

# Chapter 5

## Organizational and Institutional Building of Enterprises

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*Due to the fact that the market in the IT industry changes very fast, if sales policies and promotion plans were all to be formulated by the headquarters of the company, the result would be bad due to time-lag and regional disparities. So upon the request of regional managers, the headquarters delegated partial authority to managers of each region. In a short period of time, because the regional offices knew their local markets better, plans formulated by them were more practical; meanwhile, the incentives for employees at the regional offices were also motivated, so the delegation of power demonstrated positive effects and, as a result, the sales volume increased a lot. However, problems occurred after a while. Corrupt behavior started to happen in regional offices after they obtained power. For example, rent-seeking largely existed in terms of price policy and marketing budget spending. The whole atmosphere and culture of the company were ruined, which severely damaged the company's long-term interest. In the end, the headquarters of the company took back the power. . . (Interview with a manager, November 2007)*

Mr. Zhang, who used to work in an IT company, provided the above story. As a matter of fact, this kind of experience has been quite common among private businesses in China. In the past 30 years, Chinese private businesses went from none to something, from small in size to large scale; private entrepreneurs transformed from merchants to entrepreneurs by going through a “pre-corporate period”, “corporate period” and “fortune-making period”, in which there coexisted learning and innovations, confusion and confidence, frustrations and successes. Dealing with the conflict between work specialization and coordination, the contradiction between centralization and decentralization of power, the tension between impersonal institutions and human relationships, the balance between efficiency and control, and the considerations of maintaining both vitality and order have become the inevitable challenges for each entrepreneur.

Adam Smith indicated in “The Wealth of Nations” that a state’s fortune was derived from the division of labor and rational organization of production (and trade on this basis); the emergence of factories in modern times symbolized the start of

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rational organization of production. Henri Fayol, one of the founding fathers of general theory in business administration, positioned the functions of a manager as planning, organizing, commanding and controlling. However, apparently simple theories are not enough to solve complicated real world problems. Practitioners cannot count on theories to light their way in the dark, they can only feel their way in confusion and by zigzagging between the obstacles.

For the purpose of examining and summarizing practices, this chapter tries to describe Chinese enterprises' explorations in structure, procedures and institutions during their growth and reform process, and to discover the distinctive features and development trends of business organizations in terms of structure design, procedure improvement and institution building. Enterprises like HUAWEI, Vanke and Lenovo, who have evolved to finally become top enterprises in China, or even in the world, will be cited; enterprises which encountered frustrations during development and even failed will also be looked at. Comparisons will be made to find the rules.

## **5.1 Structure Design – Feeling the Stones While Crossing the River**

For an enterprise that has developed its own products and market, the core task would be: how to organize its production, including how to distribute tasks, how to design departments and how to arrange powers and responsibilities. The president of Lenovo Group, Liu Chuanzhi, concluded three core tasks for executives from his own experience: "Set strategies, organize leadership teams, and leading"; the last two are both related to structural design. As the link between strategies and execution, the design of organizational structure directly affects the implementation of strategies and the achievement of organizational objectives.

The challenge faced by Chinese private enterprises in terms of organizational structure was that they were starting from scratch; there was no history or accumulation of knowledge and experience. So, in the situation where they were starting from nothing, how did they overcome the obstacles and progress?

### ***5.1.1 Looking for Models to Learn From***

Generally speaking, anything new (no matter whether a product or management practice) normally come from two sources: one is innovation, and the other is from learning and imitation. The models to learn from normally come from the surrounding environment. When an organization is looking for a target to learn from, it considers two factors: one is the availability of the target; the other is the legitimacy of the target, which means the organization has to deem whether the target is advanced enough and worth learning from. There were limited resources when

Chinese private enterprises first emerged. In this circumstance, the availability of learning targets became the dominant factor. When looking around, there were so few models to learn from; therefore, they just grabbed anything they could find in the environment.

When looking at the models which private enterprises learned from at the early stage of their development, we found they imitated state-owned enterprises or government, military, foreign companies, even the organizational form of gangsterdom.

### ***5.1.2 State-Owned Enterprises or Government***

It is well-established that the mechanisms of private enterprises are more flexible than state-owned enterprises (SOEs); however, private enterprises still have many problems in terms of organizational structure and professionalization of management, even today. In this regard, private enterprises decided to learn from SOEs and governments from the beginning. Indeed, some managers of private enterprises used to be leaders in SOEs; they thus knew SOEs very well, so they consciously or unconsciously imitated the management mode of SOEs in the early days of their businesses in order to supplement their own deficiencies in management. More frequently, private enterprises learned the organizational structure and management mode of SOEs through business interactions with SOEs: they learned the good sides of SOEs and applied into their own business. As a result, we saw that some private enterprises also named their departments “divisions” or “offices”, and arranged their hierarchies the same as in SOEs or governments, such as calling section managers directors or chiefs. Some leaders of private enterprises wrote their articles like editorials, the internal documents looked like the “red titled” government papers, the slogans also closely followed the political trends, signed at the bottom as “xxx company announced”, which was clearly government style.

Of course, there were some enterprises that chose elements of the organizational principles of government that would be beneficial to them, aimed purely at developing the enterprise. For example, the president of Macalline Group, Che Jianxin, shared his thoughts once at a management forum:

*As the president, I've always focused on the study of human resources. I think the most important thing is to do organizational management. I recently studied the constitution of the Communist Party. Article 14 says: "Under regular circumstances, the central level governments of the Party should always consult the opinions of lower level organizations when making important decisions regarding lower level organizations, ensure the normal operation of lower level organizations; except for special circumstances, upper level governments should not intervene in the actions of lower level organizations." So, how come our organization has been developing so slowly? I think it is because we always intervene in the actions of lower level staff. There has not been enough delegation of power, which has caused lower level staff to have neither responsibilities nor powers. That's why I divided many business departments into three or four sections, like the first, second, third and fourth field army in the liberation army back then (Anonymous 2008).*

In the past 10 years or more, setting up Party organizations and labor unions, as well as setting up model workers by private enterprises, became popular. This was partly due to it being promoted by the government and partly the choice of private enterprises themselves. Enterprises who had set up party organizations are usually enterprises that had developed for a longer period, were large scale and had promising futures. When an enterprise develops to a certain phase, both the entrepreneur and the enterprise naturally wants to get closer to the government. We have talked about this point in the chapter of business-government relations.

### **5.1.3 Military**

Many of the Chinese entrepreneurs have experience in the military, such as Ren Zhengfei of HUAWEI, Zhang Ruimin of Haier, Liu Chuanzhi of Lenovo, Ning Gaoning of COFCO, former president of Air China Li Jiaxiang, Wang Shi of Vanke, Sun Guangxin of Guangsha Group, and Chen Ping of ZJS Express, etc. The experience of being in the military more or less influenced their management style; emphasizing execution is one of the causalities we can all imagine. A famous saying of Chen Ping vividly reflects the influence of his military experience: “execute if you understand, execute if you don’t understand; understand in execution, execute in understandings.” From daily communications, we also found that most of the entrepreneurs who were still very active in business circles were very interested in talking about the histories of the Communist Party and the People’s Liberation Army. They figured out principles from it and used them in their businesses. For example, from a TV episode describing the Menglianggu campaign, the managers of Beijing International Airport discovered the essential reason for the failure of the Nationalist forces and the success of the liberation army was cooperation; and they promoted this concept to their managers at all levels and employees.

Some entrepreneurs absorb useful learnings from the organizational structure of the military. Shi Yuzhu vividly demonstrated the military influence on him when he first started his health products business in 1994. He designated himself as the commander in chief, and set up three headquarters and seven front armies: East China, Central China, South China, North China, Southwest, Northwest and Overseas. He turned more than 30 independent branch companies into corps and divisions, and called the managers of different levels “front army commander”, “army commander” or “division commander”. In his mobilization order, he wrote: we will invest several billions of Yuan for the three major campaigns, hundreds of thousands of people will directly and indirectly participate, the operational mode of the campaign is by group army, and the direct objective of the campaign is to achieve billion Yuan-based monthly profits. Meanwhile he pointed out that the long-term goal was to forge a troop in the campaigns that could develop young soldiers to become army commanders or division commanders in a few months, and lead tens of thousands of people in a battle (Wu 2001: 180).

Similarly, Sanzhu Group, which is also in the health products industry, also adopted the organizational structure of the military in the liberation war period. Originally, the headquarters referenced to the Western model and established departments based on the kind of products; the departments were run independently and directly reported to headquarters. In order to ensure the smooth coordination of the products, it also established “the command office of the market front line”, and established “the command commission of the market front line” at headquarters. Chairman Wu Bingxin described their functions thus: “the command commission of the market front line is like the State Central Military Commission, the command commission of every provincial branch company is like Front Line Military Commission. Using the military mode to run business means militarized actions, and the biggest characteristic of the military mode is absolute obeying of orders.” (Wu 2001: 216)

Today, there are still many entrepreneurs enlightened by the cutting edge revolutions in military affairs. For example, Feng Lun wrote: “Observing from a global perspective, military organizations are evolving towards two directions, namely official organizations and legitimate organizations are becoming ‘S.W.A.T.’, while illegitimate and non-contractual organizations are becoming ‘Al-Qaeda’. ‘S.W.A.T.’ means big backstage, small frontend: spending 70 % of the money on looking for targets, and 30 % of the money on destroying the targets directly. The frontend organizations have the full functions; the backstage becomes the supporting forces of the system. The so-called ‘Al-Qaeda’ is a group activity coordinated by concept of value, culture and emotion. The cost is carried separately, and the incomes are huge. The cost of ‘9/11’ is 220,000 US dollars; however the direct cost to the United States is 200 billion US dollars, indirect cost is 400 billion US dollars. The organization of Al-Qaeda is comparatively scattered. There is no hierarchic management. Many actions were not directly deployed by Osama Bin Laden. They just use concepts of value and religious emotion to rule the organization.” (Feng 2007: 86–87)

#### ***5.1.4 The Gangsterdom***

As Feng Lun says, many private enterprises in early times had some characteristics of gangsterdom. Private enterprises were like gangsters and bandits, or rangers. They had been constrained under the old system for a very long time, so, once they were freed, they felt extremely relaxed and wanted to enjoy all the freedom and happiness. In terms of organization type, gangsterdom can be considered as a non-official organization. It is a structure in the middle between the government and the people. In the Ming and Qing dynasties, the population largely increased, and the contradictions between people and land were becoming more severe. In addition, the occupation of land by courtiers and despotic landlords by force caused more and more people to leave traditional rural society and adopt the third kind of living mode – gangsterdom. Besides the traditional type of merchants, rangers,

necromancers, doctors and theatrical troupes, there were also outlaws, thieves, ethnic groups, bandits and gangs in the turmoil of wars. These organizations and their cultures have deeply penetrated every part of Chinese society, especially the bottom class (Yu 2006). Some warlords in the era of republican China, like Zhang Zuolin and Lu Rongting – they themselves had been bandits, also ruled their troops and governed their territories by the rules of gangsterdom (Zhang 2008).

Due to the fact that private enterprises originated from the edge of the old system, they were born with the features of gangsterdom. Private entrepreneurs also use the language and the ways of gangsterdom to run business, with phrases like “make a living in the gangsterdom”, “live in the gangsterdom”, etc. In terms of management, some entrepreneurs use the ways of gangsterdom to bond people’s hearts to their purpose. They see being faithful to friends as a merit. For example, Feng Lun deems that during the period of gangsterdom (i.e., pre-corporation period), the highest level of management is the management in “Shui Hu” – “there are hierarchy of titles, but the same benefits for all”. He also carefully read the book “Bandits in Republican China” which was written by a British author, and hoped to learn incentive mechanisms from the bandit organizations.

### ***5.1.5 Foreign Enterprise***

After Reform and Opening-up, foreign-owned enterprises surged into China, especially in the southeast coastal area. Therefore, wherever foreign enterprises could be encountered, they were definitely the priority learning object for Chinese private enterprises. Besides the indigenous factors, the reason why most private enterprises adopted family business was that most foreign enterprises which came to China in the early stages of the opening-up were from Hong Kong, Macau and Taiwan (where family business dominates). The communication and mutual observation among Chinese communities naturally circulated organizational structures and management modes.

Learning from foreign enterprises was also reflected as the copying of various dazzling Western management theories. As Chinese enterprises grew quickly, they targeted the management practices of transnational companies and international communities. As a result, the multi-divisional form, matrix structure, balanced score card, scientific management and core competence came on to the copying list; private enterprises also spent big money on hiring people who used to work in foreign enterprises – the so called “internationalized talents”.

Wang Wenjing hired He Jinghua, who had rich international experience, to work for UFIDA in April 2002, in order to prepare for UFIDA’s entry into the international market. Based on research and analysis, as well as his long experience of working in foreign companies, He Jinghua restructured the sales management of UFIDA. He combined the U8 and NC product departments into one division. Then he repositioned the big client department, dividing it into a central big client division and a sector-oriented big client division to make them a sales unit with

levels; this was vertical reform. He also re-divided the previous four areas into six areas to bring the sales teams closer to the demands of the market; this was horizontal reform. In this way, two sales lines were formed: the big client sales line, which was the vertical line and the regional sales line, which was the horizontal line. This was called the “jingtian pattern system (well-field system)” inside UFIDA.

### ***5.1.6 The Variation of Fashion and Fit***

In modern times, Western culture became dominant and learning from the West gradually became a common phenomenon in every industry in China. After the establishment of the new China, the government thoroughly wiped out the old culture; the mentality of “cannot live without the Celestial Empire” completely disappeared. Once the door was opened, Chinese people immediately opened their arms to embrace the world with great enthusiasm. By this time, China had entered an era of comprehensively and massively communicating with the outside world. The call to “be in line with international practice” soon became very popular around the country. Due to the fast-changing nature of management, new ideas and new concepts constantly came up; management, especially, became a special area of learning Western theories and practices. Concepts such as the “multi-divisional form” and “matrix management” came one after another, which looked very much like nationals pursuing fashion.

The first concept that came to people’s attention was the divisional structure. The divisional structure was warmly welcomed by Chinese managers because it included some of the features of China’s economic reform (e.g. delegation of power, the sharing revenue and expenditure between central and regional governments, etc.) in the 1980s, and also because it could mobilize the incentives of lower level agencies and departments. At that time, consultations with regard to how to adjust an organization to the divisional structure greatly increased. The author of this chapter also received many enquiries from students and business people on what the divisional structure was and its application range. Some big private enterprises established the divisional structure one after another. Lenovo established six major groups (namely business divisions) in 2001, respectively: enterprise IT, consumer IT, handy equipment, IT services, Internet, and machine components manufacturing. Later, the six groups were integrated into three big groups, among which A group included PCs and laptops; B group included mobile communication; and C group included IT services. UFIDA set up a U8 division and an NC division based on its products. Both divisions have sales, marketing, services, and R&D functions; and they run separately and independently.

If the above cases show rational choices by those enterprises, some other enterprises were purely pursuing fashion. The author knows of a company which had a single product and only 20 employees; the departments in the company were all called “divisions”, but, in fact, they were just functional departments. So why

did they use the name “division”? The boss of this company answered: “Because it sounds good. My friends’ companies all use this name.” Reasons behind this fashion trend included the worship of all things foreign by some people and promotion by consulting companies. SWOT Analysis became the essential course in strategic consultation. Using initials of English words to strengthen impressions became routine in the business, e.g. 4S, 7P. It seemed that working without an S or a P was not international enough or good enough. Pursuing organizational concepts as a fashion brought many troubles, even failure to Chinese enterprises. McKinsey’s failure on Fujian Start Group is a case in point.

After Start Group was listed in Shanghai in 1996, it encountered a series of problems during its fast development. It expected to solve the two biggest problems – in its sales channel and its marketing mode – through consultation with McKinsey. At the end of both 1998 and 1999, in accordance with McKinsey’s plan, Start Group twice conducted large-scale and in-depth structural adjustments: breaking up all the branch companies and setting up different business units, with marketing and sales activities all to be conducted by the business units.

McKinsey’s prescription didn’t help Start Group; on the contrary, it worsened the group’s “illness”. For some time, management staff who were good at their jobs no longer knew how to work under the new system. In the first half of 1999, the group’s business performances declined significantly; many receivables, material assets, and inventories started to pile up; many bad accounts were produced during these structural adjustments. Start Group itself also found that too many coordination steps and endless meetings decreased the efficiency of coordination, which caused a decrease in the efficiency of the marketing system operation. Five months later, Start Group could no longer afford the pressure of the continuing declining business performances and was forced to go back to its original management and marketing system. Besides internal factors, the reason for McKinsey’s advice failing at Start Group was that McKinsey applied the successful experience of Western enterprises directly to a Chinese enterprise without modifications, copying a successful model without considering the local situation.

After several years of the divisional structure being popular, the matrix structure soon became the new favorite in business circles because of its function of sharing limited resources. In a few years, Lenovo, UFIDA and other companies all started to use the matrix structure. In 2007, Lenovo adjusted its organizational structure again. It broke up the grouping mode (namely the divisional structure), which had been in force for 3 years, and set up 4 “military regions” nationwide (the east, the south, the west and the north), and 18 small regions under the 4 big regions. This adjustment completed Lenovo’s matrix organizational structure. As we have introduced previously, UFIDA had previously already completed its transformation from the divisional system to the matrix structure under the leadership of He Jinghua. Kingdee Group also started to transform to the matrix structure after using the divisional structure for a short period of time. “The previous market was short-supplied; so once you had the products, you had the market. Back then, there were big variances in products, the competition was not intense, so enterprises were all product-oriented. After the quantity of products increased, and the types



were more diversified, enterprises found that the resources for R&D, marketing and services started to get wasted.” That is how the chief strategic officer of Kingdee explained the company’s transformation to the matrix structure.

Several years later, the problems of the matrix structure were completely exposed. There are only a few enterprises still using the matrix structure. Looking through the reasons, firstly, the matrix structure didn’t match the development phase and the actual needs of enterprises; secondly, the unique Chinese features inside enterprises’ management and culture didn’t match the requirements of the matrix structure. The matrix structure requires people to coordinate, communicate and be project-oriented instead of leader-oriented. Many enterprises cannot meet these requirements.

During the implementation of the matrix structure at some enterprises, their extensive business range meant space and time intertwined, and business and professional sides intertwined, increasing the difficulty of communicating. Some enterprises stopped the matrix structure because the branch companies had too much power, so, even though the matrix structure was set, it was difficult to really enforce. Some enterprises failed because of complicated office politics, they were human-ruled rather than regulation-ruled. Plus Chinese people were used to single leadership rather than multi-leadership; so, reporting to two bosses often caused a complicated interpersonal dilemma. The two-way commands in the matrix structure and the “unified commands” in business administration theory have always been an inevitable contradiction. Working in a matrix, everyone was subject to the confusion of whether to achieve success one way or another or act involuntarily; accept being trapped or find a way out.

While some enterprises were busy in pursuing fashion, we also witnessed Chinese executives making efforts to look for the most suitable organizational structure. The above cases about Lenovo and UFIDA were all about adventure. Guo Fansheng is an example of wisdom; he explained his journey of reforming his enterprise’s structure and changing in accordance with needs at different development phases. At the early stage, Guo Fansheng used two-dimensional matrix management. He horizontally set up a marketing department, editing department and publishing department, and vertically set up three departments – home appliances, IT and automobiles; which all directly reported to Guo Fansheng. Because of the unified management, the sales people went to attract business without dividing areas, which created an imbalance in benefits for different business areas. If it was easy to find business in the IT area, people would all focus on IT; if it was comparatively difficult to find business in the home appliances area, there would be no one working on it. In view of this, he decided to try to enforce a professional company type of business unit to solve the problems. He set up home appliances, automobiles and IT as individual business units, let the general manager of each unit take full charge of the business operation, market coordinating, and editing and publishing. After a while, the professional company type system also exposed problems. For example, it was difficult to find ideal general managers; it was prone to slipping into the human-rule system due to the concentration of power in the general manager’s hands; the Internet platforms were difficult to unify and

resources could not be shared, etc. After serious consideration, he enforced a three-dimensional matrix structure, the first dimension was product, R&D and branding, the second was branch agencies, and the third was an independent business accounting unit (Guo 2009).

### ***5.1.7 The Confusion of Centralization and Decentralization***

Just like in the relationship between central and regional government after the new China was established – “Dead once controlled, messy once delegated” so the power went back and forth between “control” and “delegate”, many enterprises also faced the same sharp challenge of balancing centralization and decentralization of powers. As enterprises continue to expand and diversify, a critical question is whether power should be “centralized” or “decentralized”? Many cases show that some enterprises stagnated or fell into difficulties because of the centralization of power; while other enterprises insisted on “democracy” of power and tasted the result of “losing a thousand pieces of gold and not having them back”. Centralization and decentralization of power really put business leaders in a dilemma.

One of the features of the management of Chinese society is the high centralization of power. From Wang An requesting 232 of his managers to report to him directly, to the famous saying of the president of IDALL Company Hu Zhibiao: “all contracts with the amount above a penny have to be signed by me”, there were many examples of high centralization of power. This centralization on one hand is an extension of the traditional Chinese culture – its “grand unification”; on the other hand, it reflects the frustration at the lack of generalized trust in Chinese society. This so-called generalized trust means the trust one can place in a complete stranger. It is well known that a feature of Chinese people’s trust is that they only trust “their own people” or people “in the circle”. This circle could be determined by the leader’s family background and could be changed along with the leader’s personal experience. In other words, the circle limits within families or friends. But it is very difficult to expand trust to people outside “the circle”. A lack of generalized trust became particularly obvious in mainland China after Reform and Opening-up: the damage to interpersonal relations caused by the “Cultural Revolution”, the decline of traditional Chinese culture after the new China was established, the difficulties of breaking down the old system and establishing the new system, and the speed of the market economy, all made integrity and interpersonal trust a rare resource. This is the social background to the wide existence of centralization of power that Chinese entrepreneurs have to face when undertaking management.

From the perspective of entrepreneurs, the popularity of centralization of power is either because of the limitation of personal capacity and insight of entrepreneurs – that they don’t know how to delegate power, or because of the “individual heroism” caused by their early success, over-inflating their confidence. By using an authoritarian approach and centralization of power at the start-up stage of their

business, some private entrepreneurs increased efficiency in decision-making while decreased management risks and achieved success. Despite the continuous expansion of their enterprises, they still tried to deal with everything by themselves with absolutely no delegation of power or insufficient delegation. As a result, they ended up extremely busy and inefficient.

*There was a group company which had 30 branch companies. Before, every branch company had its own independent finance, accounting and independent accounts. Because each branch company had its own finance power, and the management mechanism of the group company was disordered, the expenses of the group company remained very high for years; the profits of the group company were all diluted by the strong branch companies. The president of the group company was very angry; he withdrew the financial power from all the branch companies overnight, and had headquarters control all the finance. He was the only person who had the right to sign all the bills. As a result, he had to spend 4–6 hours on signing all kinds of bills every day. With the time needed for auditing by departments and the time needed for the accountants to draw cash, a request for disbursement needed 4–5 days. Because the boss could not participate in every activity, he inevitably had some doubts or even rejected some of the expenses. In addition, the boss might lack frontline information and on-the-spot experience, so he inevitably made some wrong judgments, which caused the death of some very good business opportunities. In this circumstance of high centralization of power, a manager had to spend all of his or even 120% of his energy taking care of the finances. He lost the opportunities of improving his personal capacities as well as the company's performance. (Interview with a manager in the enterprise, November 2007)*

We have seen different kinds of problems caused by centralization of power, such as a decrease in the quality of decision-making, limiting the adaptability of enterprises, and negative effects on the morale of employees. If a sales staff has to go through all the levels of the company to get one business deal approved, he or she will inevitably feel discouraged. As a result, they may turn to a passive solution, such as an attitude of “We don’t want money, we won’t do things either. What can you do about it?” In this constantly changing business environment, this centralization of power mode has already displayed its drawbacks.

After experiencing the confusion and anxieties of centralization and decentralization of power, some enterprises pulled themselves out of the vicious cycle of moving from one dead-end to another. They tried to find the balance between the two in practices. They realized that balance was the true essence of management; an excellent manager must be good at balancing. Therefore, “there should be co-existence of centralization and decentralization of power”, “decentralization in centralization, centralization in decentralization”, “centralize and decentralize at the right time” became their new management principles and practices.

Vanke Group is an example. At the early stage of its development, Vanke enforced centralized control due to its low number of staff and limited business areas. Limited resources were all centralized at headquarters; branch companies’ decision-making, personnel, capital and other professional business affairs were all referred to headquarters for decisions. At that time, the headquarters was a professional headquarters. It provided support and management services to branch companies in different cities, and participated deeply in many operations. As Vanke expanded quickly, more and more regional branch companies were established.

But, by depending on headquarters to make every decision, good business opportunities must be missed. Therefore, Vanke conducted major reform of its management and control mode in 2005. It altered the centralized control mode to a decentralized control mode. The headquarters was positioned as the strategic headquarters; its responsibilities were mainly strategies and investment, products categorization and innovation, capacity and culture, guidance and control. Meanwhile, it delegated project operation and professional management to regional companies. At the same time, Vanke started to adopt new control ideas. It assigned control to regional companies and companies in cities based on the value chain. In detail, because the front-end of the value chain of the real estate business is the key point, and also the high-risk point, for value creation, the company positioned this part as the intensive control area and enforced comparatively centralized power; to the middle part and the end part of the value chain, the company would enforce control based on balance of power and according to the principle of monitoring and supporting the services. At the decision-making phase, the group company participates in the whole process. At the middle part of the value chain, the company conducts key point decision-making and monitoring; at the end part, it is mainly support and services. Thus, Vanke achieved the unity of the opposing forces of centralization and decentralization of power.

## 5.2 A Two-Way Movement of Process Reform

In the 1980s, the concept of process appeared in the West and soon spread throughout world. Simply speaking, process is “the procedures to complete a task”. Frederick Taylor’s scientific management, Henry Ford’s assembly line, the Toyota production system and Dell’s direct selling are all cases of innovations of process. Innovation of process was popular in the 1980s mainly due to the fast-changing environment, which intensified the pressure of global competition, and the new technology revolution, especially the impetus brought by the information technology revolution. In terms of the methods of process reform, famous Western management scientists all suggested the adoption of revolutionary ways to remold the process. That was how propositions like “process revolution”, “reengineering Work: don’t automate, obliterate” came up. The sole objective of all these propositions was to shorten the time and distance a product took from production to consumers to increase efficiency.

When the author looked into the process emphasized by Chinese enterprises, a two-way movement of management process and business process were found, which was: in the management process, enterprises emphasize more on mending the loopholes to achieve effective control; and in the business process, enterprises prioritize efficiency, which is in accordance with the Western proposition of remolding the process.

### ***5.2.1 Management Process Reform: Control Is the Key***

Both private enterprises and state-owned enterprises have the problem of achieving “effective control”, which was largely solved in the West a long time ago. For private enterprises, due to their short history and insufficient institutional building, managers are facing the issue of how to maintain good order while completing tasks. For state-owned enterprises, due to the owner vacancy and serious agency problems, people seek to feather their own nests once there are chances for rent-seeking. Therefore, when Chinese enterprises try to improve their management process, they more or less consider control as the top priority, at least at the early stage.

Let’s use State Grid Corporation of China as an example. The corporation originated from the Ministry of Electric Power and electric power bureaus at all levels. Before 2004, the electric power companies at all levels basically managed in their own ways. They made decisions on grid construction and maintenance, investment and capital-raising for their own areas, and they also had autonomous rights in managing personnel, finance and materials. In the case of Shaoxing city electric power company, before 2004, its branch companies (county level) had great autonomy over their financial resources, they had their own finance departments. Even though the upper level management controlled the total budget, the lower level companies could decide themselves how to spend the money. Some directors spent tens of thousands RMB to buy a camera, some branch companies distributed tens of thousands in subsidies when holidays came. This caused an imbalance among different branch companies. The upper level had difficulty mobilizing capital; if a director-general needed to spend money, he had to consult with directors of lower level companies. Control was hard to enforce. In terms of personnel management, all levels were inclined to hire more people and expand their offices. The business was so big and belonged to the country, so finding positions for relatives or others in their personal networks was very easy. Doing things in their own ways disturbed the effective sharing of resources among regions inside the company; it also affected the economies of scale, and provided opportunities for leakage at each level. Apparently, if managers had the motivation, opportunities were everywhere. In procurement, for example, benefiting oneself from a large-scale construction project at the expense of company interest did not take much effort.

Since 2004, however, the State Grid Corporation of China has used information technology as a tool to largely enforce the intensive management of personnel, finance and materials. The main method was to change the previous situation in which branch companies had too much autonomy, and enforce centralized management of personnel, finance and materials by headquarters. It conducted necessary reform of the management process. Taking the construction of a regional sub-station as an example, the previous process was procurement first, reimbursement later. But now, budget planning has to be reported first, and the substation is then built based on the plan and the budget. Previously, whichever unit purchase the

asset paid for it. But now procurement is organized by headquarters and the provincial company together, and the project owner can only choose from the list of companies approved through a tendering process. Let's look at how the online reimbursement system intensified the internal control of enterprises. Employees have to log on to the Internet reimbursement system by using their own ID, which is their employee number, and perform applications of reimbursement and salary disbursement. The system identifies the flow spontaneously, based on the type of business, amount and other factors. Then the request is forwarded through the system to be approved. Employees can check the status of the request anytime; financial staff and managers ratify the request in the system and activate the disbursement automatically without entering any inputs. By using an Internet reimbursement system, managers cannot see the original receipts; they only justify the activities online. For financial staff, the point of the system is, firstly, not to check signatures but to check if the receipts are legitimate, real, legal and effective; and, secondly, not for accounting, but to effectively monitor the management system and control system of enterprises. For employees who submitted the reimbursement request, they don't need to run around offices getting signatures. What they need to learn is how to state things clearly so managers understand. By using the Internet reimbursement system, employees can check the budget status while submitting reimbursement requests, and enterprises can achieve the ratification process of reimbursement through intensifying internal control (Zhang 2009).

### ***5.2.2 Business Process Reform: Efficiency Is the Priority***

Compared with management process reform, which sets control as the top priority, the pursuit of efficiency was the first thing on the minds of Chinese enterprises conducting business process reform. This is also the window for us to view and understand China's economic miracle of the past 30 years. Why do Chinese enterprises have this high efficiency? How did they overtake Western enterprises and occupy the market? On some level, this resulted from the fast reaction and process innovation of Chinese private enterprises. Haier, HUAWEI, BYD and Geely are all good examples of process innovation. Below, we will use BYD as an example to introduce the features of process innovation by Chinese enterprises.

BYD's main business when it established was the production of nickel-cadmium batteries. The first production line could produce three to four thousand nickel-cadmium batteries per day, and only cost a million RMB. At that time, Japanese manufacturers used fully automated production lines and robots. BYD faced the reality that it had insufficient capital to introduce similar production lines by introducing a hybrid line that was half automatic, half manual. They found that conducting movements manually in a big range caused very tiny errors, which mostly appeared in the final step when parts were assembled. So they designed many simple and practical processes for the last step; if the standards were not met, the parts could not be assembled. By combining manual work and processes, BYD

simulated a low-level robot. In this way, certain parts of the production line became manual; therefore, the biggest advantages for BYD were very low fixed assets investment and very low depreciation costs. BYD's depreciation cost was only 3–4 %, while the depreciation cost for Sanyo and other companies with automatic production lines was as high as 30–40 %. The fixed assets investment of BYD was 1/15th – 1/10th of Japanese enterprises, and the price of BYD's products was 30 % lower than its competitors.

Most importantly, BYD's half-automated production line was very flexible. When a new product came into production, adjustments to the production line only needed to be made to some key steps and technical training for workers would be enough. By contrast, the fully automated production lines of Japanese manufacturers could only produce one kind of product. Every new product required the whole production line to be re-built, at a cost that could be tens of millions or even a billion. BYD developed and produced products by itself; it also tested equipment by itself; which largely reduced the need for capital. In addition, since labor is quite cheap in China, the restructure and innovation of the production line process to include a mix of automated and manual work to a large extent increased its low-cost competitiveness as a Chinese enterprise.

As its experience increased, BYD continued to optimize its process. It divided the production process of batteries into many detailed steps, workers in each group only needed to do one simple step; therefore, they didn't need to undergo complex training but simply enough to handle the one or two essential skills required to work in their posts. BYD doesn't even have one complete production line. Between each procedure, battery embryos need to be transported in plastic boxes. Except for battery ingredients, quality and standards in all steps are controlled by corresponding molds and calipers. The test box for testing the charge and discharge times of each battery was also developed by BYD.

Wang Chuanfu attaches great importance to efficiency. The major way of increasing efficiency in this manual-dominant production method is monitoring. Every production procedure has its team office in front of it; team leaders sitting in the office can see clearly the working status of each worker. Report forms are piled up on each team leader's desk, with each production procedure required to be completed according to certain quantity and quality standards.

BYD made great efforts in research and development. It tests almost every ingredient and component by itself. Under the precondition of ensuring quality, it tries to reduce cost and look for replaceable materials and techniques. In addition, the production equipment of BYD is practically all produced by the company's design department, engineering department and branch electric companies (Zeng 2008).

BYD achieved the balance of cost, quality and effectiveness by its unique business process. Ensuring quality first and then continuously reducing cost by many Chinese enterprises is the secret to China's economic miracle. Innovation on production (operation) process is at its core.

### 5.3 Institutionalization with Different Starting Points

Institutional building is a task that every enterprise has to face. Private enterprises and state-owned enterprises have a common challenge, which is the conflict between institutions and human relationships originating from China's tradition. That aside, challenges faced by private and state-owned enterprises are quite different. Private enterprise started from zero, it needed institutionalization; however, state-owned enterprises needed re-institutionalization to change the rigid system formed during the planned economy period and to achieve the ability to react quickly to the market and the environment. No matter how, the precondition of successful institutionalization of an organization is whether high level managers can take the lead and accept the restriction of the institutions voluntarily.

#### 5.3.1 Institutionalization of Private Enterprises

Chinese private enterprises started with zero, so institutional building also needed to start from the very beginning. We've often seen that enterprises fell into chaos due to deficient institutions or no institutions at all. The following two cases are not fairy tales, people who used to work for private enterprises in the early times would be familiar with them.

*Case one: Once there was a small company in Zhongguancun. The accountant of this company was a female. Her boyfriend was obsessed with gambling. Once he lost all of his money, he convinced his girlfriend to give him tens of thousands of Yuan from the public funds of the company, and promised to return it with interest. But he lost again. One more time he asked his girlfriend to move company funds for him. The female accountant could not stand his bothering, so she did it again. This happened again and again until the total amount she had provided reached nearly one million Yuan. When the company needed to use the cash, these two were in trouble. In the end, the girlfriend went to jail. She had much to regret.*

*Case two: A supermarket in its early days used a first generation cash register, which could not list the prices of the goods being transacted. Therefore, the cases of cashiers entering false prices were common. For example, if a customer paid 100 Yuan, the cashier would ring up 50 Yuan on the register and pocket the difference. They normally targeted male customers (because men tend to pay less attention at checkouts). As time went on, this kind of thing happened more frequently. In order to strengthen management, the company switched to third generation cash registers, and introduced barcode scanning. Then the stealing disappeared.*

Even though “developing in the chaos, growing in the wild” was an inevitable choice for Chinese private enterprises in their early stages, if the chaos continues,



progress will never be made, and even the most entrepreneurial cannot save themselves. There were examples involving Nian Guangjiu and Bu Xinsheng in the 1980s; and the failures of Mou Qizhong, Yu Zuomin and Shi Yuzhu in the 1990s. In the face of the chaos, successful private enterprises all went through the process of institutional establishment and improvement, like HUAWEI, Vanke, Haier, Lenovo, BROAD Group etc. If we can use one sentence to conclude the management principle of BROAD Group, it would be “use the institution as guidance for action”. In the eyes of its CEO, Zhang Yue, every move by the enterprise can be separated, as detailed as possible, into every move of every employee. At BROAD Group, even an employee getting divorced needs the approval of the company first. This kind of management mode is one of the key factors to maintaining the sustainable and stable development of a company like BROAD Group, which places extreme importance on the stability of the system.

During the development of Lenovo, Tang Xudong made great a contribution to the institutional building of the company. He joined Lenovo at the time of the Sun Hongbin embezzlement incident. Tang Xudong’s position was not high in the company, but his legal background came in handy. After a few months, the storm caused by the incident passed and life returned to normal; however, Tang Xudong found that “this incident had a big influence on Lenovo”. He decided it was necessary for the company to introduce the employees to the concept of “institutionalization”. This conformed with Liu Chuanzhi’s thinking.

At that time, governance inside Lenovo was really messy. The personnel director didn’t know how many people the company had, the finance director didn’t how much money the company had, the logistics manager had no idea how much storage the company had. The company had been famous in the business for its “god rules” of “no kickbacks” and “no bribes”; however, Tang Xudong found those “god rules” were only passed on orally, there were no written rules for employees to reference. He believed that any institution needed a charter which was absolutely understandable to all, otherwise there were no principles for employees to act in accordance with, and punishments and rewards from management levels would also be without reason. He drafted the first edition of the “god rules” of the company, which is detailed below:

- A: Employees are not allowed to receive kickbacks in any way for any reason during business activities. People who violate this rule shall be dismissed.*
- B: Employees are not allowed to have a second job outside the company. People who violate this rule shall be dismissed.*
- C: Employees are not allowed to seek personal benefits by taking advantage of their position and the company’s business. People who violate this rule shall have all benefits obtained confiscated, and shall be charged the same amount of money as punishment.*
- D: If employees are receiving honorariums outside the company, they need to report to the chief manager of their own department, and submit all the honorariums to the chief manager for decision. People who violate this rule shall be fined twice as much as the honorarium.*

*E: If employees are receiving gifts during business activities, they have to report to department managers. Gifts valued under 50 Yuan are subject to the department manager's decision; a gift valued between 50 and 100 Yuan is to be submitted by department manager to the chief manager; a gift valued above 100 Yuan is to be submitted by the chief manager to the personnel director. People who violate this rule shall be fined twice as much as the gift costs.*

*F: Employees are not allowed to ask each other's entitlements and bonus. People who violate this rule shall be deducted the bonus of the month.*

*G: These rules apply to all the employees of the company (official employees and contracted employees included).*

Tang Xudong's efforts and faith in "putting the company on an institutionalized track" received support from the president's office. Liu Chuanzhi even set up a special team to draft all the necessary rules and regulations. The year 1990 became Lenovo's famous "institutional building year". At the end of 1990, the company accomplished its first batch of rules and regulations (Ling 2005), which opened Lenovo's institutional building history. Later, Lenovo conducted in-depth institutional establishment, even reporting people to the authorities for corruption, which resulted in several going to jail. Every new employee was required to undergo training that included learning the company's institutions and culture, which is called "human mold" by Liu Chuanzhi.

In order to set up the authority of the institutions, Ren Zhengfei emphasized "rigidify first, solidify second, optimize at the end", and insisted this be followed regardless of circumstances, or, to use the old Chinese saying, "cut your feet to fit your shoes". However, some enterprises have paid a price for their adherence to institutional rules. Vanke is one of them.

*In order to show that the enterprise appreciates employees' concept of value, Vanke's personnel department sets the rules that people who make mistakes during work shall be downgraded first. If he or she still performs badly, they shall be dismissed. According to the "Employee handbook", dismissing an employee needs to be approved by both the chief manager of the branch company and the personnel department at headquarters, plus consultation with the employee committee. However, once, a sales manager fired one of his staff because he acted against the company's rules and caused loss but only sought the permission of the chief manager of the branch company. This action broke the company's personnel rules; however, it was meant to protect the company's interests. The person who was fired complained to headquarters. However, this sales manager threatened that, if headquarters overruled his decision, he would quit his job. After investigation, the personnel department decided to maintain the branch company's decision because, even though the branch company violated the personnel procedures, the person who was dismissed did damage the company's interests; further they claimed there would not be a next case. Conversely, the employee committee strongly opposed the personnel department's decision; they deemed that the "Employee Handbook" should be strictly followed. In the end, all the opinions were collected and reported to the president of the company, Wang Shi. Wang Shi's opinion was that the company formulated rules for the purpose of making the organization more standardized. If the branch company violated the rules, headquarters had the responsibility to correct it. Therefore, he decided to overrule the decision of the branch company. Instead, he downgraded the position and salary of that person. Soon after, the sales manager, who was very competent, quit his job (Zhang et al. 2006).*

### 5.3.2 *Re-institutionalization of State-Owned Enterprises*

State-owned enterprises already existed at the beginning of Reform and Opening-up; they had formed some institutions during the planned economy period, although some institutions may look ridiculous today, for example, even establishing a toilet needed approval from a general manager. There were also legends, such as getting one thing approved might need more than ten stamps and might take several months. If we say private enterprises were “messy”, then the main problem for state-owned enterprises was “rigidity”. Solving the “rigidity” problem and establishing a new system suited to a market economy were the priority tasks for state-owned enterprises.

Generally speaking, the institutional reform of state-owned enterprises, on one hand, was the process of the delegation of operational power by the government to enterprises; on the other hand, it was the process of enterprises reforming internal systems and getting closer to the market after obtaining autonomy. In June 1992, the State Council issued the “Regulations regarding converting operational mechanisms of state-owned enterprises”. In this document, state-owned enterprises were granted 14 major operational rights, which put state-owned enterprises’ business activities on a marketization road. Up until 2001, more than 80 % of state-owned enterprises basically had these 14 major business operation rights, including investment rights, foreign guarantee rights, import and export rights of proprietary trading, foreign contracting and labor service cooperation rights etc.

Inside state-owned enterprises, reasons such as pressure of the market, progress in the supervision of state-owned assets, and the sense of responsibility and superior consciousness of leaders triggered a series of institutional reforms, which were in accordance with the changes to the market. We can see this from the institutional building of the State Grid Corporation of China, which is a large-scale state-owned enterprise. Actually, as a big monopolized public business unit in the situation where the lack of electric power hadn’t been improved, the State Grid Corporation could have chosen another way for surviving, but it chose to put pressure to itself. As the director-general of Shandong electricity bureau, Liu Zhenya carried out the famous “Rainbow Project”, under which people who provided criticism on the work of the bureau were rewarded. Today, both the rules and the awareness for State Grid Corporation’s good service are internalized. According to the corporation’s employees, this progress mainly came from “internal benchmarking”, namely the appraisal through comparisons inside the corporation without external competition and pressure. The corporation compares performances at the same level, based on a number of indicators each year, and publishes the results. People have to work hard in order to make progress and save their reputations; meanwhile, there is the pressure of saving their positions and the impetus for self-promotion (Zhang and Wang 2009).

### 5.3.3 *The Contest Between Institutions and Human Relationships*

The biggest obstacle to implementing institutions in China comes from the social structure and the cultural tradition. The nature of institutions is to request all members of an organization to act according the same rules in an impersonalized way, namely people are equal before the law (institutions). But some incompatible logics exist in the ethics (or particularity) of China's social culture. Chinese culture stresses networks and human relationships; people normally decide their actions based on their relationships with the other party when doing things, or as Fei Xiaotong calls it: the differential mode of association. There are also many sayings which talk about the flexibility and adaptability of doing things in our language, e.g. "order different meals for different people", "eat different cakes to match with different dishes", and "sing different songs when walking on different mountains" etc., which inevitably make us treat people differently.

Another very distinctive feature of Chinese culture is the high value placed on human relationships. As a social standard in China, human relationships require people to keep harmonious relations and create reciprocity for people with whom they are close. Behaviors that break the rules shall be punished in modern enterprises; however, members of organizations will sacrifice the rules in order to maintain their networks and take care of their human relationships, which are characterized by keeping silent when encountering conflicts or making concessions to avoid trouble. The preference for personal networks and human relationships leads to invalid execution of rules and regulations when it comes to particular individuals, which undermines the authority of the institutions.

Therefore, overcoming the obstacle of human relationships is the first step which needs to be taken, and successful private enterprises in China, especially family businesses, all make an effort in this regard. For example, in order to solve problems caused by corruption inside the family business, which could not be solved by institutions, Wenzhou Sharmoon Garments Company finally chose to merge its business with an Italian company and let the Italian side provide the CEO.

*Chen Xiaoxiang and his two brothers came from rural areas of China. They had completely no sense of English and Western culture. How could they enter the Middle Asian market with this background? Meanwhile, the severe competition also required the company to have a more modern and professional management system. Was the family business style, which had bred and nourished the company, becoming an obstacle to its development? This was an unavoidable fact. Chen Xiaoxiang had very deep feelings about this: "When an enterprise is becoming bigger, it just cannot perform its original way; family members all come up with many ideas along with the growing of their experience and ages, which may cause many kinds of obstacles during the execution of a decision... I used to sign a document, which was about cash against delivery. The client knew that I was very tough with the policy (refers to cash against delivery), so they went to persuade five or six of my family members. They knew it would work on at least one of them, and then they would get the goods. Some family members thought this could show their power... In order to maintain good relations, family members normally don't investigate and affix responsibilities for some big malpractices. However, one time after another, this could lead the*

*enterprise to death.” Meanwhile he deemed that “this is not only Sharmoon’s problem, this is a common problem for all private enterprises.”*

*With this idea, Sharmoon finally found its ideal overseas partner in 2001 – Ermenegildo Zegna. After over two years’ negotiation, Sharmoon Company’s brand “Sharmoon” garment officially signed a contract with the Italian Zegna Group on March 28, 2003. By investing share capital, Zegna participated in Sharmoon’s management and decision-making. They established the new SHARMOON EZ Garments Co., Ltd. Chen Xiaoxiang was appointed as the chairman of the board, and left the Italian side to recommend a CEO. According to Chen Xiaoxiang, after the new CEO came on duty, some administrative staff who were not suited to the modern business management were requested to leave their posts. It was also required that middle level management staff needed to have College English Test (CET) – level 6, and a minimum five years’ work experience in foreign trading. It was also decided to attract people who had CET-8 to join the company. “Today, the reason we request ourselves to study is for the purpose of taking more initiatives in international competition tomorrow.”*

*As it turned out, a new broom sweeps clean. The CEO, Silvio Galimberti, with his Western cultural background, completely changed the company according to the requirements of professional management: providing insurance for all the employees, increasing subsidies for overtime work, and using the Internet system to manage finance. According to the consultant of SHARMOON EZ Group, Li Yanhui, the company bought five kinds of insurance for employees; the monthly salaries of employees were all above 3000 Yuan; the subsidy for overtime work was 150 Yuan per hour. In China, this high treatment of employees was like a fairy tale, which caused 35% more in operating costs in one year. This nearly 20 million Yuan extra cost really hurt Chen Xiaoxiang. When talking about his feelings back then, Chen Xiaoxiang said: “The only feeling is hurt! I can buy 20 Mercedes Benz with this 20 million Yuan. I don’t even have a car now, not to mention a Mercedes.” However, Chen Xiaoxiang chose to compromise, because he knew that was the essential step which Sharmoon had to take to achieve professionalization and internationalization (Dong et al. 2005).*

### **5.3.4 The Role of Top Leaders in Institutional Building**

The key factor for institutions to be successfully implemented in an organization is whether leaders are willing to be constrained by institutions or if leaders are prepared to choose “rule of law” rather than “rule by man”. In Chinese tradition, there is a saying: “the authority will be unpredictable without laws”; which means, if there is no law, the authority of leaders will be even stronger. If everything is done according to laws, what’s the role of leaders? Even today, there are still different opinions about “rule of law” or “rule by law”. The first one is a Western tradition; in this tradition, laws are used to constrain the power holders; the second one uses laws as tools for governance, it is a tool for leaders to rule people.

Among those organizations which successfully established the authority of institutions, we found that leaders taking the lead and accepting the constraint of institutions voluntarily was a premise. In Lenovo, there used to a rule that people who were late for meetings would be punished by standing. The amount of time they had to stand was equal to the amount of time they were late. Several times, Liu Chuanzhi was late due to accompanying important guests but he voluntarily stood instead of explaining. One time after another, this rule was reaffirmed.

The reason Vanke has become a transparent and very professional company is Wang Shi's crucial role in the whole process. All the arrangements of institutions were made under his lead, including the human resource system, governance system, training for managers, the standardized actions on government relations etc. This whole system has become the key factor for supporting Vanke's fast development. Wang Shi chose to be a professional manager instead of an owner; he designed the governance structure by himself and constantly improved it. The governance structure of Vanke has a feature which every good governance structure should have: everybody has limited authorities, limited responsibilities, and limited space. If there is a supreme boss of the whole company, it is easy for a situation to appear in which there is no boundary to the boss's power, so he or she can do whatever they want. Therefore, Wang Shi chose not to be the boss. Instead, he became one of the managers under the supervision of the board and shareholders. He receives supervision and constraints from the shareholders' commission, the board of directors, and the supervision commission of the company; meanwhile, he is also constrained by China's Securities Regulatory Commission, supervision and regulatory departments of the government, and the capital market. The leader accepting supervision and constraint voluntarily is certainly the key reason for Vanke successfully setting up the authority of its institutions.

## **5.4 Various Kinds of TMT Combinations**

During the organizational and institutional building of enterprises, building the top management team (TMT) is absolutely an important step. In Chinese private enterprises, there are many examples of enterprises that fell apart or even failed due to disputes among TMT. Therefore, solidarity at high levels has a significant impact on an enterprise's long-term survival. However, compared to normal internal organizational and institutional building of an enterprise, TMT building is a lot more difficult, due to the involvement of family relations, friendships and other factors.

### ***5.4.1 Combination Mode: Family, Friends and the Needs-Oriented***

What constitutes TMT in Chinese private enterprises? This is not only determined by times and environments, it also depends largely on the family backgrounds, experiences, networks and visions of entrepreneurs. Some entrepreneurs have simple experience and limited networks, so they have to look for partners from among relatives or people they are close to; some others have rich experience and wide networks, so they have more options. Thus, we can see the following kinds of TMT combinations: family style, founding businesses with college mates or friends, or looking for business partners according to needs.

### ***5.4.2 Family: Father and Son Are Always a Natural Team***

Among many private enterprises, the family business certainly is the most common organizational form. For entrepreneurs during the early stage of China's reform, choosing family members to cooperate was a convenient and had-to choice. Liu Yonghao many years later said: "If you are not my brother, I wouldn't do business together with you back then." Even though we do not have an exact ratio of family enterprises to all private enterprises, its dominant position is certain. According to a study conducted in Zhejiang province, more than 90 % of private enterprises were family business. This is consistent with the arguments of some academics who study Southeast Asian Chinese enterprises: due to the influences of traditional Chinese culture and social structure (e.g. strong family focus, differential mode of association, low social trust and the appreciation of networks during interpersonal communications etc.), the family business became the main organizational form of Chinese enterprises. Of course, during the thousands of years of Chinese history, the family has played a central role in production and livelihoods, so it was easy for this type of organizational form to be adapted to business activities.

Meanwhile, family businesses released a lot of vitality right after the introduction of Reform and Opening-up, due to its high unification of ownership and management, low agency costs, fast decision-making, and flexibility, among other features. Wanxiang Group, Joicare Group, Zhejiang Jinyi Group, Fotile Group, Lifan Group, CHINT Group, China Delixi Group, Shaanxi Huanghe Group and Huaxi Hope Group are all famous family enterprises. Chen Jinyi was born into a peasant family in Tonglu county of Zhejiang province. He started his business in 1989 and officially established Zhejiang Jinyi Group in 1993. At the beginning, there were more than 30 of his relatives working in the company, and most of them were working in high-level positions. These people included his two brothers, a nephew, and his brother in law. These people had undergo hardship with him during the start-up stage of the business and they had made great contributions to the development of the company. However, due to the fast development of the company, as well as these family members' backgrounds, some of them could not meet the requirements of the new business environment. Chen Jinyi himself also realized the defects of the family style business administration. Therefore, in 1998, he decided to move the company away from family style management and started to hire professional managers from the outside (Zhong et al. 2005).

Mao Lixiang's Fotile Group is also a family business; two generations of leaders have come from the Mao family. Production, supply, sales, human resources, finance and materials are all in one pocket of the family jacket. Mao Lixiang chose his second son, Mao Zhongqun, to take over the business, appointing him general manager without a deputy. This action apparently has the eastern feature – a son taking over the father's business. But this time, it was not only because of the blood relationship. Mao Zhongqun was completely competent and qualified to take over the business. He explored a series of successful measures for introducing and keeping professional managers. In order to maintain the healthy and long-term

development of the enterprise, Mao Lixiang set strict rules when his wife came to work for the company: relatives from both sides were allowed to work in the company, but must not carry positions above the level of workshop manager. Currently, there are still a few relatives working in Fotile, but they are all under the level of workshop manager. More relatives started their own businesses with the financial help of the Mao Lixiang couple (Li et al. 2005).

### 5.4.3 *Friends: Sworn “Brothers” (Friends)*

Friends who co-found businesses and constitute TMT are normally schoolmates, colleagues or comrades in arms. Similar experiences and dreams bring them together to look for opportunities in the tide of the market economy. In the UFIDA team, Wang Wenjing and Su Qiqiang were colleagues back in the Government Offices Administration Affairs Management Bureau of the State Council; another two original founders, Wu Tie and Guo Xiping, are their friends, who used to work for the Ministry of Finance. The “five tigers” of the founding team of FOSUN were all friends or classmates back in Shanghai Fudan University; among them, Guo Guangchang was a member of the Youth League Committee, Liang Xinjun was the research director of the Youth League Committee, Wang Qunbin was secretary of the Youth League Branch Committee of the Life Science School, and Fan Wei was the manager of the printing division. At other enterprises, members of Shi Yuzhu’s team are mostly his university schoolmates; members of Ma Yun’s team at Alibaba are mostly teachers and their students; members of Ma Huateng’s team at Tencent are also mostly schoolmates or colleagues from China Motion Telecom. The following story about Vantone’s experiences in Hainan province explains the friends combination in detail.

Feng Lun was appointed by the China Society of Economic Reform under the State Council System Reform Committee to establish a reform and development research center in Hainan province in 1988. His position was deputy executive chief. At the beginning, Hainan province gave him 50,000 Yuan, a car, a computer and an approval document for 10,000 color TVs. It also hired a bunch of people to run magazines. Pan Shiyi was one of them. Before this, Feng Lun already knew Wang Qifu and Yi Xiaodi. He got to know Wang Gongquan through Wang Qifu, and then came to know Liu Jun through Wang Gongquan. Later, Feng Lun, Wang Qifu, Wang Gongquan, and Liu Jun worked together at NANDE Group; they often sat together and talked about life, which laid a mature ideological foundation for their future cooperation. So, when Vantone Group was established, these six people were already friends. Shares in the group were split equally into six and distributed equally, so the six people had the same power in decision-making. They formed an executive board of directors; all the major decisions were made by the six people together.



#### ***5.4.4 Needs Oriented: Looking for Talents with Humility***

Organizing a TMT according to needs is an ideal situation. However, this happens rarely in Chinese private enterprises. In most circumstances, entrepreneurs have no other choice but to exploit combine the existing resources. The founding of online travel flight booking agency Ctrip.com's top team followed the model of first based on sworn friends and then looking for needed talents. The second step is the measure reflecting a needs-oriented philosophy. Liang Jianzhang went to work at the headquarters of the world's biggest software supplier company, ORACLE, in 1991. In 1997, he was transferred back to China as the consulting director of ORACLE China region. Shen Nanpeng finished his MBA at Yale University; he had many years of work experience in investment banking, and had a strong capacity in financing and macro decision-making. Ji Qi had lived in the United States for many years; he used to found and run high-tech companies, and had rich experience in management and sales. A month after the team was established, Fan Min, who also had an overseas training background, having worked in the tourism industry for many years, joined the team. Fan Min used a metaphor to describe the positions of the four original founders: "If we want to build buildings, Ji Qi is the one who gets the approved documents and the land, because he has passion and is good at dealing with interpersonal relations; Shen Nanpeng is the one to find money because he is an expert in financing; Liang Jianzhang is the one to formulate the overall framework because he understands IT and can explore business models. I come from tourism industry and I'm good at stirring the concrete and sands together to fill in the framework. And that's how the building is done. Talking about personalities, Ji Qi is very passionate and has a strong will to develop; Shen Nanpeng is all about the big moves, he always acts like a sophisticated investor; Liang Jianzhang is very rational, he talks using numbers and has good vision; while Fan Min is good at running business, and can always deal with things properly in all aspects. Four people all have their own specialties, they each handle one side of the company. We have high consensus about each person's role inside of the company."

#### ***5.4.5 Operation Modes: From Paternalism and Gangsterdom to Professionalization***

In accordance with the three forms of combinations of TMT, there are three operational modes: paternalism, gangsterdom style and the professional management team.

Paternalism mode of operation mainly exists in, but is not limited to, family businesses. Under the influence of thousands of years of the Chinese patriarchal clan system, there are traces of paternalism from time to time even in the leaders of some very modern and large-scale enterprises. The features of paternalism are that:

there is a “big daddy” whose word carries weight; centralized decision-making and control; no delegation of power; family relations are more important in assigning tasks than actual capacity; direct management; and leaders always lead and deal with issues by themselves. All these features, while bringing vitality and good order to enterprises, also brought blind spots to decision-making and, as a result, created the preconditions for failure.

Hu Zhibiao of Shenzhen IDALL Technology Co., Ltd is an example. At both the start, when the company was just a small factory, and later, when it grew into a much larger scale enterprise, Hu Zhibiao employed the family style management and operational mode. The CEO and vice CEO were namely him and his wife, Lin Ying. In terms of the decision-making and control of the company, from enterprise-wide strategies to detailed tactics, Hu Zhibiao himself had the final say. There were no decision-making teams, nor an optimized decision-making process, not even an effective mechanism for feedback. After Lin Ying took the post of vice CEO, she took over full financial decision-making power. Other high level and middle level managers had almost no say at all. All the reimbursements at IDALL were subject to Lin Ying’s personal approval. Before crisis finally struck at IDALL, a sales manager went to Lin Ying with a proposal to solve growing debt problems at the company. There was no response from Lin Ying and that sales manager finally chose to leave the company. Subsequently, many high-quality personnel left one after another, and IDALL’s top management team fell apart.

However, there are quite a number of family enterprises which continuously learned from their experiences during development, introduced new methods while keeping the advantages of a family business, and gradually transformed their businesses into modern enterprises. For example, Guo Fansheng of hc360.com proposed: “It is an entrepreneur’s responsibility to build good relations with outsiders (those non-family members), and it is the capacity of an entrepreneur to keep family members in good order.” Yin Mingshan of LIFAN Group proposed to “promote both families and talent”: using family members for stability and talented people for development.

The gangsterdom style of operation is normally adopted by TMTs formed by friends or schoolmates at the early stage of their businesses. Among these, Vantone was an excellent example of using the gangsterdom style. In 1991, in Haikou city, Vantone started to build its hierarchy. The top criterion was age; the second criterion was previous social status, which was the importance of their positions in previous work places; the third criteria was their contributions to the enterprise. Feng Lun was the oldest, he was the leader of a group at his previous work place, and he provided Vantone’s initial capital; therefore, he became the chairman of the board and undisputed leader. After building the hierarchy, it was time to distribute money. As the big brother of the team, Feng Lun made a grand gesture. The capital would be divided equally among the six team members, as would salary. Feng Lun recalled: “At the beginning stage of the business, it was hard to say whose contribution was bigger or smaller. I had the idea that assuming we were together was not an investment of money; it was of people’s cooperation. The system would not work without any one of us. That’s why we needed to equally divide the money.

Only by dividing the money equally could we avoid contradictions. We needed unity to walk longer and further.” However contradictions appeared anyway in the end. Vantone started with using gangsterdom mode and quit that stage in a businessman’s way, during which the empathy of brotherhood can still be felt. Quitting the game in a businessman’s way promoted Vantone’s organizational evolution, and the transformation from an institution-free company into a professional organization that could involve more people (Feng 2007).

Finally, TMTs according to needs mostly adopt a professional manner of operation way. They are familiar with the operational methods of modern business organizations, so they are able to work in accordance with business principles; in addition, they can manage themselves when problems contradictions occur. In 1995, HUAWEI was swept by a management storm referred to as “resign first, compete for posts again”, which required all marketing department managers to submit two documents: an annual report on the year and a resignation letter. After this move, 30 % of the managers found themselves in new posts. In relation to this event, Ren Zhengfei’s view is: “Any organization will die without metabolism. If we take care of every old contributor’s feelings, we will bury our company’s future.” On Sept, 10, 2009, which was the 10th anniversary of Alibaba Group, the chairman of the board, Ma Yun, said something which shocked everybody. He announced that the 18 original founders, including himself, would “resign together”, and “apply for our posts again” under a decision to “start from zero” at Alibaba. From then on, Alibaba graduated from the era of founders to the era of professional partners.

Along with the elapsing of time and the evolution of enterprises, many enterprises are trying to keep pace with the times, and continuously improve the operation of their TMTs. A very obvious path is the evolution from paternalism and gangsterdom to professionalized management teams. The above mentioned Jinyi Group and Vantone Group all experienced this evolution.

#### ***5.4.6 Shareholding Arrangements: From Vague to Clear***

In terms of shareholding arrangements, 30 years’ development of Chinese enterprises has resulted in the passage from a vague to a clear arrangement. Enterprises which were established at the preliminary stage of Reform and Opening-up had very vague shareholding structures. This on one hand was because of the inadequate institutional environment, which lacked institutional arrangements to support a clear shareholding; something like “Company Law” had not yet appeared, so some enterprises had to wear the “Red Hat” (i.e., private business registered as publically owned) to avoid policy and personal discrimination. Some enterprises didn’t know how to arrange shareholdings at all. On the other hand, when China first entered the market economy, people were ashamed to talk about profits and money. They were ashamed to, or they didn’t even know how to, express their claims for benefits.

As Feng Lun recalled: “It’s hard to determine which money was the capital investment at the beginning, and later on it became difficult to divide the shares clearly. We had no idea, and there was no ‘Company Law’. There was not even any evidence for us to talk about. So I said the cooperation of our people was not based on money, but a common dream, faith and the pursuit of those. We set a principle the first time we were trying to distribute the benefit. We used the mode of ‘The Marshes of Mount Liang’ – orders in titles, same benefits”.

The vague shareholding sets a time bomb for disputes; it becomes a big obstacle for many enterprises’ development. Even inside a family, when there is a conflict over profit distribution, brothers, couples, and even fathers and sons can turn against each other. The typical example is the Nian Guangjiu family of the “Sillymen Guazi” brand. The lawsuit between Nian Guangjiu and two of his sons, and his two wives turned the “Sillymen Guazi” business upside down. There were some other private enterprises which took precautions, and removed these obstacles in time, like UFIDA. During the development of UFIDA, one of the original founders, Su Qiqiang, chose to start another business, and Wang Wenjing raised money and bought Su Qiqiang’s shares. Chinese private enterprises had been constantly studying and quickly developing, after they entered the new century. Something like “clear accounting between brothers”, or “be super specific with money first, be a gentleman later” became their new behavioral standards. This evolution grew from the lessons learned from disputes caused by unclear shareholdings, and also the enforcement of institutions and norms in the outside environment, as well as the impetus of formalizing shareholdings driven by the needs of development (i.e., to go to the stock market or to introduce strategic investors).

No matter whether it was from the continuous exploration of structure, process or institutions, or from seeking to keep pace with the times in TMT management and operation, we can see that, during the past 30 years, Chinese private enterprises have been developing quickly through frustrations and experiments, constantly innovating by imitating and learning, and breaking through the traditional human relation barriers to adopt rational systems, and refining China’s experiences like a phoenix reborn from ashes.

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