership, the strategy in SLAC is practical and acclimatized to environment changes, and driven solely by market needs and owners' interests. The main success of SLAC has resulted from overseas orders, manufacturing foreign-branded goods for processing fees. This demands the expansion of manufacturing facilities and the augmentation of

[284] Li, Shao-min; Ilan, V. and Zhou, Dong-sheng (2004), 'The emergence of private ownership in China', *Journal of Business Research*, 57 (10), Oct2004, pp. 1145-1152.
Chao, J. (1998), 'Factors affecting the competitiveness of China-based companies', *Competitive Intelligence Review*, 9 (3), Jul-Sep1998, p39.
Shirley, M. (1999), 'Bureaucrats in Business: the role of privatization versus corporatization in state-owned enterprise', *World Development*, 27 (1), Jan1999, p115.
Chiu, C. (2006), 'Changing experience of work in reformed state-owned enterprises in China', *Organisation Studies*, 27 (5), 2006, pp. 677-697.
Wen, Wei (2004), 'Bankruptcy, sale and mergers as a route to the reform of Chinese SOEs', *China Economic Review*, 15 (3), Sep2004, p249-267.
[285] China Statistic Year Book 2006, compiled by National Bureau of Statistics of China, China Statistics Press, Beijing, p207. (The percentage for different ownership is calculated by the author according to the data in statistic year book.)

productive capacity in order to gain lucrative returns from quantity and quality. The limitation of mixed private and collective ownership is the contradiction in stakeholders' interests leading to myopia of strategy with a focus on short-term profit return, rigid cost control and low value added mass production. It is in contradistinction to the foreign joint venture – DSF, which operates a western approach to high value-added branded goods with a deep understanding of strategic approaches to brand marketing. The foreign joint venture demonstrates high vision of strategy for long term planning with management flexibility and knowledge advancement, responding not only to domestic market needs but also to international market standards.

In the field of branded clothing, foreign companies have many advantages because of their expertise, advanced knowledge and long history. Comparatively, indigenous firms are weak in brand building; foreign-invested firms are pone to place brands at the heart of marketing and business strategy. Given the advanced knowledge about brand management, DSF has placed the objective of developing brand equity as the core of the company's strategic management and regarded it as a key determinant of corporate values. However, investments in brand building activities do not have an immediate pay-off. Without an understanding its future potential value and with no long term vision of strategic development, many of today's Chinese companies are unwilling to invest in building product brands. Their reluctance is mainly due to little knowledge of know-how to brand building as well as lack of long term vision. They tend to be tempted and pressured by short-term profit return. DSF's brand strategy shows a long-term focus that increases its market competitiveness. In relation to ownership, the foreign joint-venture has the distinctive advantage in advanced management approaches due to direct investment and learning from the West. The foreign joint-venture is a form of indigenization that overcomes the shortcomings of foreigners or expatriates directly involved in management but utilises the value of foreign capital resources. This type of localised foreign venture is dependent upon a high degree of trust and tight legal contracts. It is a result of market reforms and adaptation to the regulatory environment. Compared to state-owned enterprises, collective-owned enterprises and privately-owned enterprises, foreign joint-ventures are the only ones positioning themselves at the top of value-added production in the clothing industry. Foreign capital is the wherewithal for the adoption of such a strategy as brand building requires constant and extensive investment for a long period without immediate payoff. Financial pressure is often the ruthless reason for killing such a strategy as such investments do not have visible returns in short-term sales and profits. Faced with such elusive, long-term and intangible benefits, it is not surprising that companies and managers always drop this strategy in planning. This is the prevalent situation in China, with a deficiency of capital to fund growth in privately-owned enterprises. Even state-owned enterprises, with privileged access to financial sources, are usually driven by short-term profit returns due to performance assessment mechanisms used for managers that emphasise immediate profits. The foreign joint-venture shows its competitive advantage in creating high value added products through its strengths in capital, technology and advanced western management techniques.

In general, of the four types of enterprises in our case studies, both the collective-owned enterprise and the privately-owned enterprise hold an aggressive strategy in expansion and growth, which benefits from the entrepreneurial vision of their private owners as well as the market survival needs. By comparison with the foreign joint-venture, they are limited by scarcity of knowledge, technology and professional teams to carry out their entrepreneurial vision. Collective-owned and privately-owned enterprises still have much to learn in order to further develop their competitiveness and capability. Being restricted by the property of ownership, the state-owned enterprise is inevitably intervened by the state administration and governance, resulting in the most conservative strategy for growth and brand building as it involves long term investment without instant profit return. This goes against its performance evaluation mechanism stipulated by the government, in spite of having the easiest access to finance resources.

8.1.2 Structure

Structure varies according to the size of enterprise, nature of work and the philosophy of management; it provides the framework of an organisation and its pattern of management and it makes possible the application of management processes that creates a framework of order and command through which the activities of the organisation can be planned, organised, directed and controlled. (Child, 1984; Birkinshaw, 2001; Mullins 2005)[286] Our case study reveals that the

[286] Child, J. (1984), *A guide to problem and practice*, Harper & Row, London.

pattern of structure is also determined by the type of ownership and is consistent with its strategy, system and culture. It reflects the way of owner's control. The state-owned LTG is a typical divisionalised structure with centralised government administration, authority and bureaucracy. The entrepreneurial firm – Dali – has the most flexible and fluid structure designed as owner-centred management. The foreign joint-venture – DSF – is characterised by a market-focused structure to meet its brand strategy, characterised by operational flexibility. Such a relatively "open" structure facilitates personal development embedded with a high level of concern to promote intraprenuership. It presents a striking contrast with the foreign joint-venture (DSF) and collective-owned enterprise (SLAC) in terms of their employee development and management philosophy.

SLAC has a 'barbell' structure, a split weight emphasis in two functions of the organisation; one on marketing & trading and the other on manufacturing. Such 'barbell' structure reflects separate entrenchments of dual-type of ownership – private owners and collective ownership. This collective-owned enterprise is the offspring of the primary socialism that has evolved into such a hybrid pattern with diversified ownership structure under later market socialism. Flexibility of management is showed at one end (top management) but extremely constrained at the other (production base). Centralised authority and linear relationships are structured from the top to the bottom to meet standardisation and cost control purposes. SLAC has adapted a management model similar to the Scientific Management approach in its manufacturing function, which emphasises a tight system of control over workers and optimising the level of workers' productivity on 'piece-rate work' (Taylor, 1947).[287] For example, the system of "overall control everyday evaluation" is applied in daily management in SLAC. Based on the results of daily evaluation, control is placed tightly over unit production and overall performance. Defects in quality and decline in quantity can be discovered promptly, so that remedies can be applied to prevent the spread of faults. Through this system, day-based production maximisation and improvement can be achieved. According to Braverman (1974)[288], scientific management starts from the capitalist point of view and method of production, and the

Birkinshaw, J. (2001), 'The structure behind global companies' in Pickford, J. (ed.), *Financial Times Mastering Management*, Financial Times Prentice Hall (2001), p75.
Mullins, J. L. (2005), *Management and organizational behaviour*, 7th ed. FT Prentice Hall, England.
[287] Taylor, F. W. (1947), *Scientific management*, Harper and Row, USA.
[288] Baverman, H. (1974), *Labour and Monoply Capital*, Monthly Review Press, UK.

adaptation of labour to the needs of capital. A distinctive feature of Taylor's thought was the concept of management control. In the case of SLAC, personal centralised control, bureaucratic control and output control are combined in the management process. Workers in SLAC are controlled not only by orders and maintenance of discipline, but also by removing them from any decisions about the manner in which their work is to be carried out. Gospel and Littler (1983)[289] suggest that by division of labour, and by dictating precise stages and methods for every aspect of work performance, management can gain control of the actual process of work. The rationalisation of production processes and division of labour tends to result in the de-skilling of work and this may be a main strategy of the employer.

Compared to three types of ownership - COE, POE and FJV - in our case studies, the structure and systems of the state-owned enterprise are the most sophisticated form of formally institutionalized bureaucracy. Strategic decision-making in such systems tends to be affected by upper authority rather than by market demands. Despite management autonomy, middle management is tightly controlled through a culture that reflects the continuing dominance of the party and centralised state ownership. Consequently, conventional Communist Party thinking on the planned economy retains a strong impact upon the ideology and behaviour of employees in LTG.

Structure in Dali is almost non-existent, providing an extreme contrast to the state-owned enterprise. There are not even documents for HR policies, management procedures, or company regulations. Basically it is NOT a structure but a pattern of dependency upon the private owner. The proprietor is very much at the centre of the management web. Informality and high flexibility are the major characteristics of the Dali entrepreneurial company.

8.1.3 Systems

To be compatible with their different structures, applied systems vary in each form of business venture. The privately-owned enterprise presents the most fluid and informal systems in communication and management. The foreign joint-venture places an open and knowledge-based mechanism with an emphasis on personal development and intraprenuership. State ownership requires formal and

[289] Gospel, H. F. and Littler, C. R. (1983), *Managerial Strategies and Industrial Relations*, (eds). Heinemann Educational Books, London.

institutionalised systems for its divisionalised large-scale organisation. Collective ownership, in merger with private ownership, shapes standardised systems with centralised communication processes and authority to meet its objectives of cost control and a scrutiny of direct supervision on mass production. However, the collective-owned SLAC demonstrates the highest conflicts in diversified owners' interests which lead to great tension in their systems and de-motivates employees. Entrenchment and defence of dual-forms of ownership in such a coexistence situation can cause conflicts to evolve and for there to be silent resistance to each interest group of employees. This gives birth to an outcome of a 'barbell' communication system, with two ends operating relatively independently with limited interactive communication in between and merely through finance and planning control. Hierarchy and impersonal rules are built into this 'barbell' structure to maintain the routine management and legal connection between stakeholders.

In SLAC, authority is emphasized in the company and unquestionable command is often the way of communication by management staff. Compliant followers are appreciated and challenges against authority are eliminated. The systems of SLAC show some common characteristics of machine bureaucracy. It has very formalized procedures in the operating level and a proliferation of rules, regulations throughout the organisation. It totally relies on employees complying and obeying as the core of the system. Decision-making is prone to follow the formal chain of authority in this collective-owned enterprise so that the interests of the private owner and the interests of collective individuals can be clarified according to their respectively owned share division. The control of the private owner considerably ramps up while the representatives of collective ownership intended to entrench their control over collective assets and retain their management independence is declining.

Institutionalisation and formalization of systems is the main feature for the large-scale state-owned enterprise. For instance, LTG is the only case study company that has passed the requirement of QMS and successfully implemented such internationally standardised quality-control systems. None of the other three types of companies have implemented such formal standardization of their quality control systems due to the cost of this system and scale of production. Such implementation of QMS is a compulsory command of the State Administration. QMS fits the demand of institutionalisation and the corporatization of state-owned enterprises. Moreover, the strong state financial background of LTG gives it the possibility to adopt QMS.

In distinct contrast, in the privately-owned enterprise, with a minimal skeleton of structure, the systems of direct control are informal and highly flexible. The proprietor is the centre of decision-making and has direct and total control over every procedure. Hierarchy is low in this system and the proprietor is the sole authority for all working procedures. Although it gives flexibility to management, it also suffers from chaos and muddle when the task becomes more complicated and when the company expands quickly. Particularly the owner in the centre is likely to be saturated with too much information and this results in exhaustion and incapability of exercising total control. It is evident in the case study of Dali that formalised structure and systems are required for systematically planning and organising business activities when size of company grows to be over 200 employees.

Nonetheless, by comparison, the foreign joint-venture (DSF), has combined systems in both formal and informal format. It has an open and knowledge-based mechanism in management structure which promotes personal development and employees' creativity and innovation. DSF emphasises formal rules for control of implementation processes and procedures while it gives autonomy to the staff for creativity. A knowledge-based learning system is highly promoted and implemented in the organisation acting as the incubator for innovation and intraprenuership. Constant knowledge education and learning becomes incumbent upon the employee in DSF rather than only necessary. Tension in DSF is created between the demand of creativity and the capabilities of employees. Although more intense education and training is designed to enhance skills of employees, however, their capacity to digest such knowledge is still in question. Constant renewal to retain its competitiveness is the major challenge for DSF as it positions itself at the cutting edge of knowledge and in the high value-added chain of the clothing industry.

8.1.4 Staff

By contrast to the collective-owned enterprise, the privately-owned enterprise and the foreign joint venture, life security and employee benefits are well embodied in the state-owned enterprise. Extra hours at work are paid at a fair rate, annual increments in salary and all round welfare is legitimated and guaranteed for the staff in line with the Labour Law. The state-owned enterprise also offers more benefits, such as stock options, housing and bonuses, to his key personnel. This is in dramatic contrast with the insecurity of employee benefits and welfare in the privately-owned enterprise and the collective-owned enterprise, where only minimal levels are promised. Employees' rights are ignored in these companies. In the privately-owned company, the owner utilises financial rewarding as the control tool in an informal and verbal approach to gain employee's commitment and motivation and to create employee's dependency upon his power. It is used at a minimum level whenever the owner feels necessary to do so. There is no formal guarantee and legitimate security for long term employee's benefits and welfare. The worst of our case studies in this aspect is the collective-owned enterprise; breach of Labour Law is frequent, and employees work during weekends for long hours without extra pay. The staff policy and training in this collectively-owned enterprise merely emphasises production skills and market ideas with an ignorance of individual needs. Although the enterprise demands change, innovation and creativity, some training courses are therefore designed to develop this culture. Nevertheless, such demands often conflict with existing systems and structure as staff are de-motivated to participate in such training because of low rewards.

Comparatively, the foreign joint-venture provides all legally required welfare and benefits to the staff with formal but short-term contracts. Furthermore, benefits are presented in DSF to attract employees. There is also personal development scheme, offering opportunity and training for ambitious individuals. These distinctive elements – open minded and high vision, cutting-edge knowledge, opportunities for personal actualization – are well merged in the staff development system in DSF. The "soft" means of rewards reflect human relations concerns in DSF, such as good working conditions with personal laptops, company cars, and compensation for travel, opportunity to study abroad and promotion, etc., which fulfil an important function in motivating staff and developing personal potential. The education level of key personnel in this foreign joint-venture is higher than in the other three case study companies. Higher education qualifications are an essential requirement for key staff in DSF as their knowledge is regarded essential for brand building and the company's long term development. The US partner emphasises the importance of this. Training programmes are essential parts of staff development planning. Written formal assessments of recruits aim to identify the specific areas that require training. Tailored training courses are thus designed to meet this need. The design of training in DSF shows that the constant education of employees is focused on their understanding of management knowledge, underpinning the company's brand. Due to the owners' U.S.

background and their direct adoption of western management practices, the strategic vision of the company is based on high value-added product development with rich culture connation, which requires a knowledge-based staff team. Therefore, constant training including off and on-the-job, aims to close the gap between advance management practices and low skilled local managers. Employees are well treated at DSF in comparison with those in the COE and POE case studies; particularly by contrast to the COE that is ruthless to its employees. This is another example of the influence of US ownership participation. The interviews in DSF suggested that motivation among interviewees is much higher than in the other three case companies.

In contrast with the foreign joint-venture, the state-owned enterprise is disadvantaged and challenged in its personnel management, particularly in the ways it recruits staff. The influence of personal relations culture is more powerful in the state-owned enterprise than in the other types of ownership, '*overriding market demands and rules*'. Such differences between the state-owned enterprise case and the other types of enterprise reveal that political power and hierarchical political authority are much greater in state-owned corporations. It forms underpinning cultural norms that direct and guide management behaviours. This common reality shapes the style of management in the state-owned enterprise and destroys ambitions and entrepreneurial willingness among employees. It also restricts innovation and entrepreneurial development and explains why staff motivation is low in state-owned enterprise. Moreover, the reward system is mainly dependent on the bonus system; the government authorities and managers are driven by profit objectives. These might improve immediate performance in profitability but does not take into account risks in long term investment. Future prospects for the development of state-owned enterprise are more related to political demands than market opportunities.

8.1.5 Style

How key managers behave in achieving the organization's goals as well as managing their employees form different patterns of actions. The management philosophy underpinning and directing key managers' behaviour is decisive and interactive with other organisational factors, such as structure, systems, culture and environment etc. The style of managerial behaviour in the four types of business venture reflects different patterns according to diverse ownership. The decisive patterns of actions will reflect the major stakeholders. This varies depending to how much influence the leaders or senior managers can impact upon management. For instance, top and middle management all play an influencing role in the state-owned enterprise due to its divisionalised structure and decentralised management autonomy in subsidiary business units. On the contrary, the owner entrepreneur in the privately-owned enterprise accounts for management style as it is an owner-centred management. Likewise, the foreign joint-venture presents its style through top management with foreign culture involvement. Western education, life experience in living in America and US partnership, has formed influencing factors to shape management style of managers in DSF. However, the leadership situation in the collective-owned enterprise is in dual forms presenting by both collective-owned managers and private entrepreneurs. Their management styles embody dialectic ramifications of two conflicting interest groups, such as 'autocratic style vs. democratic style'; 'individualistic values vs. collectivistic values' and 'capitalist mentality vs. socialist mentality'.

The style of state administration and its ideas shape the management practice of the state-owned enterprise, whereas the other types of enterprises respectively reflect their owners' interests. Leadership in relation to ownership function is vital in shaping management structures, as it is crucial to direct enterprises for either success or failure. The major difference between the leadership in the state-owned enterprise and other types is that the leaders in the state-owned enterprise do not represent independent individuals but the embodiment of the party and government as a whole. In practice if not in profession, they cannot make decisions on their own volition, but must keep consistency with political direction and principles. This is in contrast with the leaders of the privately-owned enterprise and foreign joint-venture in which individuals freely represent their ideas, identity and style. Leadership styles vary to a large extent according to ownership. For example, in line with Maslows's need hierarchy (1987)[290], the foreign joint-venture demonstrates a delegating leadership style, providing both high supportive behaviour and guidance so that their employees are expected to carry out tasks by themselves. The managers work for their own interests, achievement and advancement. An open culture and delegation of management give the highest motivators to the employees in DSF. Likewise the owner of the privately-owned enterprise has a participating and consultative style, providing a high degree of

[290] Maslow, A. H. (1987), *Motivation and Personality*, 3rd ed. Harper and Row, London.

supportive behaviour and developing a close interdependent relationship with his employees, but giving relatively low guidance for how to do so in detail as they are expected to take certain level of independence for their own work despite final decision needing to pass to the owner. The owner entrepreneur works for himself as a self-motivated leader, but his followers do not have the same high motivators due to unstable and lower rewards in the small entrepreneurial firm. The lowest motivation is for those managers who work for the collective-owned business venture for a minimum level of physiological needs. The employees are told what to do and high degree of guiding rules is applied to standardize their work. Rigid cost control is the locus of the management which results in depressed working conditions and impersonal rules. Little personal development and individual needs are considered in this collective-owned enterprise.

Comparatively, the state-owned enterprise presents a "selling" style of leadership, providing both high level of supportive behaviour and specialised guidance for administrative control and governance (Hersey et al, 2001).[291] Good working conditions, life security, high standard welfare and bonus rewards meets the satisfaction of employees' needs at levels like physiological, safety, and social; but it lacks employees' satisfaction for self-actualisation. This is mainly caused by absence of opportunities for personal creativity and inflexibility for entrepreneurship or intraprenuership, engendering tensions and hindering management development. The style of the state-owned LTG reflects the contrasting approaches of "state-planning" and "market-orientation" that will become sources of greater internal inconsistency as further market reforms are introduced within state-owned enterprises. State-owned enterprise reforms have long been restricted by socialist ideology. Because state ownership is directly linked to the state administration and the Communist Party's political systems, economic reforms need to be compatible with existing political systems; i.e. socialist ideals. In order to secure such concordance, key managers are mainly selected from the military and constant education of socialist ideas is enforced among top managers. This strong political and socialist culture significantly distinguishes state-owned enterprises from the other three types of ownership enterprises. However, free market competition requires effective management with

[291] Hersey, P., Blanchard, K. H. and Johnson, D. E. (2001) *Management of organizational behaviour: leading human resources*, 8th ed. Prentice Hall, New Jersey.

'market ideals' other than 'socialist ideals'. This is the essential contradiction within state-owned enterprises.

The management style in the collective-owned enterprise is coercive. It combines the dictatorship exploitation of the private owner, and the bureaucracy and dogmas of state management. It makes the worst case in terms of employee working conditions and treatment in comparison with the other three types of case study ownership. As such it has none of the positive features of state management (e.g. employee welfare and equality) nor the ethics and flexibility of entrepreneurial management. Instead, it emphasises dictatorship, authority and bureaucracy to meet its rigid purposes of cost control and standardized efficiency. Capital accumulation through ruthless cost minimisation is most strongly demonstrated in this form of business venture. It is evidenced in this case study of collective-owned enterprise that private ownership and collective ownership in a joint form gives rise to capitalist exploitation and ignorance of business ethics. The success of this merger is based on communal benefits and compensation of the needs for both parties; collective ownership desires getting orders to keep employees' survival and the private owner requires a manufacturing base to reduce cost and quality control. The land and capital are two essential production factors that private owners lack in China; on the contrary, it is the granting advantage that collective-owned enterprises in the state sector possess. However, the case study of this business venture shows that the private owners are prone to encroach upon collective property and to gain power for control. This gives birth to increasing tensions and disputes in management. Seeking opportunities for growth is the aim of the private owner, while survival in the market is how the collectively-owned enterprise exists because of its lack of market networking and incentives. The private owner regards the collective assets as resources to be exploited and usurped. Therefore, direct control and bureaucracy are often resisted by the private owner while intervention of state governance is frequently involved to protect the collective interests. Implicit or explicit hostility has emerged between the private owner and the representatives of collective ownership. The private owner is reluctant to hand in profits to the local authorities but attempts to use it for further expansion. Privatisation as an inevitable trend of reforms is an echo surrounding China. Implicitly, the opportunity to buy out collective ownerships at a good price could be possible in the near future, which leaves the temptation to the private owner to plan for such a possibility. This joint venture generates unsolvable conflicts such as – 'speculation over collective production resources'; 'ambiguity in ownership property'; and 'hostility between diversified owners'. The only solution seems to be either sole private-ownership or full state-controlled ownership.

The owner entrepreneur is the determining factor for the success of Dali company. His explicit leadership style with charisma is to influence people by heart and affection, not by rules. This informal leadership is built on top of his unassailable authority. He demonstrates a hybrid leadership style in his management. Besides his authoritarian nature for control of his own business, his leadership is a mixture of supportive, participative and achievement-oriented approaches. This owner actively participates in all activities and decision-makings in this business. He prefers to share ideas and consult with his managers before final decisions are made. He expects his employees to take independence for task implementation. However, his employees' readiness sometimes seems to be lower than what he expects. Insecurity and low rewards may also affect commitment and motivation of his employees.

Leadership in the foreign joint-venture - DSF - is dichotomous. The president and general manager respectively represents a different preference to management style; one is democratic and consultative style and the other plays an authoritative and directive role. They form a strategic combination as both styles are needed in such an open system. DSF provides opportunities for personal development and promotes a learning culture throughout the whole system. Delegation is often authorised to the middle management and managers are expected to make their own decisions and determine implementing procedures to achieve their final objectives. Leadership in this American-Chinese joint venture seems to demonstrate a similar style – high profile, open culture, high management autonomy. DSF emphasises end-results from the middle managers while excellent achievements are expected by the top management as the company aims to develop high profile performance. There are great opportunities to develop personal potential, but the company also challenges the capabilities of managers who take these responsibilities.

8.1.6 Shared values

The guiding concepts, values and beliefs underpinning each type of business venture are in significant contrast. Such dissimilarity seems to be a corollary of different types of ownership as the orientation and interests of ownership property vary. The foreign joint-venture adopts more western cultural values with its absorption of western management philosophy and knowledge. It explains why the foreign joint-venture leads the cutting edge of brand development. The privately-owned enterprise is a pure entrepreneurial driven business with intrinsic motivation, a total market-orientation as the guiding belief, thus it has a fluid, flexible, loose and owner-dependent management structure. The owner's philosophy and behaviour determines the organisational processes and cultural norms. To the extreme extent the state-owned enterprise is significantly influenced by the state administrative norms and political bureaucracy culture, which creates a dramatic difference with the other three types of business venture. The collective-owned enterprise as a drawback from the state sector is mixed with both values of belief – collective and individual – as well as capitalist and socialist. Its hybrid values and culture generate conflicts and tensions in management which result in the lowest motivation and least commitment from its staff. The management of SLAC emphasises cost minimization and quality control, giving little attention to individual needs and business ethics. The private owners do not take the collective employees as their responsibility to treat well. The conflicts in diversified ownership form engenders a pitiless and ruthless management style in collective-owned enterprise. It represents 'moral failure' and 'personal failure'. Burns (2005) [292] distinguishes between three types of failure in the entrepreneurial organisation: 'moral failure' which occurs when there is a breach of ethics or moral standards; 'personal failure' which relates to inadequate skills, knowledge or understanding; and 'uncontrollable failure' which happens because of events or conditions out of the control of the individual. Whilst 'moral failure' should not be tolerated, personal failure can be addressed through training, development and counselling. Uncontrollable failure is bound to happen in an entrepreneurial organisation and valuable learning can take place as a result of it. SLAC is not regarded as an entrepreneurial organisation but a hybrid model mixing with administrative and entrepreneurial features. Its moral failure can be seen not only as a result of ownership conflicts but also as the negative impact of market change. Shenyang, as a large industrial city, has been suffering from high unemployment and the bankruptcy of state-owned enterprises since reforms in the state sector since the late 1990s. Large number of redundancies from state-owned enterprises has

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[292] Burns, P. (2005), *Corporate Entrepreneurship: building an entrepreneurial organisation*, Palgrave Macmillan, New York, p117-118.

oversupplied the labour market which has given no bargaining power to low skilled labour.

In SLAC, values, beliefs and organisational culture are complex among both owners and employees. The training programmes are designed to meet the purpose of cost minimization and quality control with little concern about personal development of staff. As a collective-owned enterprises, the local government agency intervenes at a moderate level. For instance, regular reports from the general manager are required for the inspection of collective-owned assets but it leaves independence to management for strategic planning of SLAC. The local government only involves in decision making when it is concerned with collective assets and key personnel. However, collective employees have to take party education on a regular basis when there are new policies. This is similar to the state-owned enterprise, but not as intensive. This also distinguishes the collective-owned enterprise from the purely entrepreneurial firm such as the privately-owned enterprise and foreign joint-venture which have no Party policy training in their management schemes. In the case of SLAC, conflicts in values and changes in culture are inevitably taking place in the transition to market socialism. It reflects the outcome of ownership diversification and illustrates one scenario of mixed ownership experiments in the socialist market. Nevertheless, it forms the most complex case comprising of mixed values and styles, and particularly reflects the diversified interests of shareholders and hostile attitudes in management control, when compared to the other three types of enterprise ownership. Although the culture in SLAC is mixed with both socialist and capitalist values, as market reforms deepen, the capitalism values are becoming dominant in driving the enterprise. Two total different types of ideology are in irremediable contradiction in this business venture. The clarification of ownership property would possibly change the orientation of management. However, uncertainty in legislation on private ownership gives rise to myopia in marketing and planning. Short-term profit return thus becomes the locus for many Chinese domestic enterprises. Collective-owned enterprises take advantage of low cost labour intensity following the status quo of market reforms but they can become vulnerable in the low value added industry chain as many external factors will have impact upon their profitability. The further openness of international markets is a double-edge sword to this type of enterprise. On the one hand, it means more overseas orders in quantity for better profit return; on the other hand, it also means more competition and higher international standards which will challenge their low cost advantage. As Porter (1980)[293] suggests:

"Cost leadership can impose severe burdens on the firm to keep up its position, which means to reinvesting in modern equipment, ruthlessly scrapping obsolete assets, avoiding product line proliferation and being alert for technological improvements. It is relying on scale or experience as entry barriers. However, technological change can nullify past investments or learning; low-cost learning by industry new comers or followers, through imitation or through their ability to invest in state-of-the-art facilities; inflation in costs that narrow the firm's ability to maintain enough of a price differential."

SLAC has achieved cost advantage through large volume orders and cost minimisation on labour, manufacturing facilities and land. This strategy gives SLAC a short term sustainable competitiveness in price. In the long run, it is very susceptible to lose its competitive advantage and engage in a price war, which it will struggle either on the margin of survival or shakeout of competition (Johnson and Scholes, 2002)[294].

The key spiritual values that drive the state-owned enterprise, at the management level in particular, are '*Loyalty and Consistency*' with the Communist Party, the central authority. It is an inviolable principle and a prerequisite above the business orientation of LTG. Without this premise, everything is meaningless and irrespective. Party meetings are held routinely and are as many as business operation meetings. Ad hoc activities assigned from the Central Committee of the Communist Party reinforce the education of 'Loyalty and Consistency' on a frequent basis and they constitute a core part of LTG's enterprise activities. This special character predominantly distinguishes the state-owned enterprise from the other three types of business venture. Such driving belief is decisive to how managers prioritise their time and work; it also unravels an important reason why the state-owned enterprise is slow to react to market changes. Such constantly imposed Party education moulds employees' values and this inevitably has an impact on management philosophies and behaviours. The top managers seek for infallible performance and short term returns other than long term investment. Such management philosophy is deeply embedded in both state

[293] Porter, M. E. (1980), *Competitive Strategy: techniques for analyzing industries and competitors*, The Free Press, New York, p45.

[294] Johnson, G. and Scholes, K. (2002), *Exploring Corporate Strategy*, 6th ed. FT Prentice Hall, England, p320-322.

administration mechanism and performance assessment systems. It is not surprising that prudent and myopic behaviour are in favour of managers in state-owned enterprise. Too many constraints and intervention from the state administration gives little versatility to the operation and practice of state-owned enterprises. It further explains the style of management in LTG. Bearing in mind market values that require entrepreneurship and risk, there is an inevitable conflict of cultures within the enterprise as a whole. Take the recruitment system as an example; the state-owned enterprise has no choice but to opt for a closed-internal allocation of recruitment because of its deeply embedded political hierarchy culture. Anyone who would like to survive in the state-owned enterprise must make a compromise in matters of political needs. Such an inexorable underpinning culture and values will inevitably confine further reforms on market-driven management. Although reshuffle reforms instantly ameliorate the status quo of state-owned enterprise, it is likely to encounter a plateau afterwards.

The management philosophies of the owner entrepreneur in Dali, the privately-owned enterprise, focus on the importance of family culture and showing democracy, consideration and respect to all employees. The work climate is friendly and harmonious with little hierarchy, making employees feel psychologically comfortable. The owner entrepreneur tries to share the attitudes of his employees by educating them to have the right values so they cooperate and comply with his direction and decisions. The proprietor is the centre of a power culture and imposes total control throughout the whole organisation. This is similar to how Handy (1993) [295] describes a power culture.

"It depends on a central power source with rays of influence form the central figure throughout the organisation. Control is exercised from centre by the selection of key individuals. There are few rules and procedures, and little bureaucracy."

But also the business prides itself on having a strong learning culture. This is strongly promoted in the company by the owner entrepreneur. Peter Senge (1999)[296] even observes that learning organisations can only be built by leaders with fire and passion. Timmons (1999) [297] says successful entrepreneurs are 'patient leaders,

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295 Handy, C. B. (1993), *Understanding Organisation*, 4th Ed., Penguim, London. P23.
296 Senge, P. (1999), 'It's the learning: the real lesson of the quality movement', *Journal for Quality & Participation*, 22 (6), Nov/Dec1999, pp. 34-40.
297 Timmons, J. A. (1999), *New Venture Creation: Entrepreneurship for the 21st century*, Irwin/McGraw-Hill, Singapore.

capable of instilling tangible visions and managing for the long haul. The entrepreneur is at once a learner and a teacher, a doer and a visionary.' Being a learner and a teacher are two of the prime tasks for a leader in a learning organisation (Burns, 2005).[298] The owner of the Dali entrepreneurial firm frequently arranges field-visits to advanced companies nationwide and actively joins industry associations, in order to find ideas for continuous improvement. His approach is more pragmatic and direct perception can be reached compared to the traditional training courses. He constantly educates his employees and stresses the importance of learning and improving their working practices. Such a learning culture has led to innovations in the quality control system and marketing. Burgoyne (1995)[299] says that a learning organisation facilitates the learning of all its members and continuously transforms itself. Garratt (1994)[300] views learning organisations as essentially liberating and energising and as crucial for organisational survival and growth.

In like manner, the organizational culture in the foreign joint-venture (DSF) is constructed as distinctive learning and knowledge-based; it is keen on renewal of itself constantly. Learning is reinforced through constant training programmes. The willingness and exigencies to learn new things have become both formal and informal norms for staff. The manager entrepreneurs of DSF are also the advocators and preachers for the dissemination of brand connation and promotion of a learning culture. The goal of the company is shared by all employees, which is described as "*In pursuit of the high and the beyond*". "*The High*" is defined to be the highest profile brand in the world; "*the beyond*" is denoted to develop Sunfed to be a hundred year enterprise with a solid foundation. This organisational goal reflects its ambition and long term development vision, while the spirit of "being the best" inspires employees. Rich cultural connotations and legend under the brand, express a prolific brand personality and value, which gives customers an emotional experience that builds the company's competitiveness in a way hard to intimate by its competitors. The top managers play a valuable role in teaching and educating employees to the extent that their values and philosophies have changed employees' behaviour and mentality. They promote a high profile style of quality of life, encouraging employees

298 Burns, P. (2005), *Corporate Entrepreneurship: building an entrepreneurial organisation*, Palgrave Macmillan, New York.
299 Burgoyne, J. (1995), 'Feeding minds to grow business', *People Management*, 1 (22), Nov1995, pp. 7-15.
300 Garratt, B. (1994), *The Learning Organisation*, Harper Collins, London.

to pursue excellence. Knowledge is highly respected in this company and creativity and innovation in marketing and technology are a key focus in employees' education. This is the key value in the company's culture that creates an environment to develop employees' capabilities, encouraging their creativity and innovation. An emphasis on autonomy to staff is regarded as an essential philosophy underpinning DSF's management to activate employees' potential, which is a precondition to achieve high performance in the market. The philosophy of performance management is to stress self-oriented result-driven performance.

To sum up, the privately-owned and foreign joint-venture enterprises are the organisations in possession of strong learning cultures, which are in sharp contrast with the administrative culture in both the state-owned and collective-owned enterprises. As Hofstede et al (1990) [301] suggest the different dimensions of organisational culture discriminate between entrepreneurial and administrative organisations. Such contrasts are summarised in figure 8.1.

Figure 8.1 Entrepreneurial vs. Administrative cultures

Entrepreneurial (Privately-Owned Enterprise & Foreign Joint-Venture)	**Administrative (State-Owned Enterprise & Collective-Owned Enterprise)**
• Results-driven	• Process orientation
• Job-orientation	• Employee orientation
• Small and fluid	• Inflexible and institutional
• Open system	• Closed system
• Loose control	• Tight control
• Pragmatic	• Normative orientation
• Market driven	• Political driven
• Capitalist with market ideal	• Socialist ideal
• Low power distance	• High power distance
• Low uncertainty avoidance	• High uncertainty avoidance
• High risk taking	• Low risk taking

Source: original source is adapted from Hofstede et al (1990), with amendment according to the author's findings in case studies.

[301] Hofstede, G., Neuijen, B., Ohayv, D. D. and Sanders, G. (1990), 'Measuring organisational cultures: a qualitative and quantitative study across twenty cases', *Administrative Science Quarterly*, 35 (2), Jun1990, pp285-316.

8.1.7 Skills

Skills refer to the distinctive capabilities of key personnel and the firm as a whole, which form the core of competitive advantage that firms are keen to sustain. In line with resource-based theory (Grant, 2005)[302], a firm's strategic capability is underpinned by the resources available to an organisation. From a strategic perspective an organisation's resources include both those that are owned by the organisation and those that can be accessed to support its strategies. These can be classified as physical resources (e.g. machines, buildings or production capacity), human resources (e.g. knowledge, skills of people and adaptability), financial resources (e.g. capital, cash, shareholders and bankers) and intellectual capital (e.g. patents, brand, customer database and partner relationship). Amongst these, human, intellectual and reputational assets are more often difficult to imitate, and so can be the source of competitive advantage (Haberberg and Rieple, 2001)[303].

Independent management autonomy is now demanded in state-owned enterprises and is the most significant change compared to the former socialist command model. Ownership diversity and involvement in market competition have diluted the old ideology of the planned economy, requiring entrepreneurship and institutional innovation in management. This is a demanding task for the managers of state-owned enterprises. LTG as a state-owned enterprise has some special advantages that the other types of ownership enterprise do not have. Benefiting from its long history of development, state-owned enterprises have trained a large number of professional teams and experienced specialists in core businesses which form the elite of the organisation with expertise and loyalty. Moreover, state-owned enterprises also have privileged access to other types of resources, such as capital, land and labour. Especially, access to the capital market in China is still limited; the major banks dominating the capital market are state-owned banks that favour more state-owned enterprises over other types of enterprise. Furthermore, the Communist Party and administrative authorities are powerful agencies which can provide many concessions and favours for state-owned enterprises. Such issues associated with government-controlled resources are very demanding for other types of enterprise. For instance,

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[302] Grant, R. M. (2005), *Contemporary Strategy Analysis*, 5th ed. Blackwell Publishing, Oxford, p152-159.

[303] Haberberg, A. and Rieple, A. (2001), *The Strategic Management of Organisations*, FT Prentice Hall, London, p248-252.

free access to capital and loans is a common problem for all privately-owned enterprises, and policy discrimination creates higher entry barriers for private ownership; for example, the granting of export and import licenses.

Following the rapid pace of economic growth, state-owned enterprises have attempted to become more market focused. In order to build up its competitiveness, LTG has adopted a diversification strategy in the attempt to utilise its resources as a defence response to external changes. LTG had purchased and merged other dying companies and further invested in state-of-the-art dye technology and equipment. This buy-out had its dual purposes, as not only did it help out another state-owned enterprise to avoid bankruptcy but also it gained greater control of wider industry chains. Guided by its diversification strategy, LTG has also invested on other areas such as real estate and logistics transport to increase its competitiveness. According to Theodore Levitt's (1968)[304], as a solution to external changes, companies should define their served market broadly rather than narrowly, which explains why LTG has set upon its diversification investment strategy.

'*But such broadening of the target markets is of little value if the company cannot easily develop the capabilities required for serving customer requirements across a wide front. Evidence suggests that serving broadly defined customer needs is a difficult task and created serious management problems.*' (Grant, 2002)[305]

As its businesses scope has widened, the top management of LTG has experienced a shortage of capable talents to run their divisional businesses suffering lack of skills in human resource management. Due to constraints in rewards and performance assessment system, LTG is unable to retain its core competences – those highly skilled talents. Some have left the state-owned enterprise and become competitors in the same industry. The current imperative task for the state-owned enterprise is to build an entrepreneurial culture throughout the corporation which can facilitate the growth of 'intrapreneurs'. As Burns (2005)[306] defines "*the term 'intrapreneur' is used to describe the individual charged with pushing through innovations within a larger organisation, in an entrepreneurial fashion. They are entrepreneurs in larger organisations.*" The emerging market economy requires a strong entrepreneurial

[304] Levitt, T. (1968), *Innovation in marketing: new perspectives for profit and growth*, Pan Books, London.
[305] Grant, R. M. (2002), *The resource-based theory of competitive advantage: implications for strategy formulation*. In Segal-Horn, S. (eds) *The strategy reader*, chapter 9, Blackwell, UK, p181.
[306] Burns, P. (2005), *Corporate Entrepreneurship: building an entrepreneurial organisation*, Palgrave Macmillan, Hampshire, p134.

culture and the injection of new human resources is necessary for long term development of state-owned enterprise. Transformation from conventional personnel management to a market-driven human resource management is a tough challenge for state-owned enterprises under the ideology of socialism. Their intrinsic recruitment systems are certainly in need of change to free market mechanisms. However, for reasons regarding tradition, authority and relationship culture, the transition to an open recruitment mechanism will inevitably engender great tensions in the power structures of state-owned enterprises. The current status quo of state-owned enterprises does not encourage entrepreneurship neither intraprenership. Some top managers and bureaucrats inevitably resist change – even if it is ultimately in their own interest. They will even resist it to the point of trying to sabotage it. As Kirby (2003)[307] suggests that this could because:

- *They think it will have a negative impact on them;*
- *It affects their social relationships within the organisation;*
- *It means long-standing habits have to be changed;*
- *The needs for and benefits of change have not been properly communicated;*
- *Structures, systems, rewards are not aligned with the changes and inhibit them;*
- *They feel coerced, not in control.*

These reasons for resistance to change seem to be the case in the state-owned enterprise case study, which are also the source of management tensions. To overcome this, the state-owned enterprise will need to develop a shared vision for the future and communicate with different levels of employees more effectively. Rewards and performance assessment need to be altered to fit the need of intrapreneurs. A learning culture needs to be put in place to facilitate innovation and corporate entrepreneurship. (Lambing and Kuehl, 2007)[308] Although the state-owned enterprise may experience a 'control-crisis', it would be a necessary growth process that cannot be avoided (Haberberg and Rieple, 2001)[309].

In the case of the collective-owned enterprise, its skills rely on two groups of experts. One is the private owners who have the marketing capability to get orders/contracts for the manufacturing base. The other is the production group in

[307] Kirby, D. (2003), *Entrepreneurship*, McGraw-Hill Education, Berkshire, p148.
[308] Lambing, P. and Kuehl, C. (2007), *Entrepreneurship*, 4th ed. Pearson Prentice Hall, New Jersey.
[309] Haberberg, A. and Rieple, A. (2001), *The Strategic Management of Organisations*, FT Prentice Hall, London.

possession of expertises in technology and production skills. They guarantee the quality and delivery of product and form an important core competence of the organisation. Nonetheless, due to lack of marketing skills, they have to depend on the private entrepreneurs to provide orders and customers. The absence of a proper reward system generates low motivation among staff in this collective-owned enterprise. The objective of management is to improve employees' motivation but the reality is far from this goal. As the complexity of technology progresses and the number of employee increases in the near future, human resource management will be a major issue for SLAC. An increase in wages and improvements in work conditions will be the demand of labourers. The battles between the different interest groups will expand to the first line labour defending their legal rights. This type of business venture reveals many of these tensions and conflicts. Property ownership is a main focus of change in the transformation to a market economy, and this inevitably affects managerial behaviour and organisational processes. It is evidenced that ownership clarification needs to be manifested in this business venture to release increasing tensions.

The privately-owned enterprise, as an entrepreneurial firm, has successfully exploited opportunities in the cashmere market place. Within ten years, it has developed its own featured capabilities and skills in the market. These core competences in Dali enterprise are analyzed in terms of: leadership, business reputation and networked resources, and technology in machanisation. The leadership is the most important competence in this entrepreneurial business, as everything depends on the proprietor's preferences and capabilities. As a successful entrepreneur, the owner demonstrates his high capability, charisma and wisdom. He is the determining factor for the fate of this organisation and his strong leadership is an incontrollable competitiveness. His entrepreneurial qualities definitely account for the strength of the business. The strategic focus and intuitive vision and sensitivity allow him to find opportunities in the market. His flexible and informal structure with quick decision-making processes allows him to swiftly respond to market trends. He leads an adaptive and organic firm and cultivates a strong learning culture to facilitate innovation and constant breakthrough. However, as their businesses grow entrepreneurs face challenges and problems as the nature of their organisations change. The more rapid the growth, the more difficult this is. Entrepreneurs have to change the way they operate – recruit reliable managers, delegate to them and control and monitor their performance. The organisation must become more formal and to a certain extent some formal rules and processes need to be applied and built into the structure and systems so that the implementation of complex tasks can be predicted and monitored. The privately-owned entrepreneur is likely to face up to the next growth phase of his company – 'autonomy crisis' and 'control-crisis' as Greiner (1972)[310] suggests in his growth model for the entrepreneurial firm. Particularly, entrepreneurs generally have a strong internal locus of control, which means that there is a danger they will be unable or unwilling to delegate responsibility to their management team. The entrepreneur needs to shift the company's dependence from a brain to a think tank. The leader then faces a crisis of autonomy that will only be addressed by putting a management team in place and delegating work to it. Growth in this phase comes because the team is in place and effective delegation is taking place. The business is no longer a one-man-brain. However, there is always the danger that delegation becomes abdication of responsibility and, as the firm continues to grow, there is a loss of proper control. Entrepreneurs will then encounter the next control crisis.

In the foreign joint-venture its core competences are gained by developing people and providing opportunity for self-actualisation. Such as the key staff in marketing, brand design, technology and the R&D centre mould inimitable skills in DSF. The open and learning culture facilitate its formation of distinctive capabilities as constant training and knowledge education help to overcome 'personal failure'. The Western culture and advanced knowledge in marketing and branding open the staff's view and raise their desire for learning. The use of foreign capital and its joint ownership gives it a competitive strength. Lack of skills and advance management and technical knowledge are common problems for most domestic firms. As The China Development Report on the Textile Industry (2004)[311] reveals:

"Chinese garment factories usually concentrate on labour intensive manufacturing work and low value added products. They lack marketing and branding knowledge to build high value added products, therefore, they are unable to become a R&D based industry but cluster in the low technology and labour intensity industries."

[310] Greiner, L. E. (1972), 'Evolution and revolution as organisations grow', *Harvard Business Review*, 50 (4), Jul/Aug1972, pp. 37-46.
[311] '*China development report of textile industry*' (2002/2003), compiled by China Textile Industry Associate, China Textile Publisher, Beijing, p52.

Foreign joint-ventures are effective ways of strategic learning for Chinese firms to shift their locus of low value adding to high value with knowledge advancement. Compared to the other three case studies – the privately-owned enterprise and the collective-owned enterprise, and even the state-owned enterprise that place their focus on manufacturing and outsourcing with low-value added products, the foreign joint-venture has a high profile in producing value-added branded goods. It reflects how this foreign joint venture operates on the basis of very different principles (derived from its US co-ownership) than the other three types of indigenous-owned case studies.

In view of the case study findings, the comparisons between the four types of ownership, as analysed by the McKinsey 7-S framework may be summarized as in figure 8.2.

Figure 8.2 Organisational Profiles of Each of the Four Case Studies According to The McKinsey 7-S Framework

	State-Owned Enterprise	Collective-Owned Enterprise	Privately-Owned Enterprise	Foreign Joint-Venture
Strategy	Cautious, diversification	Expansion through low-cost volume	Growth in capability	Brand Focus (market penetration)
Structure	Multi-divisionalised business units	Machine bureaucracy	Organic and entrepreneurial	Adhocratic and Professional
Systems	Closed Formal; institutional; personal connections	Closed formal; hierarchy	Informal and open	Combination of formal and informal; open
Staff	Professional and specialist; and political	Low-skilled; no individual development	Multi-roles; opportunities for individual development	Highly-skilled; high vision of personal development
Style	Administrative and bureaucratic	Hierarchical, impersonal; and exploitative	Adaptive and fluid	Open and entrepreneurial; knowledge-centred
Shared values	Political culture, socialist ideals	Mixed socialist and capitalist values; cost minimization	Market-driven; family-type management	Learning orientation; belief of knowledge power; self-actualisation
Skills	Expertise competence; technology and production capacity; access to finance	Production capacity; low cost leadership	Production capacity; expertise of team; capabilities of owner	Highly-skilled managers; knowledge advancement; brand; foreign capital

Evidence from the four case studies suggest different types of ownership, shape distinct dissimilarities in their organisational characteristics and management patterns. Environmental influencing forces, such as economic reforms, WTO accession, globalisation and competitors, are likely to impact upon organisational change and ownership evolution of each type of business venture (see chapter one). These form the social and economic conditions for a changing market socialism in which these four types of business venture have emerged.

The textile industry that the four types of enterprise operate within is a traditional industry with a long history that is a major contributor to China's export revenue. Since 1995, China has become the largest supplier of textile goods, taking approximately one sixth of the global share, and competing with other three major players: USA, the European Union and Japan. After WTO accession, world markets have opened up for China as quotas on textile goods are nullified. As a result, export quantities to WTO member countries have significantly increased. On the other hand, non-tariff and non-quotas barriers have been raised against China's textile goods. These have often taken the form of technical barriers, anti-dumping action, labour standards issues, specific permission requirements and administrative delays. As global competition becomes more severe, trade friction in textile goods with other countries is increasing. During the first half year of 2005, there was a total of 16 cases of this nature, when WTO member countries imposed specific requirements and administrative delays against China's textile trade. In responding to this, the Chinese government nullified export tariffs on 81 types of textile goods on 1st June 2005.[312] Nevertheless, as the effect of trade friction, exports to the United States and the European Union in 2006 have fallen by 60 percent and 35 percent respectively.[313] According to the agreements signed in 2005 between China and the EU, and China and the US, annual growth rates for the export of certain textile products is restricted to between 8 to 12.5 percent and 10 to 17 percent respectively until 2008.[314] "*Trade difficulties are going to be diversified and complicated with some frictions more difficult to cope with such as anti-dumping, social responsibility and technical barriers*" Zhang Li (2006).[315] Comments made by official responsible for the textile industry from the Bureau of Economic Operations under the National Development and Reform Commission (NDRU).

These influencing factors from international markets will inevitably have an impact on the strategy and organisational process of those enterprises involved in

[312] Lu, Qi (2006), *WTO Outline*, Shanghai Fudan University Press, Shanghai, p217.
[313] 'EU China Trade Brief', *Oxford Analytica*, November 2006.
[314] In June 11, 2005, China and the EU reached an agreement on the annual growth of exports to the European market for the ten lines of Chinese textile products from June 11, 2005 to the end of 2007. With an agreed base quantity, annual growth limits are set between 8 and 12.5 percent during this period.
In November 8, 2005, the US and China sign a three-year agreement. A total of 21 types of clothing and textiles are placed under import restrictions, and the agreement provides for progressive annual increases in imports of major textile and apparel products from China by 10 to 15 percent in 2006, 12.5 to 16 percent in 2007, and 15 to 17 percent in 2008.
[315] www.china.org.cn (accessed 26th February 2007) by Yuan Fang, May 26th 2006, China Internet Information Centre.

foreign trade. Furthermore, according to 'China Xinhua News' (2006)[316], the recent depreciation of the RMB has become a major issue for garment manufacturing companies in exports, as the trade requires a turnaround time of two to three months; a one to two percent fluctuation in profit margins is already factored in from the beginning. The revaluation of RMB and the likelihood that it will continue to appreciate in time to come has raised concerns for the continued competitiveness of China's textile industry, which has until now, been riding on its one market advantage; its low price. The appreciation of the RMB will have a long-term effect on those companies with a focus of international trade business. The state-owned enterprise (LTG) being an example; it will see its lucrative profit margin decline if the RMB appreciation continues by 5 percent. The average gross profits of the textile sector is approximately 5 to 10 percent. Since the majority of Chinese products are low-end and easily replaced, it would be difficult to expect foreign customers to absorb any extra costs. Evidence suggests that 'diversified investment' and 'specific high-technology development' have been the emerging shift-strategies for Chinese textile enterprises responding to these external threats. 'Home brand building', however, as a long-run strategy with a more advantageous competitiveness, is not prevalently adopted by domestic firms despite the Chinese government appeals to domestic firms to do so. The recognition of brands is scanty among the majority of domestic firms and mainly it is a result of poverty in knowledge and management theory. The literature on Chinese management still remains meagre which raises the demand for rich theory development to guide and direct practices. Moreover, the financing of the private sector and knowledge dissemination system is not well developed and industry infrastructure and government advocacy to promote 'home brands' still has a long way to go. It will be a challenge for the Chinese government to change its administrative role from that of 'support' to effective policies that will re-adjust the infrastructure of China's industries and its regulatory environment.

8.2 The Development of Market Socialism in China: Some Emerging Trends

8.2.1 Future Perspective of Chinese Economy

316 http://news.xinhuanet.com/english/2007-02/08/content_5715808.htm (accessed 26th February 2007) 'China's textile factories earn less than national industrial average', by Yuan Liang, *China View, Xinahua News*, February 8th 2007.

Over the last two decades, China has been remarkably transformed from a socialist planned economy to a market-oriented economy. Market socialism is constantly changing towards the trends of globalisation and further marketisation. Confronted with ever intensifying international competition, enterprises in China (whether state-owned or not) have to make constant adjustments in order to keep abreast with these ever changing market conditions. The Chinese government has deepened economic reforms in the state sector and made further melioration of the regulatory conditions for foreign investment in 2006. For instance, barriers in the financial service and banking sectors are being lifted for foreign capital entry and an amendment on the Foreign Enterprise Law allows wholely-owned foreign enterprises to set up in China. The new Foreign Trade Laws that were implemented in 1st July 2004 allows for the full entry of collective-owned enterprises and privately-owned enterprises to engage in foreign trade. During 2001 to 2005 domestic firms with licenses for foreign trading have dramatically increased from 45,000 to over 200,000.[317] After the 16th National Congress of the Communist Party convened in November 2002, some laws and regulations which are consistent with international practice and beneficial to the development of the national economy were put forward to ensure compliance with international arrangements. Policies and regulations which discriminate against the development of the private sector will gradually be abolished, to be replaced by those amended and improved to support and encourage the development of private enterprise. China's accession to WTO and the promulgation of policies for attracting foreign investment will inevitably trigger off an influx of transnational companies into China, intensifying the impact on China's domestic enterprises. After 24 years of reform and opening-up, many world-known transnational companies (e.g. Motorola, Siemens, Alcatel, Nokia, Philips and General Motor) have established joint-ventures and wholely-owned enterprises in China. They have achieved fabulous success in the Chinese market, as the market-oriented reforms in China is a powerful statutory support to their efforts in developing world markets. These companies are witness to the development of Chinese market socialism, significantly influencing China's economic development and facilitating 'learning from the best practices' for domestic firms. Continuous promotion and attraction for foreign direct investment will be pursued by the Chinese government which will lead

[317] *China Foreign Economy, Trade, Co-operation and Enterprise Yearbook (2005)*, Compiled by China International Trade Promotion Committee, China Commercial Press, Beijing, p269.

to ever-more fierce competition between China's enterprises and large foreign-owned enterprises on the domestic market. It is expected that the role of the non-state-owned sector in China's economic development will continuously be reinforced, and will make further contribution to the growth of the national economy. It is likely that market socialism is changing to market capitalism; the "Socialist ideal" will be diluted and eventually replaced by "market ideals".

8.2.2 Future Trends of The Four Types of Business Venture:

The current status of the Chinese economy is clearly divided into two major dominant sectors – state-owned and private. The state-owned sector includes those state-owned and controlled enterprises while the non-state-owned sector comprises collective-owned, privately-owned and foreign-invested enterprises. Comparing these three emerging forms of private business venture, the foreign joint-venture and the privately-owned enterprise appear to have greatest growth potential. Both two types have strong entrepreneurial learning cultures and high market orientation. Foreign joint-ventures benefit from access to advanced knowledge, capital and technology to facilitate their growth and competitiveness. These influences also shape the 'behaviour model' of managers in these organisations, which increasingly mould the formulation of organisational processes in terms of their strategies, systems, structures, cultures, human resources, and product portfolios. As a consequence, innovation and entrepreneurship are becoming the foundation of their competitive advantage. The two types of enterprises all reflect innovation in the following areas which Schumpeter (1996)[318] describes as:

- Constant introduction of new or improved goods or service(s);
- Constant introduction of new processes in service delivery systems; new production, marketing, sales, distribution and supply chain management systems;
- Opening up new markets in either overseas or domestic segments
- Identification of new sources of supply of raw materials
- Continuing adoption of new technologies

While foreign joint-ventures are built on knowledge-based processes which allows them to develop higher value-added products, privately-owned enterprises are

[318] Schumpeter, J. A. (1996) *The Theory of Economic Development*, Transaction Publishers, New Jersey.

comparatively disadvantaged in this respect. However, they can overcome this flaw by attracting highly-skilled talents to develop more knowledge-centred product profiles. This trend increases the demand for a supply of graduates and skilled capable managers. The problem is, that at this present juncture in its development, there is a scarcity of such talent in the Chinese labour market.

The trend of marketisation of state-owned enterprises is towards corporatisation and diversification. A new management system for state property was established in 2003 together with the issuance of relevant laws. In the days to come, except in some special fields (national security and vital economic significance), large and medium size state-owned enterprises will mostly be transformed into non-state-owned but state-controlled enterprises. State-owned enterprises are now more market-orientated in respect of price setting. However, there are still some significant non-market elements in corporate governance and internal management. For instance, "closed" recruitment mechanisms, leading not only to senior management being subject to government appointment or removal, but also staff who are often selected by "who-they-know" internally through a political hierarchy. Moreover, inconsistent performance assessment systems with government stipulated reward standards demonstrate the non-separation of government from enterprises management. As state-owned enterprises will face severe competition from both domestic entrepreneurial firms and foreign firms, their inflexibility and constraints from the administrative culture will ultimately hinder their growth and competitiveness. They will decline if future reforms in innovation and entrepreneurship cannot provide significant remedies. Undeniably further reforms on corporate entrepreneurship will be a huge challenge to change the behaviour model of the 'socialist ideals' of state-owned enterprises.

Collective-owned business ventures are likely to fail in the future. They will evolve into private ownership. The contradiction between the interests of different owners in this type of business venture is irreconcilable. The collective-owned enterprise is a special historical legacy that will gradually decline under market socialism to be replaced by private ownership. As competitive conditions continue to change both the international and domestic markets, the impact will be addressed by this type of enterprise, relying on overseas orders and only producing low-value added goods on a low-cost advantage.

Evidence provided by the case studies show that labour unions play a dependent and weak role in the power structure in the state-owned sector while their function in the non-state-owned sector is non-existent. The rapid growth of the Chinese market economy has given a rapid rise to a private sector which has yet to develop a code of business ethics and corporate social responsibility (McEwan, 2001; Ying, 2002)[319].

8.2.3 The Role of The Communist Party in China

The relationship between governments and markets is a concern in all countries. The role of government is to create a favourable environment for fair competition for businesses by means of macroeconomic control. Compared to the governments of Western countries, the Communist Party in China plays a different role in developing the market economy. China's market socialism is the result of government policy shifts from the traditional socialist planned regime. It is also a process leading the Communist Party to gradually change its functions; to decentralise its administrative control; to reduce the size of government; to reform the economic administrative system and to create a dynamic market economy. In the coming decades, China's political agenda will be focused on developing strategic international relations with United States, Russia, the EU, Latin America and Africa; controlling interest conflicts and territory tensions with Japan, Taiwan and North Korea. Energy scarcities will also place an imperative task on the Communist Party as the country searches for new sources of energy in the near future. As Richard Scase (2007)[320] points out: "*China's huge thirst for oil could persuade it to engage in economic imperialism, especially in Africa where it is already buying companies and supporting many governments with its aid programmes.*"

Market socialism is characterised as socialist ideology with market forces. The state-owned sector is still a major share of the economy and this reflects the political will. Tensions between 'state' and 'market' socialism become prominent when market reforms go so deep they touch the political and cultural underpinnings of the political regime. Market socialism comprise both opportunities and problems which generate complexity and diversity in its unique market structures. Understanding these dynamics of market socialism is important for understanding business practices.

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319 McEwan, T. (2001), *Managing values and beliefs in organisations*, FT Prentice Hall, London.
Ying, Hong (2002), 'Business ethics: is it useful? – an empirical study of Chinese enterprise' *Business Ethics: A European Review*, 11 (4), Oct2002, pp. 335-342.

320 Scase, R. (2007), *Global remix: the fight for competitive advantage*, Kogan Page, London, p150.

8.2.4 Final Remark:

Some Comments on The Present Research

Our research has focused on four types of emerging business venture under market socialism in China. They are the offspring of market reforms that have evolved from the legacy of state socialism and the command economy. Such ownership forms shape the character of businesses as they participate in the market economy. As Haberberg and Rieple note: "*As most organisations are subject to a range of stakeholder influences, stakeholders shape an organisation's objectives and also the yardsticks that are used to access its success and failure. Also different stakeholder groups can be a powerful influence on the extent to which an organisation can change its strategy.*" (Haberberg and Rieple, 2001)[321] Our case studies have shown how different ownership forms shape a diversity of management practices.

However, there are some issues about the present research that need to be emphasised. These may be considered as follows:

(a) The textile industry was selected as the context for the case studies because of its critically significant role in market reforms in China. Compared to other industries, the textile industry was the pioneer in market transition, and it also experienced the greatest impact of China's WTO accession. Businesses operating in this industry reflect state-of-the-art trends in terms of the implementation of market economy reforms. Therefore, the industry was appropriate for studying emergent forms of business ownership and their impact on management practices.

(b) There are shortcomings in this research associated with the role of case studies in producing valid theories. The use of case studies is still controversial in management research, 'the case study has long been stereotyped as a weak method; but it can only be a rigorous method of research if the researchers follow the principles and structured procedures' (Yin, 2003)[322]. The measurement problem, 'a small number of cases and big conclusions', often raises questions of generalisability

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[321] Haberberg, A. and Rieple, A. (2001), *The strategic management of organisations*, FT Prentice Hall, London, p6.
[322] Yin, R. K. (2003), *Case study research: design and methods*, 3rd ed. Sage Publications, London.

of findings (Lieberson, 1985)[323]. This is the case with the present research and is, indeed, a factor that has to be taken into account when interpreting the findings. But case studies allow for the analysis of complex issues. The complexity of these in the case studies was managed by using the McKinsey 7-S framework, providing an analytical framework for understanding qualitative data. Since the vague nature of qualitative information is a major problem of case studies, this can be overcome by structured data collection. This is what we have tried to do in this research.

According to emerging forms of business ventures we identified in our literature review, four case enterprises were selected to represent four types of ownership under market socialism. The aim of this study was to explore the main characteristics of each of these types of business venture and discover the impact of ownership on management processes. Not only were structured questionnaires used to collect in-depth and wide ranging data, but also multiple sources of evidence were utilised to minimize the risk of researcher bias. By comparative analysis across four cases, differences and similarities were analyzed in order to examine the impact of ownership. Four cases were described in detail in order to depict their rich organizational profiles so that differences in their management processes could be identified. The four cases were selected as typical representatives of four emerging forms of ownership; 'typicality' of cases is a fundamental criterion for the selection of a small number of cases. It may not cover all the variety of ownership forms, but as typical representatives, the likelihood of generality can be obtained to a certain extent. For instance, the common characteristics of state-owned enterprises distinguish them from privately-owned enterprises. Collective-owned and foreign-joint ventures also demonstrate critical contrasts. Each type of business venture represents distinctive behavioural patterns and organizational profiles due to their different ownership forms. These are generalisable and applicable to other enterprises with similar ownership forms. Nonetheless, the limitations of a small number of cases are inevitable as they cannot cover the whole variety of management practices under market socialism. We are aware of the complexity and diversity of ownership restructuring accompanying rapid enterprise development in these changing market conditions. Case study research only provides a glimpse of such dynamics. Further research on ownership

[323] Lieberson, S. (2000), 'Small N's and big conclusions: an examination of the reasoning in comparative studies based on a small number of cases', in Gomm, R., Hammersley, M. and Foster, P. (2000), *Case study method*, (eds). Sage Publications, London.

impact will compensate for this limitation by using mixed methods of data collection; both qualitative and quantitative.

(c) The use of the McKinsey 7-S framework played a key role in the study of our cases. It comprises seven elements for describing and understanding an organization as a whole. The 7-S framework is not merely an analytical tool; it also serves as a conceptual underpinning to indicate what range of information needs to be collected. Each S-factor can be operationally stipulated and used for measuring key organisational variables. However, these factors interact and explain each other; they cannot exist alone. This feature facilitates the analysis of management processes for an 'interaction effect' of all the variables that make up a comprehensive explanation. Other successful applications of this framework are evidenced in Peters and Waterman's 'In Search of Excellence' (1982) and Pascale and Athos' 'The Art of Japanese Management' (1986). It can be very useful when applied to understanding an organization as a whole. It almost covers every aspect of management providing a systematic analysis to cutting through the complexity of an organization. However, it demands full access to organizations and high 'time-energy cost' in fieldwork. The enterprise must be open to this research which often raises issues of confidentiality. Moreover, it requires access to a wide range of information from informants, and sufficient time and energy to devote to interviews and observation. We have experienced in our fieldwork the patience and time needed to conduct case studies. We revisited our key informants more than three times to complete our questionnaires and each time spending more than one hour for each of these interviews. This places a high demand on the co-operation of case study companies. It would not be realistic to conduct such research without the commitment of CEOs and managers. Our research benefited from this advantage.

(d) This present research is entirely focused on qualitative analysis. Our research needed to explore how organizational processes work and how owners and managers behave in each type of business venture. It needed to analyze the 'interaction effect' among seven elements (strategy, structure, systems, staff, style, shared value and skills) of our case study organizations. People's perceptions and points of view needed to be examined; strategies and systems needed to be described; decision making processes and leadership style had to be portrayed. All of these required a quality approach. How these management processes operate demands a qualitative case study approach. Quantitative research is unable to explore these organisational processes in depth.

(e) In the selection of case studies for this research, ownership is the main dimension of examination as the distinctive characteristic of each pattern of business venture. Size and scale of organization that may possibly affect management processes and strategies have been neglected. Due to historical reasons, state and collective-owned organizations are larger and enjoy economies of scale. Private firms, particularly entrepreneurial firms, tend to be small because of the late emergence of market reforms. Thus, the ownership is the main focus throughout the entire analysis; the 'size effect' is reflected in organisational processes – structure, strategy and systems – and as a variable to examine, but it is not treated as a criterion of case selection. In the author's point of view, 'size' is also determined by owners' interests and their different strategic visions.

(f) The data was collected in the Chinese language. Some meanings may get lost in the process of translation from Chinese to English. The author's cultural background may unconsciously influence data interpretation. It is impossible to control for this and represents one limitation of the present research.

Future Research

The agenda for further research should focus on the relationship between innovation and entrepreneurship to ownership forms. Our present work has studied some emerging trends of ownership formation and the impact of these for organisational profiles. Further research should explore the competitive effect of ownership diversification, addressing the importance of innovation and entrepreneurship in both state and private sectors. Ownership diversification, as the main strategy of market reforms, has dramatically changed the structure of market forces and successfully created a market orientation in enterprise management. Through ownership diversification practices, enterprises are expected to develop their competitiveness and create market-oriented management to fit in with changing market conditions. Rather than examining the general patterns of emerging forms of enterprise, the focus of research should be on the causal effect of ownership diversification for the competitiveness of enterprises. In China, deregulation, privatization, internationalization and technology advancement demand that all types of enterprise should build their competitiveness in order to survive in the new market situation. The generation of new ideas and development of new products and services is crucial for the constant renewal of organizations. Linking the effects of ownership diversification, this future research needs to explore how innovative and entrepreneurial activities in different types of organization result in entrepreneurial spin-offs, new products and services. Such research needs to develop concepts and methods for creating organizational cultures that facilitate the development of innovation and entrepreneurship. The barriers and facilitators to the generation of innovation and entrepreneurship need to be identified. In addition, correlations between internal entrepreneurial characteristics, attitudes and opinions, with external environmental influence need to be tested across the private and state sectors. This further research needs to consider how changes in property law can be supportive of entrepreneurial development.

One crucial issue in case study research is how to gain access to companies to conduct empirical investigations. Cooperation is vital if there are to be interviews with key staff and owners (ideally), access to financial information, company documents and the ability for direct observation. Gaining access to desired case companies has been a major constraint in most case studies research. Companies may be willing to answer survey questionnaires but case study investigations require direct access to internal organizational processes, meeting key staff and participating in their work activities. Documentary information that reflects their policies, regulations, and systems also need to be available to the researcher. Such data is almost impossible to access in most companies as it touches upon commercial confidentiality and political sensitivity. It is particularly the case in China and especially in state-owned enterprises because of the state administration and political confidentiality. The Administration and Inspection Committee of State Assets" (AICSA) is a powerful government agency which centralizes the administration of all state-owned enterprise in China. It explicitly stipulates that state-owned enterprises are forbidden to expose any internal information to external bodies. Managers in state-owned enterprise will rarely risk their careers by breaking such political rules. Gaining full access to a state-owned enterprise has been a major achievement in the present research. Full access to case study companies is a key factor in determining the success of qualitative management research, besides factors such as limited budgets and time-energy costs. In fact, access to companies is one of the major challenges facing those who wish to do management research in China. In this, we succeeded when many others have failed.

More research is required to explore the changing dynamics of management practices as government reforms continue to change the conditions of market socialism in China. The literature on Chinese management, generated by empirical case study research is meagre. Our intention in this research was to explore, if only by reference to a small number of case study enterprises, some emerging trends. If this stimulates more detailed studies of evolving ownership forms and the effects of these for management practices under Chinese market socialism, this research will have served its purpose.

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Appendix -1 Major Reforms Between 1994 – 2004[1]

1994 The system of tax distribution

The system of tax distribution financial system initiated in 1994 contains mainly the division of the post-tax-reform 18 tax categories into central and local taxes and the sharing of tax revenues between central and local authorities. At the same time, two taxation authorities were set up wherein the central and local governments levy and manage taxes separately. The direct result of this reform was that the proportion of the central financial income to total financial revenue rose from 22 percent in 1993 to 52.2 percent in 1995, to 54.93 percent in 2002 and further to 57.47 percent in 2003.

The merger of exchange rates

At the end of 1993 China decided to carry out reforms of the exchange rate mechanism. The merger of exchange rates was introduced to the Renminbi (People's Currency). On January 1, 1994, the dual exchange rate was changed into a single managed floating exchange rate system. The post-merger exchange price quotation was fixed at one US dollar against 8.7 yuan. From that time until December 2003, the conversion rate of Renminbi to US dollar appreciated by about 5 percent in 10 years.

1995 Modern enterprise system

At the forums held respectively in Shanghai on May 22, 1995 and in Changchun on June 26 the same year, Jiang Zemin delivered speeches, calling for reinforcing confidence, clearly setting tasks and actively promoting state-owned enterprise reform. He said the basic characteristics of the modern enterprise system are summed up in four sentences "distinct property rights, clearly defined rights and duties, the separation of government administration from enterprise management and scientific management", they are an interrelated integral whole and must be fully and accurately understood and implemented.

1998 Proactive financial policy

In 1998, in order to cope with the Asian financial crisis and prevent economic recession, the Chinese government adopted a proactive financial policy. The government got involved in market economic operation through a purposeful investment policy, designed to absorb precipitation funds, maintain economic aggregate and promote the restoration of "savings--automatic investment mechanism" by the "savings--government investment" method, but the actual result was manifested as a direct impetus to "savings--government investment--economic growth".

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[1] Source: 'Review: 13 keywords of economic reform', October 30, 2004, People's Daily Online. http://english.people.com.cn//200410/30/eng20041030_162190.html

Prudent monetary policy
In 1998, in order to cope with the impact of the Asian financial crisis and overcome the tendency of domestic deflation, and to coordinate the "proactive financial policy", the Chinese government introduced a "prudent monetary policy", which helped the Chinese economy to tide over difficulties and maintain a relatively rapid growth.

1999	***Debt-to-equity swaps***
In August 1999, the State Economic and Trade Commission put forward a concrete plan, condition and scope for debt-to-equity transfer and declared that the debt-to-equity work would soon start in China. At the same time the State Council approved the scheme of the Industrial and Commercial Bank of China, the Agricultural Bank of China and the Bank of China to establish the Huarong Assets Management Company, the Great Wall Assets Management Company and the Dongfang (Eastern) Assets Management Company respectively.	

2000	***Rural tax-for-fee reform***
In March 2000, the then Premier Zhu Rongji, in his "Government Work Report", pointed out that active efforts should be made to push rural tax-for-fee reform, so as to fundamentally reduce burdens on farmers, and decided that experiment on this be carried out in Anhui Province that year, and that experiences summed up there should spread to other places. In the year 2000, the total tax fee of farmers in Anhui Province was reduced by 1.69 billion yuan, with the rate of decrease reaching 31 percent, the charge of fees in rural areas tended to become standardized, and the phenomena of "arbitrary collection of charge, unchecked apportionment of expenses and abuse of fund-raising" was basically kept under control.	

Urbanization
On June 13, 2000, the CPC Central Committee and the State Council issued "Some Opinions on Promoting the Sound Development of Small Towns". The Proposal on the "10th Five-Year Plan" passed by the Fifth Plenum of the 15th CPC Central Committee in October pointed out: Raising the level of urbanization and transferring rural population can provide a vast market and sustained motivation for economic development. It is an important measure for optimizing urban and rural economic structures and promoting a virtuous cycle of the national economy and the coordinated development of society. The whole Party and people of the whole country should be told "to implement the strategy of urbanization without delay"

Implementing development of the western region	
On October 26, 2000, the State Council issued Document 33, and the Circular on implementing the policy measure for the development of the western region. The scope for application of the policy on western development encompasses Chongqing Municipality, Sichuan, Guizhou, Yunnan, Shaanxi, Gansu, and Qinghai provinces, Tibet, Ningxia Hui, Xingjiang Uygur, Inner Mongolia and Guangxi Zhuang autonomous regions.	
2001	***Reform of the administrative examination and approval system***
On October 24, 2001, the State Council held in Beijing a video conference on the work of reforming the administrative examination and approval system, making arrangements for accelerating the work of reforming the administrative examination and approval system. The main objective is to establish an administrative examination and approval system compatible with the social market economic system and realize institutional innovation through reform.	
2002	***QF11***
On November 7, 2002, the China Securities Regulatory Commission and the central bank jointly promulgated the "Interim Measures for the Management of Domestic Securities Investment by Qualified Foreign Institutional Investors [QF11]", which came into effect on December 1, 2002.	
2003	***Rejuvenating northeast China's old industrial bases***
On September 10, 2003, Premier Wen Jiabao chaired an executive conference of the State Council to discuss questions on implementing the strategy for rejuvenating northeast China's old industrial bases, putting forward guidelines, principles, main tasks as well policy measures for the rejuvenation. The conference pointed out: supporting the accelerated adjustment and transformation of northeast China's old industrial bases is an important strategic decision put forward by the 16th CPC National Congress.	
2004	***Green GDP***
GDP has its limitation, it reflects only economic development, but does not reflect the influence of economic development on the resources environment, thus making it easy to overestimate the economic scale and economic growth and giving people a distorted economic picture. Green GDP is a supplement to and perfection of GDP. Within 2004, the state has chosen six provinces and cities including Beijing, Jilin, Shaanxi, Guangdong and Shanghai as the pilot units to carry out green GDP accounting	

Appendix 2. Economic Development in China: A Brief Chronology

FOUR STAGES OF DEVELOPMENT	YEAR	IMPORTANT EVENTS
1st Stage Planning economy	1949	The Establishment of China
	1949-1957	The Chinese planning system evolved in the direction of copying the Soviet model, and progress was assisted by a sizable volume of Soviet aid.[1]
	1958	The 'Great Leap Forward' and the split with the Soviet Union.
	1959 - 1969	The 'Culture Revolution' started and the whole society was led into political crazy by Mao Zedong.
	1975	A statement of objectives: 'four modernization' – agriculture, industry, science and technology, defence, first put forth by Zhou Enlai.[2]
	1976	China's economic reforms were launched after the arrest of the Gang of Four in 1976. A weak foundation gained in agriculture.
2nd Stage Reform on De-collectivization & Privatization	1978	CPC 11th Central Committee made the decision to shift the policy stress to socialist modernization, and implement the strategic reform and opening to the outside world.[3]
	1984	CPC 12th Central Committee adopted the decision on restructuring the economic system, which signalled the elevation of the reform of China's economic system to an urban-centered stage.
3rd Stage Economic transformation to a market socialism	1992	The 14th National Congress of the CPC established Deng Xiaoping's theory of building socialism with Chinese characteristics as the guiding policy in China and put forward the goal of China's economic reform as establishing a socialist market economy system.
	1997	Hong Kong was returned. The 15th National Congress of the CPC stressed the non-public-ownership sector in part of socialist economy and essential production factors – such as capital and technology was participated in reform for bigger steps. The second generation of leader, Jiang Zemin has carried forward and deepened Deng's open theory since then.
	1998	The reform had gone smoothly in every aspect, and important progress and achievements had made in grain circulation system, SOEs, banking system, etc.
	1999	China's willingness and arrangement to WTO accession.
	2000-2001	Progress was made in restructuring SOEs. And China officially joined WTO.
	2002	A socialist economy is being set up, the basic functions of the market in resource allocation have been obviously strengthened, and the initial framework of the macro-adjustment and control system has taken shape. The form of economic growth is changing from the extensive to the intensive type. A great promotion is made to private sector.
4th Stage Market Socialism steps into political reform and economic globalization.	2003-2004	New leader government represented by Wen Jiabao has taken over and the Beijing/China's development model is recognized by the world and replace the Washington consensus. A political economy is in process of taking place. An attention to speeding up of banking sector and to the rural economy, and to revitalising the north-east.

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[1] Nove, A. (1991) *The Economics of Feasible Socialism Revisited*, Happer Collins Academic, London. P157.

[2] Thorelli, H. B. (1985) *Market Socialism in the People's Republic of China*, International Marketing Review, Summer85, Vol.2 Issue 2, p7, 8p.

[3] CPC is a breviary for The Third Plenary Session of the Communist Party Congress (CPC) http://www.asianinfo/chineseeconomy/economicrestructuring/ (accessed 12th January 2005)

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Appendix 3 Letter of Introduction to Fieldwork Research

调研计划介绍

我是英国肯特大学的博士生，正在研究的博士课题是关于‘中国市场经济下新兴四种类型企业的发展研究’。这项研究需要通过对具体个案的管理实践调研，了解四种类型管理实践在市场转型过程中的特点和所有权改变带来的影响，为企业管理理论模型提供依据。

此次的课题研究的意义和贡献在三个方面：*首先*，通过分析复杂的管理现象，找出其特点和规律性，尤其是所有权改变和企业管理发展之间的关系，对四种迥然不同的企业管理模式的特点进行分析研究，为完善和发展中国的管理理论，尤其是在组织行为学方面提供更多的理论和实践依据；*其次*，在第一步的基础上，对市场经济中出现的企业类型和管理模式的未来发展方向提出预测和政策上的建议；*再者*，由于快速但不平衡发展的市场经济，导致相对复杂多样化的管理实践与管理理论间的相对脱节，国际间的管理学术交流不发达，作为此次调研的另一重要意义，我们的研究结果将填补这项空白。

感谢贵企业的支持和合作，在实际案例调研中，我们承诺，应企业要求实行匿名制，企业信息和情况只应用于学术理论研究。调研程序安排如下：

I. 访谈企业总负责人 CEO/GM
II. 访谈相关部门负责人 KEY STAFF/MANAGERS
III. 年度报告及相关资料

调研结束后，我方愿意为贵企业提供一份分析报告，为管理创新和企业需解决的管理问题提供理论指导和建议，给您企业管理的未来发展提供与世界先进管理理念的接轨和比较。

此致，

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Introduction of Field Research

As a doctorate student and researcher, I am working on a research topic 'Emerging forms of business ventures in China'. Through case studies of management practices in China, the characteristics of different types of business ventures under economic reform and market transformation are to be explored, and their interactive relations between organizational change and environmental impact to be explained. The contributions of this research are reflected in three aspects:

First, through studying and analyzing the complex phenomena of managerial behavior, their characteristics and regularity are to be identified and explored. Second, based on case studies, emerging trends in management development are to be identified. Third, rapid but uneven development of market economy has led to a diversity of management practices, while a gap has emerged between managerial practice and theoretical conceptualization. There are few cases on the complexity of management practice under market socialism.

I would be grateful for your enterprise's cooperation and support in this field research. We promise to keep anonymity and confidentiality of the enterprise in the selection of case studies. All the information and data collected from the cases will only be applied for academic purposes and theoretical study.

Again, thank you very much for your anticipated cooperation and support. If you are willing to cooperate, please write to me/call me so that we can meet and I can give further details of the purposes of the research.

Yours sincerely,

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Appendix 4 Questionnaires

Part I. Questions to CEO/President[1]

(Referring to top management)

Externally, what kinds of opportunities and challenges does your enterprise encounter?

Internally, what kinds of problems and challenge does your enterprise face? (Weaknesses)

What is the strength of your company in the market?

As the economic reforms deepened, what is the most influential change the reforms have brought into your organisational development?

What is the history of the establishment and development of your enterprise?

Strategy （企业战略）

1. What is the long term strategy for organisational development? What is the goal for the next 5-year or 10 year? Do you have policy or plan to implement and realize these goals?

2. What is the short term strategy for your operation? What is your priority in organisational development? Which embody in divisional operating strategy? For example, marketing strategy in market and sales department? Manufacturing strategy in production department?

3. How does your company tackle with the change from external environment? Such as institutional change or political change?

[1] The questions designed for top management are required to gather answers to all questions listed. Whereas the questions designed for middle management are shorted for relevant information in relation to the departments in which they operate.

4. How is the strategy developed in you company, who is involved and how are decisions taken?

Structure （组织结构）

1. What is the most important department in your company?

2. How many and what processes are involved for one decision - from original idea to implementation? Respectively stated at two levels – top management (e.g. board directors) and middle management (e.g. departmental managers)

3. What is the degree of autonomy at divisional or departmental levels, and how does CEO control these subordinates?

4. How are tasks carried out? Through teamwork or hierarchical commands, or otherwise?

5. Could you describe your organisational structure/chart – functions in each department, job specialization and employee organisation; relations and coordination between departments. (literal documents are required, such as archive and profiling information)

6. How are budgets appropriated to each department? How do these departments meet their targets? Who decides the budget? How is the performance in each department measured?

System （系统/机制）

1. What do you think is the most important system in your organisation?

2. How does the CEO control the whole company and each department? Particularly how is the finance department controlled?

3. What is the communications processes between departments and subordinates?

4. How is the planning system operated in the company? How do managers plan to achieve for objectives?

5. What are the main criteria and principles for employee reward and sanction systems?

6. What are main characteristics of the marketing and production systems?

7. Is there any innovation in your company? How do you process innovation? And how are product portfolios and markets developed?

8. How is R&D developed, and how much is invested in R&D? How far has it contributed to organisational growth?

Shared value （价值观/文化）

1. What are the main management philosophies – for example, employee recognition; rewards; and customer relations?

2. How would you describe your organisational culture – for example, the way you and your staff do things in this organisation?

3. What kind of culture do you desire for your management – for example, entrepreneurial, bureaucratic, or innovative, etc.? What makes you feel frustrated?

4. What kind of cultural conflicts are you experiencing?

Style （管理方式）

1. What kind of leadership style you think you engage yourself?

2. What kind of approaches do you use to solving conflicts?

3. What is the work climate like in the organisation?

4. How far is there a reliance on formal process, such as meetings or paperwork or informal face-to-face?

5. What kind of perception do you have of western management? Do western management ideas influence your management style?

Staff （人力资源）

1. What is the knowledge structure of your key personnel?

2. What are your recruitment policies in human resource management? (Incl. selection criteria, training and mentoring process for new recruits)

3. Do you have any training policy/program for first-line staff and managers/supervisors? If do, what is the training content and frequency?

4. Do you have a staff development policy - such as job rotation, tenure, promotion procedures?

5. How do you evaluate individual performance and what criteria do you use for reward and sanctions?

6. As it is known, the term of HRM is adopted from western management practices, what kind of impact does such adoption place on your HR practices?

Skill （能力/竞争优势）

1. What range of expertise do the key personnel possess?

2. What kind of technology is involved in your management? Including application of technology in production and application of information technologies in the office.

3. Which following aspects reflect the competitive advantage of your organisation?
   a) Product (quality & design)
   b) Product branding
   c) Marketing and sales
   d) Financing
   e) R&D (if any)

Part II. Questions to Managers

(Referring to middle management)

1. As economic reforms deepened, what do you think of their impact? What has been the most influential change on your organisation's development?

2. Externally what kind of opportunities and challenges does your enterprise encounter?

3. Internally what kind of problems and challenge does your enterprise management face? (Weaknesses)

4. What are the strength and weaknesses of your company? And your department?

5. Does your company have long term strategy/goals for organisational development or short term strategy/goals for operations in your departmental planning? If it does, what they are?

6. How is strategy developed in your company? Who is involved and how are decisions taken?

7. How many and what process are involved for one decision - from original idea to implementation? Respectively stated at two levels – top management (e.g. board directors) and middle management (e.g. departmental managers).

8. What is the degree of autonomy at divisional and departmental levels, and how does the CEO control these?

9. How are the tasks carried out? Through teamwork or hierarchical command, or otherwise?

10. How are budgets appropriated to each department? How do departments meet their targets? Who decides the budgets? How is the performance in each department measured?

11. What is the organisational structure/chart; functions in each department, job specialization and employee organisation; relations and coordination between departments. (literal documents are required, such as archive and profiling information)

12. What do you think is the most important operational system in your organisation?

13. How does the CEO control the whole company and each department? Particularly how does he/she control the finance department?

14. How does communication flow between departments and subordinates?

15. How is the planning system operated in the company? How do managers plan to achieve their objectives?

16. What are the main criteria and principles for employee reward and sanction systems?

17. What are the main characteristics of the marketing and production systems?

18. Is there any innovation in your company? How is innovation managed? And how are product portfolios and markets developed?

19. How is R&D developed, and how much is invested in R&D? How far has it contributed to organisational growth?

20. What are the main management philosophies in your company?

21. What is the organisational culture? What are the values and beliefs?

22. What kind of culture do you desire for your management? (E.g. entrepreneurial, bureaucratic, or innovative, etc.)

23. What makes you feel frustrated? What kind of cultural conflicts are there in this business?

24. What kind of leadership style you perceived in your company?

25. What kind of approaches do you use to solving conflicts?

26. What is the work climate like in the organisation?

27. How far is there a reliance on formal processes, such as meetings or paperwork or informal face-to-face?

28. What kind of perception do you have of western management? Do western management ideas influence your management style?

29. What are the recruitment policies in human resource management? (Incl. selection criteria, training and mentoring process for new recruits)

30. Is there any training policy/program for first-line staff and managers/supervisors? If do, what is the training content and frequency?

31. Is there any staff development policy – such as job rotation, tenure, promotion procedures?

32. How is individual performance evaluated? And what criteria are applied to reward and sanctions?

33. What range of expertise do the key personnel possess?

34. What kind of technology is involved in your management? Including application of technology in production and application of information technologies in the office.

35. Which following aspects reflect the competitive advantage of your organisation?

(1) Product (quality & design)

(2) Product branding

(3) Marketing and sales

(4) Financing

(5) R&D (if any)

Appendix 5 List of Interviewees

Government officials and professionals[1]

1. Mr Gao Fujun - Director of Dalian Foreign Trade & Economic Cooperation Bureau (DFTECB)
2. Mr Fan Chenghua – District Director of DFTECB
3. Mr Ding Lianyu - Section Chief of DFTECB (Foreign Trade Section)
4. Mr Fu Qingzhong – Secretary Director of Liaoning Province Foreign Trade & Economic Cooperation Depart.
5. Mr Bai Guangwei - Section Chief of Dalian Customs (Goods Administration)
6. Mr Qin Xiaotang - Director of Administration Council of Economic Development Zone of Dalian (ACEDZD)
7. Mr Yao Qiang – Section Chief of (ACEDZD) (Enterprises Administrative Section)
8. Mr Wang Xingjia – District Director of National Tax Bureau Dalian
9. Mr Guo Dezhi – District Director of Local Tax Bureau Dalian
10. Mr Tang – Section Chief of Civil Council of Sheng Yang City (Industry Administrative Committee)
11. Mr Wang Benhai – Lawyer & partner of Chengyu Law Firm
12. Ms Zhang – Accountant of Jiaxing Accounting Firm

Case 1. Times Group (SOE) 8 interviewees

13. Mr Li Xiao – GM of Times Group
14. Mr Qi Zhengming – Secretary of the Communist Party of Times Group (1992-2005)
15. Ms Liang – Secretary of the Communist Party of Times Group (2005-)

[1] Government officials were interviewed in an informal, open-ended manner except for Mr Gao Fujun who was interviewed in a formal manner. Interviews with government officials was for gathering information to analyse the business environment by reference to regulations and policies. The professionals, such as lawyers and accountants were interviewed for information analysis and interpretation. These informants played an important role in accessing and selecting case companies, as well as facilitating comprehension and analysis of data collected.

16. Mr Jia Zhi – Office Director of Times Group
17. Mr Liu Qinghai – Director of Strategic Planning Department of Times Group
18. Mr Ma Yu – Secretary of Board of Directors of Times Group & Manager of Exp. & Imp. Department of Times Group
19. Mr Chen Xuejun – Manager of Service Imp. & Exp. Branch of Times Group
20. Ms Du Lili – Manager of Facility Management of Times Group Mansion

Case 2. Shenyang Liming Anna Clothing Co., Ltd. (COE) 9 interviewees

21. Mr Liang – GM of Liming Anna Co., Ltd.
22. Mr Fan – VGM of Liming Anna Co., Ltd.
23. Mr Tang Shaokui – Manager of Operation Depart. of Liming Anna
24. Mr Peng Zhenning – Manager of Manufacturing Depart. of Liming Anna
25. Ms Zhang Lixin – Manager of Personnel Depart. of Liming Anna
26. Ms Gong – Manager of Marketing Depart. of Liming Anna
27. Mr Gao – Manager of Technology Depart. of Liming Anna

Case 3. Dalian Dali Cashmere Product Co., Ltd. (POE) 7 interviewees

28. Mr Zhu Li – President & GM of Dali Cashmere Co., Ltd.
29. Mr Ding Yang – Office Director of Dali Cashmere Co., Ltd.
30. Mr He – Partner of Dali Cashmere Co., Ltd.
31. Ms Liang – Director of Finance Depart. of Dali Cashmere Co., Ltd.
32. Ms Jia – Manager of Marketing & Sales Depart. of Dali Cashmere Co., Ltd.
33. Ms Xu – VGM of Dali Cashmere Co., Ltd. (Marketing, Sales and Manufacturing)
34. Ms Wang Bin – Accountant of FTZ Enterprise

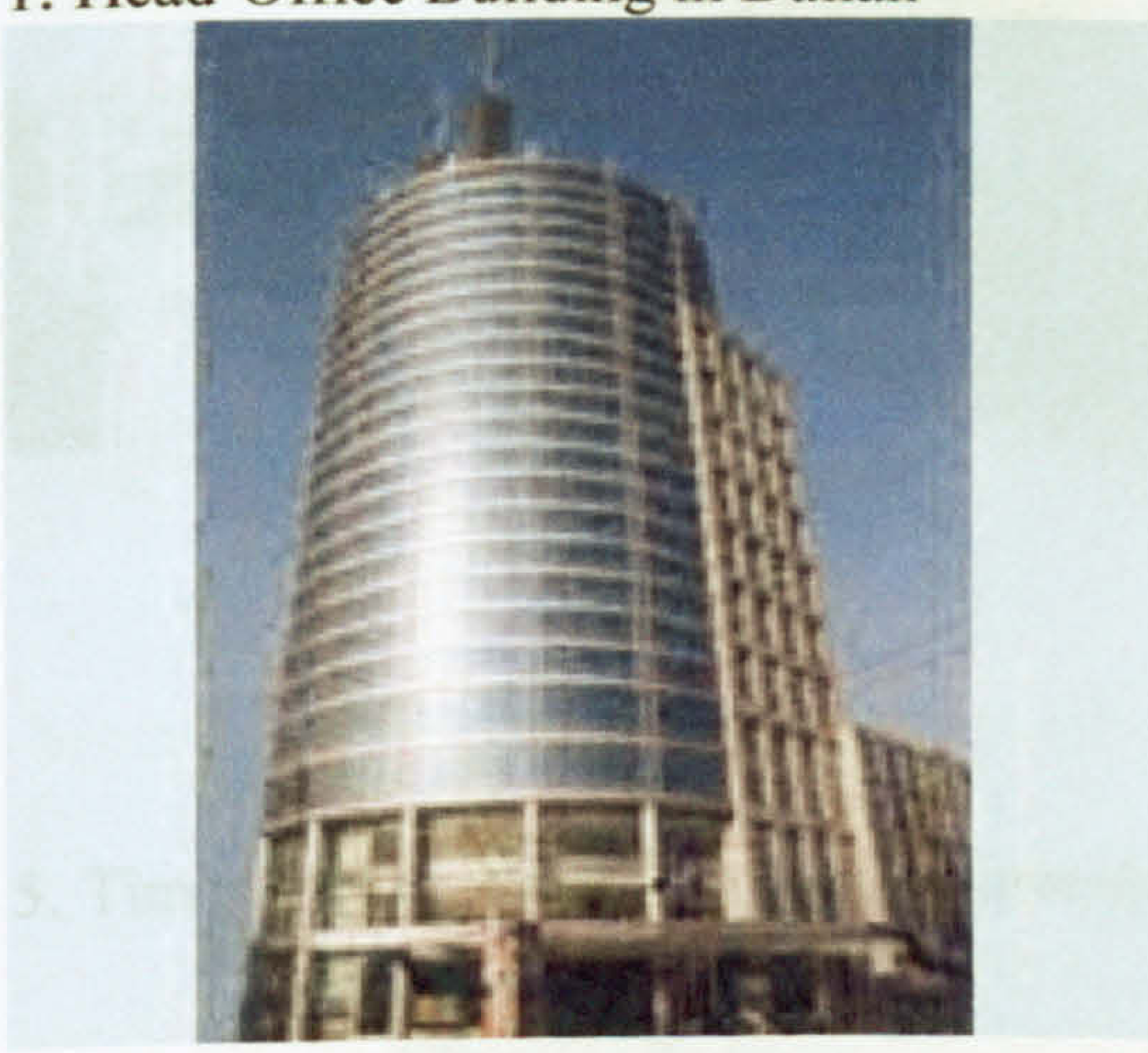
Case 4. Dalian Sunfed Fashion Co., Ltd. of Sunfed Group USA (FIE) 6 interviewees

35. Mr Charles Lee – President & CEO of Dalian Sunfed Fashion Co., Ltd. (Sunfed Group USA)
36. Ms Zhou Yan – GM of Sunfed Fashion Co., Ltd.
37. Ms Zhou Hong – VGM & Chief Designer of Sunfed Fashion Co., Ltd.
38. Mr Liu Ming – Manager of HR Depart. of Sunfed
39. Mr Larry Chen – Manager of Marketing & Sales Depart. of Sunfed
40. Mr Hong Fei – Manager of Technology Depart. of Sunfed

Appendix 6 Photographs of Case Studies

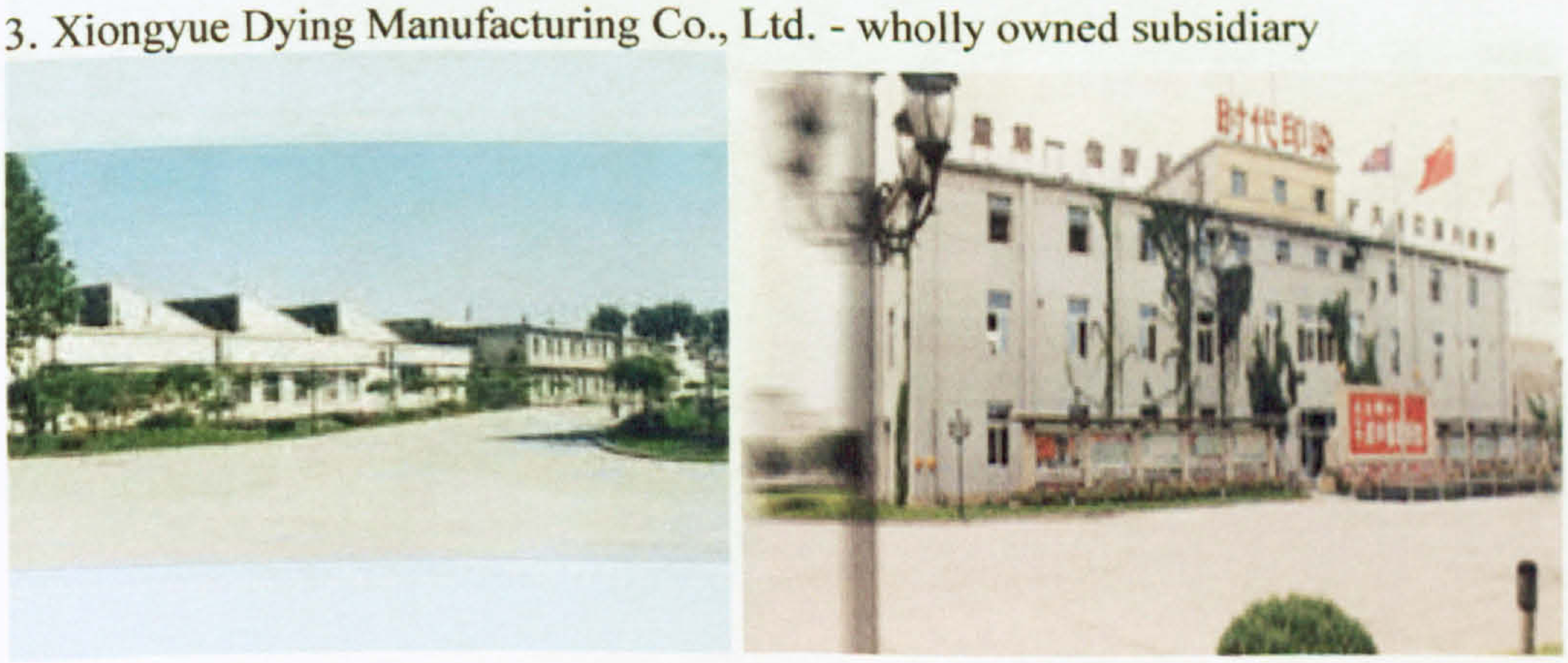
Case (1) Liaoning Times Group Plc.

1. Head-Office Building in Dalian



2. Staffs working at the office of Dalian

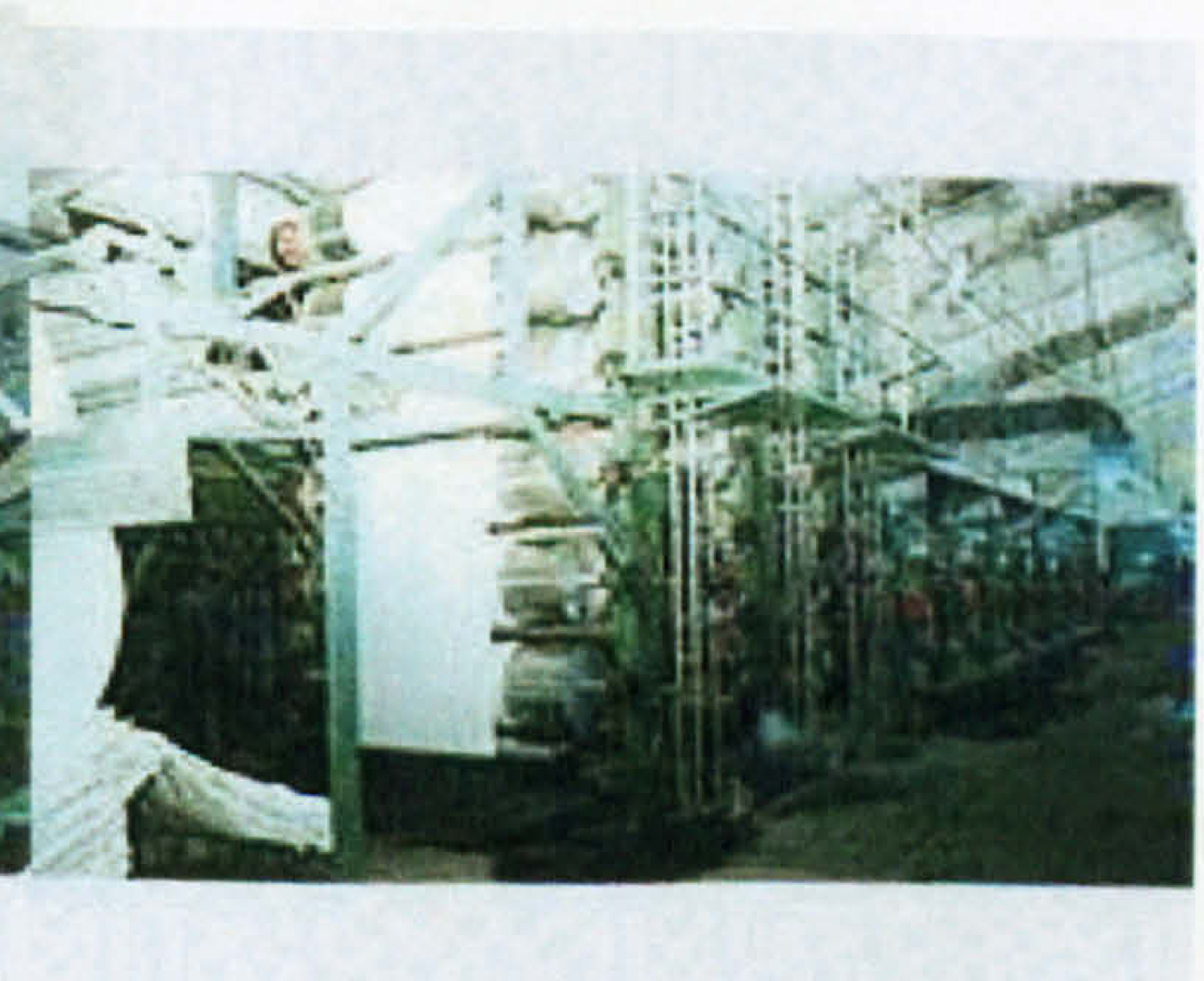
3. Xiongyue Dying Manufacturing Co., Ltd. - wholly owned subsidiary



4. Times Shihe Garments Manufactory

5. Times Ya Du Hotel – diversified investment

6. Large-scale production line, top-of-the-line equipment



Staff at Garment factory

Inspecting raw materials before production

Checking for any stitching irregularities and loose threads

7. R&D: Computer-assisted design room

Staff designing samples for customers

8. Garments products made by Times Garment Manufactory

Suits

Rain coats

Casual wear

Working wear

Knitwear

Children' Wear

Night wear and beddings

Shoes, Caps & Sports Wear

Fabrics and accessories

Appendix 6 Photographs of Case Studies

Case (2) Liming Anna Fashion Co., Ltd.

1. Anna Office Building

2. Management Staff Meeting

3. Liming Anna Factory

4. Retail Store

Appendix 6 Photographs of Case Studies

Case (3) Dali Cashmere Co., Ltd.

1. Mr Zhu Li in his office

2. Dali's factory building

3. Mottos on company's walls

'Excellence is created from bit by bit'

'The concept determines the way of development and the calibre of people determines the quality of product'

'The concept creates fortune, the wise sails the boat with the help of the current.'

'Please watch your thinking, it will influence your behaviour,
Please watch your behaviour, it will influence your habit,
Please watch your habit, it will influence your character,
Please watch your character, it will influence your fate.'

'Family' – a big Chinese character hanging on the wall in Mr Zhu's office, which demonstrates he runs the company as a big family.

4. Rewards and honour of Dali Cashmere:

Honour 1 'Faithful Enterprise on contract –abiding and credibility' issued by Dalian City Commercial and Industrial Administration Bureau.
Honour 2 'LiaoNanWang Cashmere – 2002 the Favourite Brand in Dalian', issued by Dalian People's Government.
Honour 3 'LiaoNanWang Cashmere – 2003 the Favourite Brand in Dalian', issued by Dalian People's Government.

Honour 4 'LianNanWang- the Famous Brand in Liaoning Province' issued by Dalian City Commercial and Industrial Administration Bureau.
Honour 5 'The satisfactory enterprise of the customer' 2004, issued by Dalian, Shahekou District Consumer Association.
Honour 6'AAA grade Credible Enterprise 2003 – 2004' Dalian People's Government.

5. Office

6. Show room of LiaoNanWang cashmere inside Dali's building

7. LiaoNanWang cashmere product

Appendix 6 Photographs of Case Studies

Case (4) Sunfed USA, Dalian Sunfed Fashion Co., Ltd.

1. General Manager of Sunfed

3. Designer of Sunfed

2. Show-room inside company building

3. Retail store

4. Products