

Institutional Transformation and the Creation of Chinese Entrepreneurial Networks

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Paper prepared for the Corfu pre-conference of the Session X: Diaspora Entrepreneurial Networks, C. 1000-2000, 13th International Economic History Congress, Buenos Aires, 2002.

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Abstract

How should we understand the Chinese diaspora entrepreneurial networks that had emerged in the last few decades? My paper is to provide a socio-historical analysis on the transformation of Chinese business networks since the late 19th century, and to illustrate how a historical analysis could help us to understand the nature of the contemporary Chinese diaspora business networks.

Traditional Chinese economy did not produce entrepreneur. Merchants that were tied up by traditional business networks were expected to be more cooperative with each other than to compete with the others within the networks. The introduction of the Western corporate forms in the late 19th century however had transformed the structure and function of the traditional Chinese business networks. The new organizational format was adopted by the Chinese merchants which in turn was used as a *carrier* of personal resources. The use of networks was reinvented through this new organizational format. Business networks were still in use but were reinvented in the new contour of business community where companies became more and more influential. This new institutional setting finally allowed the emergence of entrepreneurs in China.

While capitalism was discontinuous in the Mainland China after 1949, diaspora of Chinese in the post-war East and Southeast Asia had on the other hand created an economic miracle partly through cross-border entrepreneurial networks. The institutional transformation of the Chinese business organizations is a crucial factor that should be focused on in order to understand this economic success.

Introduction

It is undebatable that the economic growth that happened in East and Southeast Asia in the last few decades could largely be attributed to the business activities of the Chinese diaspora.¹ With different approaches available to explain this economic miracle created by the Chinese, one major argument is that the success of the Chinese was because of a unique pattern of business organization. This pattern of organization has created what some scholars would call a “network-based economy,” in contrast to a “firm-based economy,” which is common in many Western economies.² A network-based economy is an economy that is based on relational networks. It is the networks, rather than the individual firms, that are the key contributor of the economy. In a firm-based economy, firms on the other hand are the key contributors of the economy, and networks, if they ever exist, are secondary and are embedded in firms.

While a typical Western economy has developed an institutional foundation that could facilitate autonomous individual economic actors and therefore facilitates a firm-based economy; Asian economies, notably Chinese, Japanese and Korean economies, are rooted in social and economic institutions that encourage personal ties and network formation. With different institutional settings in the societies, the organizational logics of the economies will be different.

I am arguing that the present mode of Asian capitalism was resulted from the interaction between pre-existing social and economic institutions and the changing economic environment. Pre-existing institutions, while not deterministic, are

¹ There are many literature describing the Chinese Diaspora economy, see for example (Brown 1995; Kao 1993; Lever-Tracy, Ip, and Tracy 1996; Omohundro 1983; Redding 1990, Weidenhaum and Hughes 1996; Yeung and Olds 2001).

² For a discussion on firm-based economy, see (Biggart and Hamilton 1992). For a discussion on the nature of a network-based economy, see (Hamilton 1996)

consequential in the subsequent development of the economic institutions (Arthur 1994). Socio-economic transformation is largely path-dependent. New ideas that were borrowed from other social settings would be incorporated in and altered by the existing way of life.

This paper is to provide a socio-historical analysis of the emergence of the network-based economy among the Chinese business communities in East and Southeast Asia. I argue that the institutional and historical settings in China during the turn of the 20th century had constrained and therefore shaped how the economy reacted to the changing external conditions and had produced a particular kind of network-based economy.

In this paper, I am going to describe the features of the traditional Chinese business networks and the institutional transformation, in particular the introduction of Western corporate forms, that happened in the Chinese economy during the turn of the 20th century. I will then discuss the consequence of this transformation by focusing on how the traditional business networks were degenerated because of the structural change of the business community, and how personal networks were reinvented during the rise of the Chinese entrepreneurship.

Traditional Chinese Business Networks

Networks in the traditional Chinese business community were used on the one hand to extend business opportunities but on the other hand, and more importantly, to stabilize the business. Merchants were connected together so that regulations that were set by the guild could be reinforced. Traditional networks, while helping individuals to maximize the utilization of one's business opportunities, were at the same time promoting cooperation among those who were linked up.

Chinese Native Banks as an Example

The organization of native banks (*qian zhuang*) in modern China gives a good example on how the traditional networks worked in the late Qing economy. Serving as the principal financial institution in China's advanced commercial economy during the late imperial times, Chinese native banks were among the most traditional forms of Chinese business. Through an ownership analysis of all native banks in Shanghai during 1927, the operation of the native banks can provide a vibrant example on how interpersonal networks function in a traditional Chinese business setting.

Specializing in short-term loans to merchants, native banks would issue guaranteed promissory notes payable to the bearer normally at a specified later date. The modern counterpart to these notes would be endorsed post-dated checks that could circulate as money. Merchants who were short of cash would pay a fee and interest for a short-term loan in the form of promissory notes to buy goods that they would, in turn, plan to sell before the due date of loan. The endorsed note given to the seller of goods could then be redeemed at the native bank for money or perhaps circulated as currency up to the date of redemption.

Native banks normally provided services to a known group of merchants and tradesmen. Wealthy merchants who had some capital to invest and many good connections in the commercial community usually started the banks.³ Although a few were single proprietorships, most native banks were organized through partnerships from four to six people.⁴ Sometimes partnerships would link closely related family members, but in most

³ In our sample it appears that many investors used to be opium traders or dyestuff merchants.

⁴ In a few cases, the number of partners involved was as few as two and as much as seven or eight.

cases partners would have no kinship ties among them and instead would be predominately friends, business colleagues, and fellow-regionals. In Shanghai, the guild of native banks linked all the banks together to form an overarching financial network that guaranteed the local currency and ensured the continuity of commercial transactions in that location.

A key feature of the native bank investment was the cross-investment patterns. Rather than investing one's capital in only one place, as a sole proprietor for instance, native banks investors would rather diversify their investments in different banks than place all their money in one bank. Partnerships created from such cross-investments neither created nor reflected a core business elite in each location. Rather these partnerships represented interpersonal networks allowing investors to bridge multiple and distinct groups within the commercial community.⁵ The set of partners for any particular bank would likely interconnect fellow regionals, business colleagues, and reputable individuals from outside the native regions who possessed good business contacts, possibly links to foreign and Western-style modern banks. Native bank organizers would also often solicit partners that could bridge some of the regional cleavages that existed in most immigrant urban settings.

The operating capital of the native banks was usually quite small.⁶ Different from modern Western banks that require very large pools of capital to support and guarantee business operations, Chinese native banks depend more on personal trust as an asset and personal ties as a guarantee. Partnerships in the Chinese native banks thus represented not

⁵ Even if one family owned a bank, the family would expand its business by opening multiple native banks with different names and with different managers. For example, the Cheng family of Suzhou invested in twelve different banks between 1876-1953 through different combination of family members (People's Bank of China, 1960: 738-741).

⁶ The average is 100,000 taels in 1927. It used to be even less in previous decades.

only a pooling of capital, but also sets of relations that can potentially be tapped by each partner.

The membership list for the Shanghai native banking guild provides information on partnerships for 78 native banks listed in Shanghai during 1927.⁷ Only five of the 78 native banks were sole proprietorships. The rest were formed by partnerships. Because of cross-ownership, most of the banks are directly or indirectly linked up with each other.

Representing by a line between two banks when there is at least one interlocking ownership, Appendix One show that 50 of the 78 native banks were linked through cross-ownership.⁸ This web of relations represents the linkages of the players (both banks and individuals) in Shanghai's native banks community.

This pattern of interlocking demonstrates a collection of "weak ties" to create an extensive interpersonal network across Shanghai's native banks. Most of the interlocks are singular, i.e. no more than one partner has cross-investment in the same two banks and there appear to be no family groups represented among the interlocks. Rather than forming into one closed group, native bank investors extended their connections by linking themselves directly and indirectly to multiple groups of people which in turn provided the foundation for native banks to operate as a financial system.

The system worked quite apart from the state officials and state's legal framework. Partnerships were made on the basis of unlimited liability, and bank loans were unsecured. The entire system operated on the basis of reputation--the banks' reputations, the partners'

⁷ People's Bank of China (1960: 264-268).

⁸ Except the 5 banks that with individual ownerships, the other 23 banks are also linked up together one way or the other into a few clusters.

reputations, and the borrowers' reputations or that of their guarantors.⁹ The system works because the entire commercial community acting as third-party monitors backs every transaction. Information about misdeeds on the part of merchants or banks would circulate throughout the community, making it impossible to do business again in the community.

Since trust among banks was so important for the maintenance of the efficiency and stability of this traditional financial institution, native banks relied on a collective mechanism to guarantee the trustworthiness of the system: the local association of native bankers. Associational membership was monitored closely. To be a member of the guild, a bank needed to invite a person of high prestige within the community to serve as its guarantor.

An important feature of native banking was realized through the network of native banks. Every native bank would accept the promissory notes issued by every other native bank in the locale. Rather than cashing the notes upon receipt every time, just as modern banks would do, every night after business hours, all the native banks, monitored by the banking guild, would exchange each other notes to settle accounts. This exchange allowed banks to operate without a large capital reserve. The personal ties served at least one more function for native banks. When a bank began to run out of cash, for example, when it issued more bank notes than it can afford to clear; the bank would have to ask for help from other banks with which they maintained connections. Personal ties helped to establish these “strategic alliances” so that the amount of operating capital could be minimized and the chance of long-term survival maximized.

⁹ Chinese merchants will consider it as a disgrace if the bank requires a mortgage for loan. Reputation, and not property, is supposed to be used as a mortgage.

The operation of the native bank illustrates that personal ties were necessary for a merchant to get into the bank business, but the same ties were also acting as constraint on one's business conduct. So long as you were tied to the group (through the guild), you were supposed to conform to the rules and regulations set by the group. The networks therefore performed a function of guaranteeing the stability and functioning of the business through which conformity to the group norms could be reinforced.

New challenges

This traditional mode of business operation was running relatively well and stable in the highly commercialized Chinese economy in the Ming and Qing dynasties. Government also welcomed this "self-regulated" economy so long as sufficient revenue could be generated. With limited administrative power, the Chinese government simply granted exclusive rights to guilds, brokers (*yiahong*), or a small group of merchants to either control and regulate the market or monopolize certain businesses (e.g. salt trade), and collected tax and fee from them rather than directly from every individual economic actors.

Since the mid-1800s, foreign economic invasion had progressive been destroying the traditional economic system in China. The invasion became more intense after 1895 when China lost in the Sino-Japanese war and had to grant more privileges to foreign countries (e.g. open more treaty ports). Foreign goods were replacing domestic made goods in many major sectors (e.g. textile). Overseas companies, mostly trading and finance at the beginning and manufacturing later, increased vigorously overtime and were putting tremendous pressure on China's economy. Table 1 shows that the number of foreign trading houses had increased 21 time in 35 years since 1893.

Table 1: Number of Foreign Trading Houses in China

<i>Year</i>	<i>UK</i>	<i>USA</i>	<i>France</i>	<i>Germany</i>	<i>Japan</i>	<i>Russia</i>	<i>Others</i>	<i>Total</i>
1893	354	30	33	81	42	12	28	580
1903	420	114	71	159	361	24	143	1,292
1913	590	131	106	296	1,269	1,229	184	3,805
1920	679	409	180	9	4,278	1,596	224	7,375
1928	682	574	181	319	8,926	1,112	499	12,293

Source: Wang (2000:140)

This extreme competition had stimulated enormous discussion among the government, intellectuals and the business community, and had fostered tremendous institutional changes – mostly could be described as westernization - in the economy that had never happened before in the Chinese history.

The Institutional Transformation of Business Organizations in China

Since the late 19th century, there was a share belief in China that in order to increase the national strength, commerce had to be developed and modernized, and in order to develop the commerce, the economy should be organized under the Western style corporate forms (Guo 1995; Zhu 1996). The introduction of company law in 1904 represented the first step of the Chinese government to institutionalized commercial activities in China according to the Western model. In order to compete with their foreign counterpart, Chinese merchants were mobilized to join together to establish *Gongsi* (company). The introduction of corporate forms into China, especially the corporate form with limited liability, constituted a key landmark on the capitalistic transformation of the country's economy. The early stage of Chinese capitalism can therefore partly be characterized by the ways the Chinese merchants reorganized themselves into companies in

order to capture capital and to re-gain control of the national market. New business organizational concepts such as board of directors, shareholders, general meeting, and limited liability, etc. were introduced into China and gradually changed the contours of the commercial life in China.

China Incorporated

The result of this institutional transformation in the economic sector, however, was not as progressive as expected, and one would argue that the introduction of corporate forms and the related institutional transformation (e.g. legal reform) were not very successful. In terms of the number of firms registered as company under the company law, the transformation was not significant. Between the first year (1904) of the promulgation of the first Chinese company law (*Gongsi Lü*) and 1912 (end of Qing Dynasty), the total number of registered companies was less than 200. There were only 1,185 more companies registered as limited company between 1912 and 1927 (Shanghai Municipal Archives 1996).¹⁰ Comparing with what happened in Britain, for example, where thousands of companies registered in the first few years after the liberalization of limited liability company and increased rapidly in number since then, China didn't experience the kind of rapid growth of company establishment after the company law was introduced.¹¹ There wasn't immediate effect on the organization of the Chinese economy.

¹⁰ The statistics on the number of registered company is actually incomplete and sometime contradictory. There were some official records on how many companies registered between 1904 and 1927. After 1927, registration was decentralized and local governments rather than the central government were responsible. This change had created a problem for archives research since local records were usually difficult to keep, and in fact, most of them were not available anymore after the wars. Most data that are available now are contradictory in terms of the number of companies on the records.

¹¹ In Britain, for example, there were 770 limited companies existed by 1858, 599 of them formed after the 1844 Joint Stock Company Act . In 1864, there were already 1,929 companies and in 1866, 2,917 (Todd 1932). "From 1864 to 1889 the (official) number of companies in existence increased at a practically constant

However, when we look at the Western history of the emergence of corporate forms, it suggests that it actually took a few centuries for the company form to be mature and being accepted by the public. The idea of joint-stock company, which involved many people as shareholders to do business, existed as early as in 1553. It took about two hundred years to develop into its mature form before it finally acquired its legal status in the 1800s.¹² Without such a long tradition of joint-stock business operation in China, it is reasonable to expect the Chinese to take some time to accommodate and to understand this new institution before they would be more willing to adopt it.¹³

Nevertheless, based on the statistics that are available, there is evidence indicating that a transformation on how business was organized indeed happened, and the capital accumulation for the modern economy did occur over time. Table 2 shows that there was an increase in corporations' capital size at least since 1915. Companies with a capital size of more than 1 million Yuan composed only 2.3% of all registered companies in 1915, but had jumped up to 8.6% in five years.

Table 2: Percentage Distribution of Investment Capital Size in Corporations

	(in Yuan)					
	<i>10,000 - 50,000</i>	<i>50,000 - 200,000</i>	<i>200,000 - 500,000</i>	<i>500,000 - 1,000,000</i>	<i>1,000,000 and above</i>	<i>Total</i>
1915	31.9%	57.8%	6%	2%	2.3%	100%

average rate of nearly 2,250 companies in every five years. This trend rose from 1889 to 1907, and the average increase became approximately 8,250 in five years. The rate of increase again rose, between 1907 and 1914, to an average of 15,000 in five years.”

¹² Each country had somewhat different trajectories in terms of the timing of the institutional development of company as a business form. Britain, for example, promulgated the Joint Stock Company Act in 1844 and only until 1855 limited liability was included in the Act.

¹³ Even in Britain, a large quantity of registered companies actually didn't survive for too long after they took the advantage of the new company law and registered as companies. About one-sixth of the companies effectively formed in 1856-65 were sold, amalgamated or reconstructed, the proportion rising from 13.7% of the formations in 1856-59 to 17.8% of those in 1863-65. Almost 36% of the ordinary companies formed in the decade ceased to exist in any form within five years of promotion, with an additional 4.5% having to be sold or reconstructed. Some 54% had ceased to exist within ten years and only 8% exist in the 1930s in the original form (Shannon 1933: 409, 418). This reflects that even in a place with a long history of social understanding of it functioning, the corporate form still needed a long time to maximize its performance.

1920	24.4%	49.6%	12.4%	5%	8.6%	100%
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Source: Chen, (1989: 261) (modified)

The global economic conditions during World War I were very favorable to China, and the institutional reform had benefited from this and had created a “golden age” for the Chinese capitalists ((Bergere 1989). Especially between 1914-1921, accumulation and investment in the “new economy”- the industrial production - had increased a few folds in less than a decade (see Table 3).

Table 3 : Rate of Increase in Private Industrial Investment

(in 10,000 Yuan)				
<i>Industry</i>	<i>1913</i>	<i>1921</i>	<i>Growth Rate (%)</i>	<i>Average Annual Growth Rate (%)</i>
Cotton Spinning	1,423	9,842	691.6%	27.35%
Flour	885	3257	368.0%	17.69%
Silk Reeling	1,603	2253	140.6%	4.00%
Tobacco	138	1,680	403.2%	15.13%
Cement	294	746	308.8%	12.34%
Match	294	746	308.8%	12.34%
Total	4,628	18,658	403.2%	19.04%

Source: Huang and Yu (1995:114) (modified)

The data about later period were basically incomplete. What are available are figures either only in a certain year or only of a certain city. One estimate of the corporation registration statistics and capital size is shown on Table 4. While the statistics indicate that the total number of companies established during the year was not impressive, it does suggest that limited liability company, with more than 70% of those who registered between 1929 and 1935 were in this form, was the most preferable organizational form. Even more significant is that the capital size of the limited liability company was always much larger than other corporate forms. Not to mention the comparison could be even more extreme when we compare limited liability company’s capital size with other

organizational forms such as sole proprietorship and partnerships that were still dominant at that time.

Table 4: Statistics on Corporate Registration, 1911-1935

(in Yuan)

	<i>Number of Registered Companies</i>		<i>Total Registered Capital</i>		<i>Average per Company</i>
	<i>Number</i>	<i>Percentage</i>	<i>Total Capital</i>	<i>Percentage</i>	
Before 1928	716	-	463,127,560	-	646,826
Feb,1929- June, 1935	1,966	100.00	560,394,615	100.00	285,043
a. unlimited	509	25.89	25,539,780	4.56	50,176
b. limited partnership	56	2.85	3,924,200	0.70	70,075
c. limited liability	1,384	70.40	528,869,035	94.37	382,131
d. Joint-stock limited partnership	17	0.86	2,061,300	0.37	121,253
Total	2,682	-	1,023,522,175	-	381,626

Source: Chen, (1961:59)

We can therefore argue that even most economic activities were still conducted through traditional partnership or sole proprietorship, a significant percentage of the national capital was incorporated. An accurate data collection in 1933 China (Table 5) indicates that limited liability companies that were registered in that year contributed 92.1% of the overall investment, with an average capital size of at least a few times more than other corporate forms.

Table 5: 1933 Nation-wide Corporate Registration in China

(in Yuan)

<i>Corporate Forms</i>	<i>Total Capital Size</i>	<i>% out of overall investment</i>	<i>No. of Company</i>	<i>Average Capital size for each Company</i>	<i>No. of Company established in Shanghai</i>
Unlimited	252,000	2.8%	22	11,454	10
Limited Partnership	214,300	2.4%	27	7,937	15
Limited Liability	8,292,154	92.1%	52	159,464	34
Joint-Stock Limited Partnership	240,000	2.7%	6	49,000	5
Total	8,998,454	100%	107	84,097	64

Source: China Second Archives (1996:230-4)

While limited liability company was the organizational format that could attract most investment, the overall number of it was still not significant enough to transform the Chinese economy into a corporate economy. One would argue that the low number of companies being established was due to the fact that corporation as an institution actually needs a more comprehensive external institutional support. With the lack of an effective accounting system (Bryer 1993; Gardella 1992), an objective court system (Lee 1993), a more rational stock trading mechanism¹⁴ and other supportive legal regulations such as bankruptcy law (Mei 1935; Mitrano 1973; Wu 1935), the corporate form became too risky to adopt as a way of organizing one's business. Adding to these adverse conditions was a poorly written and unclear company law that made it difficult to follow (Li 1974; Li and Xiong 1995; Yao 1914) and a complicated registration system that highly discouraged company formation at least at the beginning (Lun Gongsi Zhuce Zhidu (A Discussion on the Company Registration System) 1917).

The underdevelopment could also be explained by macro factors such as capital scarcity, unequal international competition, civil wars, Sino-Japanese war, and an inefficient government. Nevertheless, the transformation of organization of the economy had indeed taken place, even though slowly, and the contour of the Chinese economy had eventually been changed. Corporations as the new economic actors were gradually established in China, even though the real impact of this corporate economy could not been

¹⁴ Stocks were once considered to be something that could make quick money in China during the early 1880s. The stock of the China Merchants' Company, the first Chinese company, was 100 taels in 1872 and was up as much as to 255 taels in 1882, but soon dropped to 56 taels in 1883 because of market fluctuation. See *Shenbao*, June 3, 1883, Oct. 21, 1883, Nov. 1, 1883, Nov. 5, 1883.

seen until a later stage when it finally got a chance to develop outside the Mainland after 1949.

Guilds and Chambers of Commerce

The emergence of companies as new economic actors in modern China was also reflected in the changing contour of the business community during that time. As discussed above, the traditional economy in China was organized and regulated by numerous guilds - *gongsuo* (sometimes also called *huiguan*).¹⁵ These guilds or trade associations were organized by merchants that were doing a common trade or business, who most of the time were coming from the same native place. The main functions for these *gongsuo* were on the one hand to organize the merchants to minimize competition among those who were doing the same business and on the other hand to gain approval from the government on monopolizing the business. Most *gongsuo* had their code of regulations to govern business practices, and usually a *gongsuo* membership of the particular business will be required in order to enter the business.

The way that the Chinese business community was organized started to experience changes at about the same time when the 1904 Company Law was officially introduced to the public. While the existence of traditional merchants organizations were still persisting for a longer time, new forms of business associations emerged since the turn of the 19th Century. The major change was the transformation of traditional business association into Western modern business association – typically, the chamber of commerce.¹⁶

¹⁵ See (Hamilton 1977; Pang 1985; Rowe 1984). For a classical description on Chinese guilds, see (Morse 1909).

¹⁶ For an excellent treatment on the transformation of business and trade associations in modern China, see (Yu 1993). For an overview description of the same process in Shanghai, see (Zhang 1990: 509-91). For

Even among the guilds, there was already a trend to relax membership criteria from the original combination of common origin and common trade to just common trade (Rowe, 1984: 276-7).¹⁷ The development of the chambers of commerce in China represents the further relaxation of the membership criteria and signals the emergence of relatively independent economic actors in the Chinese economy.

The Shanghai General Chamber of Commerce, as the most influential chamber of commerce in early 20th century China, gives us a representative example on this change. In 1902, the Shanghai Commercial Council, a chamber of commerce in experiment, was established partly out of a sudden enthusiasm on Western style business associations from the Imperial state. The Imperial state was suddenly aware how a united organization of the merchants could reinforce the state bargaining power in international trade treaties and had therefore persuaded the business community to self-organize.¹⁸

The membership at the beginning was composed mostly of traditional merchants with gentry status across different native place origins and different businesses. With representatives only from a few key Chinese enterprises, most of the members are representatives from guilds and trade associations (Xu and Qian 1991:43-47). In 1912, the association was reorganized into a more mature form – the Shanghai General Chamber of Commerce. One of the major changes of this association was that the regulations on

discussion on exemplars of other modern business organizations that were established during that time, see for example (Bergere 1992). By 1908, there were 39 general chambers of commerce and 223 branch chambers established in China. By 1912, the total number rose to 794, and in 1915, 1,262 (Chan 1977: 226).

¹⁷ Some native place associations that were based on common origin were structured in a way to incorporate sub-groups that were based on common trade. All guilds that were formed by merchants from the same native place became part of this much larger native place association. The Siming Gongsuo that was organized by Ningpo people is a typical example of this type. See (Tao 2000)chap. 4.

¹⁸ The first Chinese Code on business associations, the Concise Statutes of Chamber of Commerce, was promulgated in 1904 by the Qing government. The Statutes (with different names afterward) were revised and expanded continuously in 1913, 1914, 1915, 1916, 1918, 1923, and 1927. See Pang (1995) for a collection of those versions.

membership had largely revised. The annual membership fee had significantly lowered from 300 taels of silver to 100 taels for guild members, and more importantly, individual firm could be a member for only 50 taels.¹⁹ The real change, nevertheless, did not occur until 1920, when 31 of the original directors didn't get reelected. Younger elites from the new entrepreneurs class finally took more control on this modern Western business association.²⁰ The number of members, and particularly individual firms as members, had increased steady since then.²¹

The major impact of the emergence of this modern form of business association was the breaking down of traditional organizational patterns of the economy. The traditional structure of the business community was dissected into sectors of different native places and different businesses. Since most traditional businesses were dominated by people from a particular native place, cross sector investment was not common unless it was something that your fellow regionals were also doing.²² Boundaries among each business (and each native place) were relatively tight. The changing composition of the Chamber of Commerce reflected the changing structure of the economy with more and more business activities being conducted by individual firms, and cross-investment became less restricted as a practice. The proliferation of chambers of commerce in China at the same time also became an institutional support for the structural change of the business community. It was a transformation that signified the emergence of modern firms in the Chinese economy.

¹⁹ Based on the Articles of Association of the Shanghai General Chamber of Commerce.

²⁰ The average age for the 35 directors before the reorganization in 1920 was 57.2; the average age after the reorganization dropped to 44 (Xu and Qian 1991: 246).

²¹ See various years of membership list of the Shanghai General Chamber of Commerce.

²² Depending on how much capital they had, *Hui* merchants for example would usually be involved only in a few kinds of trade such as salt trading, tea trading, pawnshop, limber, food, and textile (Wang 1997). In general, Chinese merchants in the traditional economy, including *Hui* merchants, would only invest in one or very few types of business at the same time.

The Rise of Entrepreneurship – the “New Style” Merchants

As discussed about, traditional merchants were supposed to be embedded in business networks rather than existed as individuals. Individual merchants were always being recognized as part of a larger group – *bang* or a trade coalition.²³ The social recognition of merchants in Ming and Qing Dynasty was based on where they were from or what business they were in and not much on whom they were as individuals. Merchants from the *Jin* region of China (*Shanxi*) would be *Jin* merchants and were embedded in the *Jin* merchants’ networks; and merchants who traded tea would be tea merchants and were embedded in the tea traders’ networks. As part of a larger group, merchants were expected to be cooperative and not to compete with each other. Rules and regulations were set by guilds that were formed by merchants from the same region or merchants doing the same business. High conformity was expected which was necessary as a way to guarantee the stability of the particular trade. No matter how successful the merchant was, he should be subordinated and conform to the networks he belonged to. Since business opportunities were highly constrained and regulated by guilds or trade associations,²⁴ chances for business expansion and therefore for business elites to emerge were rare.

The time that business elites could emerge was usually when either a particular merchant or a particular *bang* had secured exclusive resources from the Imperial state. Hu Xiuyang, a prominent native bank merchant in the Late Qing, became extremely rich and high-status not because of his success in his native bank business which could be very

²³ The smallest unit of this *bang* sometimes is not even the individual merchants. Sometimes it is the whole kin as a unit. In some kin, every male kin member is a merchant, and they act and make decision together as a group. See (Xue 1985) for a description of this practice among the Ming dynasty *Huizhou* merchants.

²⁴ In some manufacturing sectors, for example, the number of apprentices the shop owner could have was set by the guild. In this case, your shop could rarely expand and produce more even if more buyers could have been found.

profitable, but largely because he had extensive personal connections with high level state officials. A lot of *Jin* merchants from the *Shanxi* province became very wealthy mainly because they were engaged in salt trade at the earlier stage – a business that needed license that was exclusively franchised by the government, and *Piaohao* at the later stage – a financial business that involved huge amount of government remittances and deposit (Zhang 1995).

Because of the changing institutional settings mentioned above in the late 19th early 20th century, merchants were allowed to free themselves from the traditional constraints and to engage in competition rather than cooperation. In contrast to the traditional merchants that were confined to those traditional businesses, “new style” merchants (“*xinshi shangren*”) during the turn of the 20th century were referred to as merchants that invested in “new style” enterprises – manufacturing, banking and finance, public utilities, etc. The social consequences however were more than just about an alternative pattern of investment. Those who invested in these modern businesses were at the same time more likely to use the Western corporate forms to organize their businesses and therefore much less likely to be confined by the traditional guild-related economy. Chu Baosan, for example, was one of those who had successfully transformed themselves into modern entrepreneurs by engaging in a diversity of modern businesses that were organized in Western corporate forms (see Appendix 2 for a list of Chu’s investment in his life time). Liu Hongshen’s business conglomerate, as another example, was organized as a group of related limited liability companies that had diverged investment in a wide range of modern businesses - harbor, match, cement, wool spinning, coal mining, enamel, banking and insurance (Shanghai Shehuikexueyuan Jingji Yanjiusuo 1981). Modern corporate forms that assume regulation

from the state rather than from the guilds had helped Chinese merchants to break the traditional ties that promoted cooperation rather than competition.

Firm as Carrier of Personal Resources

The adoption of corporate forms to establish one's business is largely because of its design allows capital consolidation and at the same time with legal protection (e.g. company as juristic person, limited liability, etc.). In China, however, this institutional design had also turned out to be a *carrier* of personal resources – a device that made the personal resources much more effective. At some point, the availability of this institutional device had facilitated the emergence of business elites in China.

It is certainly true that it was the engagement in modern businesses that allowed the creation of a much larger size of wealth than those who engaged in traditional businesses. And corporate forms, especially limited liability company, became the most obvious choice for the organization of those modern businesses, since usually a much larger capital size was needed. This institutional transformation of business organizations, however, should be understood as a path dependent process that had its origin from the traditional business practices. The introduction of corporate forms in China had set up new rules of the game in organizing business, but at the same time the corporate forms had provided a device that allowed some of the traditional business practices in China to be revitalized and sustained.

Through shares subscription from the public, limited liability company allows entrepreneurs to create a much bigger enterprise than those that are based on sole proprietorship or partnership. At the same time, by using the governance structure of

modern corporate form, entrepreneurs can distance himself from the real owners – the shareholders and can gain more control on the decision making process. Also, the limited liability allows investors, and at the same time also the entrepreneurs, to be able to spread out of their investments to more companies and created a much larger network.

Incorporating Resources

Rather than solely depending on personal capital, a corporation with the ownership divided into shares of equal value can help the entrepreneurs to create a firm that can incorporate outsiders' resources. In the context of China, individual entrepreneurs can use this “western” institutional design to consolidate resources that are directly or indirectly connected to oneself, with the hope that a considerable amount of total strangers will also be interested in investing in the corporation. Comparing with traditional partnership that would permit the pulling of resources only among a small group of people, corporate forms provide the institutional construct that allows more people to participate in basically any amount that is at least equal to the cost of one unit share.²⁵ The company as a device therefore became a pivot of the networks of resources that the entrepreneur could accumulate and exercise.

A typical example of how entrepreneur could organize a large size business by using other people's resources is the case of Wing On Company. One of the largest department store in China at the beginning of the 20th Century, Wing On was a limited liability company established in Hong Kong in 1907 but soon set up the same store in Shanghai in 1913. A shareholders list of 1919 indicates that the Guo's family, including

²⁵ It is not uncommon among the Chinese to own less than one share when they have joint ownership with other persons.

everyone, only owned 5.6% of the overall shares of the company. Besides the other 20% of ownership belonged to the Hong Kong Wing On, which the family also owned a small portion, 75% of the company was owned by outsiders. Out of the total capital of 2.5 million Yuan (for 100 Yuan a share), those who invested less than 1,000 Yuan constituted 78% of all the shareholders. That means the company was able to be established mainly because the institutional design – the limited liability company - allowed many small investors contributed to the very large capital size that was needed. Without them, Guo's family alone, or even along with the family's closed friends, would not have the needed amount of resource to set up this company.

In terms of mobilizing personal resources, Guo's family used its overseas Chinese background to look for subscribers of the company's shares. It turned out that out of the 75% of the shares that were subscribed by outsiders, there were at least 65% of the shares being subscribed by overseas Chinese.²⁶

Voting Rights and Control

The practice of voting rights in the Chinese companies had facilitated concentration of control by the entrepreneurs. In theory, voting right should be corresponding to property right. The number of votes a shareholder could exercise should be the number of shares that was hold. In history, however, both English company law and Japanese commercial code had provisions that limited the voting rights of larger shareholders as a protection of minority shareholders. The 1845 English Company law, for example, stated that “every shareholder shall have one vote for every share up to ten, and he shall have an additional

²⁶ Besides the 65.7% of shareholders that could be identified as overseas Chinese, there were actually another 5.5% of investors that could not be identified and some of them could be overseas Chinese too.

vote for every five shares beyond the first ten shares held by him up to one hundred, and an additional vote for every ten shares held by him beyond the first hundred shares.” (Sect. 175) The Chinese had a similar practice as early as in 1872 when the first Chinese company was established, and had included related provision on various versions of company law that could be used to constrain larger shareholders.

However, due to the way those provisions were written, manipulation of what would be done by those who were actually in control was possible. None of the version of the Chinese company law had put a straight limit on how the voting right should be regulated. In the Article.100 of the 1904 Company law, it stipulated that during the shareholders’ meeting, shareholders should have one vote for every share up to the first 10 shares, for those who have more than10 shares, the company “can use” the Article of Association to set a specific limit on how many shares will be counted as one vote. In the 1914 Status for Commercial Companies, the provision had been modified that the company “can and allow to use” the Article of Association to set the limit. While the provision had finally changes in 1929 to that the company “should use” the Article of Association to set a limit, it does not suggest how the limit should be set except that the total votes that any shareholders could exercise should not be more than 20% of the overall number of votes.

This flexibility on the restriction of voting rights allowed the founders of the company during that time to choose the arrangement that could serve their best interest. For those founders who were going to have a larger share of the company, they could set a very loose limit on their voting rights, for example, every 2 shares beyond the first 10 shares would be counted as 1 vote, rather than every 10 shares as 1 vote. For those who were not going to have a larger share of the company, they could set a more restricted provision on voting rights to minimize the influence of the larger shareholders. In practice,

however, most of the time, there was little limit on the voting rights, or simply used the one share one vote principle in a typical Chinese company (Wang 1930). This was because it was rare to have larger shareholder in a company, so there was no need to control them. The 20% limit that was set in the 1929 Company Law was also not really controlling anyone since it was very rare for anyone to have such a large size capital being invested in one single company. Because of the investment pattern in China during that time – that investors were usually only holding small amount of shares, it was of the best interest of the founder(s) to simply use the one share one vote principle. The more scatter the ownership structure, the less efficient it would be to control the management. (Dou 1999:42).

For small capital size Chinese firms, they are usually run by the family and have little distinction among ownership, management and control. When a firm is getting larger, or on the other hand, when there is a firm that needs larger capital, we will start to see more separation among ownership, management and control, with the features of shared ownership, segmented management and centralized control.(Hamilton 2001:64).

The historical development of corporate forms in China had in fact institutionalized practices that had eventually facilitated this particular distinction. While it coincides with what Chandler describes as a typical feature of most corporations – an ownership management distinction, what happened in China was not in a way that the shareholders as the owners were actually controlling the company. The institutional transformation in China during the early 20th century did not create the same foundation corporate forms as in the West that one could assume a corresponding relationship between ownership and control; even if it is just indirectly, that you control what you own.

Guo's family did not own a significant amount of shares that needed to control the company in terms of share holding, but since they had the chance to control the board of

directors, and the regular shareholders were mostly small shareholders and had no power (or intention) to compete with the Guo's family. The family was easily in control of the company without "owning" it.

Since only a small group of people (usually family and closed friends) who was really controlling the board of directors of the Wing On Company, they could easily implement rules and regulations that they could benefit from. For example, the board of directors of Wing On had the final control on how to distribute profits. If profits were distributed equally amount shareholders, larger shareholders would get more proportionally. The Guo's family in this case could not accumulate too much wealth since they only owned a little more than 5% of the overall shares. What happened was that they in turn distributed the profits not just to the shareholders but a significant part of it, as bonus, went to the directors, promoters and shareholders who hold positions in the management team. For example, in 1918, the Shanghai Wing On had put aside 10% of the annual profits as dividends for shareholders, but at the same time 15% of the profit as bonus. In 1927, 8% of the profits went to the shareholders, but 20% went to directors and other related people.(Institute of Economics 1981: 64-69). The Guo's family benefited a lot from this since it just happened that a high percentage of those who could have bonus were family members of the Guo.

The profits eventually shared by the family was also increased by retaining a significant amount of profits for reinvestment (usually more than 50%), so as to make the company better and become even more profitable. The capital size of Wing On has increased 6 times in 14 years since they established. The profits that the company could generated were significantly increased accordingly.

Company's Savings Division

Until the mid-1930s, many bigger Chinese firms had set up a savings division – the *chuxubu* as a subsidiary division within the company structure. Since the banking system was never very well developed in China and the native bank system was too ‘personal’- in a sense that only those who somehow personally connected to the bank owner would use their service, ‘enterprise’ became a good alternative for those who were looking for a place to deposit their savings.²⁷ Enterprises on the other hand were more than willing to accept outsiders’ deposit since it was always difficult to get loan from the bank, and it became the best way to solve the under-capitalization problem (Xinhua Chuxu Yinhang 1935). In fact, many bigger firms with good reputation had engaged in this kind of business and were usually more than willing to give an interest rate higher than the bank rate to attract more deposit.

According to the Company Law, however, a company should conduct the business that it was registered, so a cotton mill was supposed to be a cotton mill, and nothing more than that. The establishment of *chuxubu*, which was a savings service, was actually against the company law unless the enterprise was a bank. The government did not take action on it until the mid-1930s and there was not without protest for the action. There is no way to know how much those companies actually got from the deposit, but a study that based on one hundred case studies shows that the proportion of deposit out of total capital size was more than 35% on average (Xu 1942). The implication of this practice, however, is not just about capitalization of the company. While we have limited information about the overall practice of this savings service, the well-documented case study on the Wing On Company

²⁷ There was actually a long history in China that people leave their money to the merchants for a period of time to gain interest.

could probably show us some common practice on *chuxubu* during that time (Institute of Economics, SASS 1981).

In 1918, one year after the business was started, the savings accounts in Wing On increased tremendously in the first few years (see Table 6). Guo's overseas Chinese background had brought to the company a good source of deposit from overseas Chinese. Local residents, with more confidence with the company later, also contributed a significant amount to the deposit.

Table 6: Saving Accounts in Shanghai Wing On Company, 1919-1921

<i>Saving Account</i>	(in Yuan)							
	<i>1918</i>		<i>1919</i>		<i>1920</i>		<i>1921</i>	
	<i>No. of Account</i>	<i>Amount</i>	<i>No. of Account</i>	<i>Amount</i>	<i>No. of Account</i>	<i>Amount</i>	<i>No. of Account</i>	<i>Amount</i>
Overseas Chinese	14	16,285	50	146,559	128	280,965	106	211,247
Shanghai Residents	2	1,327	17	132,254	65	54,264	292	376,048
Total	16	17,612	67	278,813	193	335,229	398	587,295

Source: Institute of Economics, SASS (1981: 75) (modified)

Since the company was not really a bank, there wasn't any transaction besides those that was within the company. The deposit was in fact used by the company as an internal cash flow and also to support other companies of the Wing On conglomerate.²⁸ The Guo's family also used the deposit in the savings division to give out loans to themselves and to their relatives and close friends with an interest rate lower than the market rate (Institute of Economics, SASS 1981:79). At the same time, they also "created" further profits by putting money in the company's savings division. With a different account book that was "internal," Guo's family (and their closed friends and relatives) was actually getting higher than usual interest rates by putting money in the company's saving division.

²⁸ Wing On later expanded into the businesses of textile, fire and marine insurance, life insurance, and hotel.

By controlling the board of directors, company policy that is favorable to those who is actually controlling the company can easily be made. When the Chinese shareholders are minority shareholders most of the time, and with a long time business culture of “silent partner,” management and control would not be separated in a typical Chinese company.

Conclusion: A new kind of business networks

The introduction of the Western corporate forms had eventually changed the contour of the Chinese business community. Individual merchants that were connected with each other through traditional business networks - either based on common place of origin or common trade - in the end had been reorganized under a new institutional setting.

A new kind of business networks that represented a combination of old and new elements emerged. While interpersonal ties could still serve as the institutional foundation that facilitate cooperation, individual participants of the networks could at the same time use those ties to maximize their business opportunities. The major difference between the traditional business networks and the contemporary one is that the contemporary one allows the business expansion of the individual entrepreneurs so long as they could consolidate the resources that they would need for the expansion. My paper argues that this change was partly made possible by the adoption of the Western corporate forms as the organizational format of their business. The rise of the Chinese capitalists class could be because they were the one who engaged in the “new economy” – manufacturing and modern finance, but it was the introduction of the new business organizational form – the Western corporate forms that allowed them to be able to consolidate such a big size of capital to participate in those highly profitable businesses.

Because of the particular route of economic transformation in China, entrepreneurs using Western corporate forms to organize their business were able to exercise a degree of control that would not be found in a Western context. Individual merchants were able to consolidate a much bigger quantity of resources than before without the typical constraints from the guilds. Old practice on interpersonal relationships continued to function, but at the same time allowed individual entrepreneurs to coordinate those resources in a more flexible way, and in a way to increase one's competitiveness in the marketplace. By relaxation of membership in business and trade associations, the transformation of the traditional business networks represented a broadening of scope of possible connections (Rowe 1984:283-5).

Since the 1920s, large business conglomerates were formed by individual entrepreneurs in China through the creation of multiple personal networks by connecting oneself to both the traditional networks (e.g. native bank networks) and a contemporary one (e.g. the industrialists networks) (Li 2000; Tao 2000). Construction of multiple layers of networks, which would cross native places and cross business sector, and now cross companies, become possible in the new institutional setting. On the contemporary setting, Chinese entrepreneurs are also using different level of networks to expand their business. Robert Kuok of Malaysia, for example, was diversifying his "silent empire" through cross investment in many companies that was based on personal connections (Cottrell 1986). His empire composed of a group of core family business with an extended network linked, in different degree, well beyond the family firms to a wide variety of businesses(See Appendix Three).²⁹ The networks continued to expand on yet another level where Chinese

²⁹ While the holdings in his core business were always high (some were 100%), his cross investment varied a lot, some were as low as 1%, with many of them less than 10%.

diaspora entrepreneurs, each with their own business conglomerate, teamed up together and ‘cooperate’ to explore even more business opportunities. What Appendix Four shows here is the amount of business deals that was generated in Asia between 1990 and 1994 by a cross-border entrepreneurial networks that major ethnic Chinese diaspora entrepreneurs are embedded.³⁰

³⁰ What indicated were publicly announced joint business deals between 1990 and 1994 at value of over 10 million US dollars. See (Redding 1995).

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