

A Study on Business Succession in Small and Medium-Sized Chinese Enterprises

Yang Wang, Takashi Kondoh
Aichi Institute of Technology, Aichi, Japan

The survival and development of SMEs (small and medium enterprises) is an important issue for the Chinese economy. In particular, business succession in SMEs is a persistent issue. Business succession involves selection of a successor, asset inheritance, transfer of management rights, accumulation of business connections and technology succession, and so forth. This all requires smooth execution of a business succession plan. However, many SMEs do not have a business succession plan, nor are they preparing one. Our task is to explore the reasons these preparations are not being made. Here, the purpose of our research is to get a picture of the status of preparations for business succession in SMEs in China, and the actual circumstances of succession, based on the results of a fact-finding survey of Chinese SMEs, and at the same time bring to the surface the primary factors which influence preparations and plans. The results of the analysis shed light on the status of business succession preparations, successor's awareness of issues, decision making, and so on. This survey highlights the awareness of business succession among business managers.

Keywords: business succession, small and medium-sized Chinese enterprises, changes in presidents

Background

According to “Market In-Depth Survey and Investment Strategy Analysis and Analysis of China’s Enterprise Management Project Industry”, in a market survey and analysis report on Chinese business projects and investment strategies, there were 40 million small and medium-sized enterprises (SMEs) in China as of 2017, accounting for 99% of the total number of companies, 60% of the Chinese GDP, 50% of tax revenue, and 80% of urban employment. SMEs play an important role in supporting a nation’s economy. Further, 90% of SMEs are family businesses, and many of these businesses are now at the point where business managers must consider successors (Chinese Family Business Succession Report, 2017).

Xinhua News Agency reports that the “Chinese Family Business Development Report” (2011), a report published by Beijing city in 2011, gives a comprehensive analysis on the business conditions and growth processes of family businesses in China, indicating that “Chinese family businesses play an important role in the development of the economy and society, and although they increasingly contribute to this development,

Yang Wang, Business Administration and Computer Science Doctoral Program, Aichi Institute of Technology, Aichi, Japan.
Takashi Kondoh, Ph.D. (Engineering), professor, Faculty of Business Administration, Aichi Institute of Technology, Aichi, Japan.

Correspondence concerning this article should be addressed to Takashi Kondoh, Graduate School of Business Administration and Computer Science, Aichi Institute of Technology, Jiyugaoka Campus, 2-49-2 Jiyugaoka, Chikusa-ku, Nagoya 464-0044, Japan.

they are also facing issues with succession and generational transitions”. The *China Securities Journal* also states that family businesses account for 80% of all privately-operated companies in China, and that “succession” is the greatest worry for such companies (Asano, 2011). A great many companies have been founded in China due to the country’s reform policy of opening up to the outside world in the early 1980s. Thirty years later, the founders of these companies now need to consider business succession. A look at company succession for SMEs in the developed nation of Japan reveals that most business managers of such enterprises are 66 years of age, with the average age for the 20-year period from 1995 to 2015 rising from 44 to 66. It is now time for some several 100,000s of business managers to consider business succession (Li, 2014). Chinese SMEs will also likely be facing the issue of aging business managers 20 years from now (Small and Medium Enterprise Agency, 2013).

As previously mentioned, SMEs account for the majority of enterprises in China and account for at least 80% of total employment, serving as the foundation for the Chinese economy and employment. China is still a developing nation, however, and it is increasingly difficult to manage SMEs in an environment of mass production. It will be important for SMEs to continue to develop along with China as a whole.

Business managers of SMEs are extremely busy with running their enterprises, and even those who are considering business succession do not have clear plans. They lack the awareness of how to prepare for the upcoming period of business succession. It goes without saying that enterprises that have not made sufficient preparations for business succession are at great risk, as these companies would need to rush to find a new president at great loss in a sudden emergency, such as death or illness of the business manager. SMEs are weaker than large enterprises with regard to financial, manufacturing, and information-gathering capabilities, so it is important for SMEs to be willing to leverage their strengths (such as the ability to make quicker decisions, the ability to flexibly respond to the needs of consumers, and the benefits of preferential tax treatment) and to make constant improvements in business planning and business succession.

Although SMEs face many issues with business succession, they generally do not take these problems seriously. In order to understand and resolve these issues, we referred to business succession support measures for Japanese SMEs, conducted a fact-finding survey targeting business managers of Chinese SMEs, and then analyzed the results.

The purpose of our research is to get a picture of the status of preparations for business succession in SMEs in China and the actual circumstances of succession, based on the results of a fact-finding survey of Chinese SMEs (mostly in the manufacturing industry) with 400 or less employees, and at the same time bring to the surface the primary factors which influence preparations and plans. The results of our analysis shed light on the status of business succession preparations, decision making on successors, and so on. This survey highlights the awareness of business succession among business managers.

Prior Research

Many family operated enterprises in Japan have been in business for 50 to 60 years, and the majority of these enterprises have been passed down anywhere from three to five times.

In Japan, it has been argued that enterprises and businesses are not necessarily owned by the business manager, and there has been a long history of focusing on business succession research in enterprises (Record China, 2010). Successors also inherit and maintain the reputation of the enterprise and have an important responsibility as “relay runners” who must communicate this to their descendants (Record China, 2010; Adachi,

1974). In other words, Japanese business succession research has characteristically stressed the survivability of a business over the social position of its business manager. Major research can be classified into the following subjects: selection of a successor for the current business manager, inheritance taxes, and the succession process (Record China, 2010; Adachi, 1974).

On the other hand, major research on business succession in China seldom covers business succession in SMEs, as many of these enterprises undergo rapid growth under the founder and then disappear.

As shown in Figure 1, according to “2017 Chinese Government PR Material” (2017), 8% of Chinese business managers were 60 years of age or older in 2017, while 32% were between 51 and 60, and 42% were between 41 and 50. This age distribution of enterprise business managers reveals that 32% will reach an advanced age (between 61 and 70) 10 years from now and that business managers between 51 and 60 years of age will account for 42%. Such enterprises will need to take business succession into consideration if they intend to survive over the long term. However, they will likely face a range of problems in doing so, such as how to train successors.

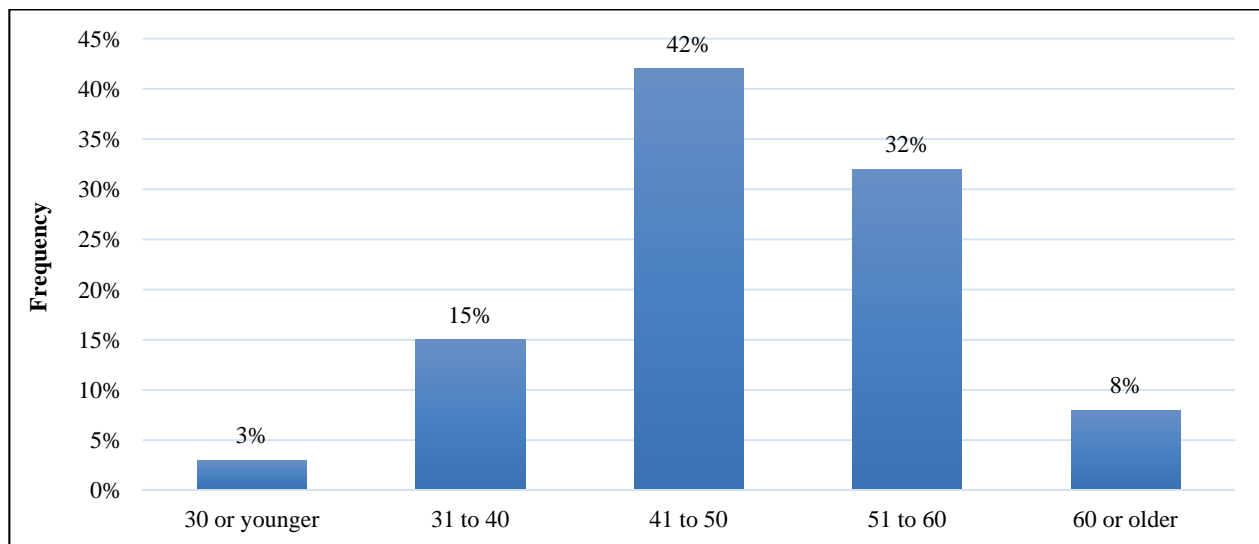


Figure 1. Age distribution of business managers in Chinese SMEs. Source: Chinese government PR material (2017).

Overview of Study on Chinese SMEs

In order to get a picture of the status of preparations for business succession and the status of succession, we conducted a direct survey on trustworthy Chinese SME business managers (103 people). The survey was conducted from December 2017 to January 2018. Approximately 100 surveys were distributed to Chinese SME business managers. 67 valid responses were collected, leading to a valid response rate of 67%.

Most of the enterprises were in the manufacturing industry (43%), 16% were in the construction industry, and less than 10% were in other industries. 40% of the valid responses were received from small and medium-sized manufacturers.

Enterprises were asked about the general situation of their companies, the age of their business managers, whether they were making business succession preparations, their reasons for business succession, their business succession concerns, whether they have decided on successors, and items related to business succession advisors.

Chinese SMEs can be classified into one of three asset categories based on how enterprise assets are owned: state-owned, aggregated, and sole proprietorship/private-operated (privately-managed) (Ochiai, (2014). This survey targeted sole proprietorships/private-operated SMEs (family businesses) with 400 or less employees.

Results of Study

Our survey of Chinese SME business managers showed that 20% of enterprises were “preparing for succession” and 20% have “sufficiently prepared for succession”. 33% of enterprises responded that they “feel it is necessary but have not prepared”, 12% of enterprises responded that they “do not feel it is necessary”, and 16% of enterprises responded with “other”. This indicates that approximately 61% of enterprises have not made preparations. A range of problems, including the aging of business managers, will likely face these enterprises over time as business environments change.

31% of enterprises “have decided on a successor”, while 69% of enterprises “have not decided”. This indicates that quite a few enterprises “have not decided on a successor”. Many enterprises “have not made preparations”, and approximately six out of every ten (61%) will face a range of business succession issues in the future.

When asked about “business succession advisors”, the top response was “consult with friends/family” (16 responses), followed by “consult with tax accountant” (13 responses) and “consult with lawyer” (14 responses). These were followed by “consult with external tax accountant” (11 responses) and “consult with SME consultant” (9 responses). In contrast, around 10% of business managers responded they would consult with a financial institution, intermediary, or other organization. The fact that most chose to “consult with friends/family” shows the importance of human relations where there is a friend or experienced senior associate upon which to rely on.

When asked why they would close their companies, most business managers replied that their “children do not want to inherit [their] business” (37%), while 30% selected “no young employees”. 26% stated that their “company has no future”, suggesting instability in Chinese SMEs. Less than 20% selected “no successor” and “poor company performance”. For many Chinese SMEs that go out of business, there is a sentiment of having no future and facing issues with employment, causing an overall feeling of instability.

Out of 53 respondents asked about business succession issues, the top response was “issues with collateral for loans” (10 responses). There were five responses each for “share purchasing”, “family successor coordination”, “connections with financial institutions”, and “employee coordination”. Other issues (successor decision, inheritance tax, company real estate, connections with clients, shareholder and employee trust, and successor ability) were all selected less than 10 times each.

Comparison of Business Succession Concerns in Chinese and Japanese SMEs

Next, we compared the concerns of Japanese and Chinese SMEs to identify business succession problems in Chinese SMEs. The survey results were compared with those of an identical survey we conducted in 2013 on Japanese SMEs (Wang, 2017). Comparing these surveys, which are depicted in Table 1, revealed that, while 31.1% of Japanese SMEs were concerned about “successor decision”, the percentage of Chinese SMEs that selected this concern was much smaller at only 3.2%. This indicates that business managers of Chinese SMEs are not aware of how serious the aspect of selecting a successor is. 4.4% of Japanese SMEs and 32.3% of

Chinese SMEs responded that they were concerned about “issues with collateral for loans”. This reveals that Chinese SME management is heavily dependent on loans and that they are operating under unstable business conditions. 33.3% of Japanese SMEs and 16.1% of Chinese SMEs stated that they were worried about “share acquisition/purchasing”. The comparative lack of concern over “share acquisition/purchasing” is likely due to there being less regulation of inheritance tax in China. 8.9% of Japanese SMEs and 16.1% of Chinese SMEs responded that they were concerned about “family successor coordination”. This is likely because Japanese SMEs determine successors more quickly and therefore are not concerned about coordinating family successors. A high percentage of Chinese SMEs was worried about “connections with financial institutions”, suggesting a heavy dependence on such institutions and general instability.

Table 1

Comparison of Business Succession Concerns in Japanese and Chinese SMEs (Multiple Responses Allowed)

Business succession concerns	Japanese SME study survey results (%)	Chinese SME study survey results (%)
Successor decision	31.1	3.2
Issues with collateral for loans	4.4	32.3
Share acquisition/purchasing	33.3	16.1
Inheritance tax	28.9	6.5
Family successor coordination	8.9	16.1
Company real estate	2.2	3.2
Connections with clients	11.1	3.2
Connections with financial institutions	6.7	16.1
Shareholder and employee trust	17.8	3.2
Employee coordination	6.7	16.1
Successor ability	44.4	9.7
Other	8.9	22.6

Note that a higher percentage (44.4%) of Japanese SMEs indicated that they were concerned about “successor ability”, while 9.7% of Chinese SMEs selected this answer. Successor training support is often provided in Japanese SMEs, and such enterprises are likely highly aware of a successor’s abilities. This comparison suggests that Chinese SMEs have a much lower awareness of business succession than Japanese SMEs. As inheritance tax and income tax become more regulated, the issue of business succession will likely become more serious for SMEs. Furthermore, if rapid growth of the Chinese economy results in the government providing easier access to support from financial institutions (and more stable economic conditions), concerns over “issues with collateral for loans” and “connections with financial institutions” will become more severe. This will likely also have an effect on business succession.

Discussion

It has been reported that there is little information provision/consulting support available for Chinese SME management. Furthermore, SMEs are faced with a range of business succession issues, such as share distribution within families with regard to succession, asset and successor disputes, tax burdens, and insufficient capital. It goes without saying that advice from an expert is needed to resolve these types of economic problems. Additionally, business succession requires various types of capital, and some argue that a specialized guarantee system is required for business succession (such a system exists in Japan).

In China, experts have little interest in and knowledge about business succession, so a comprehensive awareness of business succession is a must. It is important to have tax accountants/certified public accountants, other business managers, friends/relatives, and officers/employees who are not relatives for consultations regarding business succession.

The difficulty of finding successors for SMEs in China is therefore a serious issue, and even if a business manager has made sufficient preparations for business succession (or is attempting to do so), he or she will soon have to worry about the issue of future successors.

In the advanced nation of Japan, national and local governments provide a range of support measures. SMEs have access to a rich support system that includes such resources as the “Management Succession Facilitation Act” enacted in 2008 and the “Small and Medium-Sized Enterprise Business Succession Handbook: 29 Q&As (Revised for 2011 FY Tax System Revisions)”. “Safeguard the Future of Your Company: Smooth Business Succession,” a guide published by the Small and Medium Enterprise Agency, and consulting services offered by the Organization for Small & Medium Enterprises and Regional Innovation branches (Small and Medium-sized Enterprise/Startup Comprehensive Support Centers) are other helpful resources for Japanese SMEs.

The Chinese government first became aware of the importance of establishing support systems for SMEs in the early 1990s and began investigating concrete methods. However, while there are non-business organizations that focus on offering technical support and providing information to SMEs, none of these organizations provide support on business succession.

Multiple responses in our survey indicated that enterprises were not making any special preparations for business succession (approximately 60% of enterprises) or that they felt no need to make preparations as the business manager had just recently inherited the business. Many business managers believe that the economy, circumstances, and future of their enterprises are all unclear (and that this situation will continue or become worse in the future), which is why business managers must gain a stronger awareness of the unstable situations in which they operate. There is no guarantee that a business manager will be able to continue to operate his or her enterprise in the future. Enterprises can make succession feasible by gaining an awareness of these risks and by accumulating experience and knowledge within the enterprise. This should help lead each enterprise to its ideal course of action. Unless enterprises pass their experience, technology, and some degree of preparatory expenses down to the next generation, successor generations will once again be faced with succession problems and the expenses required for succession. Although some argue that succession generally only occurs once every 20 to 30 years, this can actually occur as frequently as every 10 or 20 years in the manufacturing industry and construction industry—especially for technology and quality control succession. Providing a clear path ahead can reduce the burden of succession on business managers. Business succession will become a serious problem for Chinese SMEs, many of which undergo rapid growth under the founder and then disappear.

One example of a support measure would be to propose a checklist for understanding the current state of business succession. A checklist similar to that in Table 2 could allow an enterprise to begin preparations based on the current conditions and then to plan succession focusing on areas in which the enterprise has not made sufficient preparations (Maekawa & Suekane, 2011). A checklist could also highlight awareness of business succession similar to a survey.

It would also be important to have such a list checked by not only friends and family, but by experts (such as lawyers, certified public accountants, or tax accountants) as well. While there are many laws and preferential

tax treatment measures in place, these can be complicated and enterprises could mistakenly determine that they apply or do not apply to them.

The best solution would be to continue to create business succession plans and to conduct business succession in an environment in which business managers can avoid meaningless risk and focus on future management. Even if experts are available, China's national government and its local governments will need to provide a range of support measures to increase enterprises' awareness of and knowledge about business succession.

Table 2

Comparison of Business Succession Concerns in Japanese and Chinese SMEs

<input type="checkbox"/> Do you understand the economic state of your company? (Assets, number/age composition of employees, cash management, debts, competitiveness in industry, etc.)
<input type="checkbox"/> Do you understand your status as a business manager? (Shares held in your own company, the value of other personal assets, debts, individual bonds, etc.)
<input type="checkbox"/> Have you written a list of potential successors? Are there any candidates among your relatives or among individuals inside or outside your company that could become successors? Does each potential successor have the required ability and aptitude? (Leadership ability, mutual understanding ability, breadth of vision, fortitude, dynamism, flexibility, management ability, health, etc.) What about attributes for each potential successor? (Age, career history, desire to manage company, human relations with relatives/officers, etc.)
<input type="checkbox"/> Have you investigated potential problems (and solutions) that could arise during succession? How are your relations with your legal heirs? What is the share ownership situation in your company? Identify inheritances and investigate tax payment methods.

Several respondents were extremely busy with their day-to-day business operations and indicated that they had "no time to think about business succession". It is important to realize that management problems and succession problems are connected. Business plans involve the entire enterprise, and once business succession takes place, changes in management direction and business content will follow. Many business managers consider sales strategies, seek profit (such as reducing expenses), and expand the scale of their businesses as their major management issues. However, the issue of business succession is a crucial factor in any business plan.

There are many enterprises with business plans that have not made preparations for business succession. It is crucial to increase managers' awareness of business succession when creating a business plan.

Conclusion

Chinese SMEs lack awareness with regard to business succession. These enterprises have to increase their efforts in making preparations for business succession. Such enterprises will need to look to advanced nations like Japan to study business succession success cases, business succession support measures, and successor plans. Furthermore, support agencies will also have to provide support measures.

A time span of 10 years is required for an enterprise to spend enough time selecting and training a successor and for the successor to make preparations for business succession. Ultimately, the president of an SME must be aware of the importance of business succession and must make sufficient preparations in order

for the business succession process to go smoothly. If a business manager does not have the will to work towards an efficient business succession or does not work hard enough toward that goal, any available support measures will be meaningless as such measures are ultimately not a replacement for proactive business management.

China is still a developing nation. In order for the country to continue to develop with stability, there should be means for SMEs to smoothly pass down people, assets, and intellectual property and for business succession to be conducted efficiently. The Chinese government will also need to develop policies for SME business succession in accordance with the conditions in China.

References

- Adachi, M. (1974). The current state of business managers (-)—Looking at family precepts/store rules for established businesses. *The Ritsumeikan Economic Review*, 21(2), 1-24.
- Adachi, M. (1993). *Management of established businesses—Learning on the road to continuation and prosperity*. Hiroi-kegaku-en Publishing Department.
- Asano, K. (Trans.). (2011). *China Securities Journal*.
- Chinese family business succession report, “family business, inheritance”. (2017).
- Chinese family business development report. (2011).
- Japan restoration strategy—Japan is back. (2011).
- Li, N. J. (2014). *Current status and future outlook on support measures for small and medium-sized enterprises in China*. Takasaki, Japan.
- Maekawa, Y., & Suekane, A. (Eds.). (2011). *Shinise-Gaku Textbook*. Doyukan.
- Ochiai, Y. (2014). The bulletin of the graduate school of business. *Japan University of Economics* 2014, 3(1), 143-161.
- Organization for Small & Medium Enterprises and Regional Innovation, Japan (SME business support website). (2011).
- Record China. (2010). The serious problem of succession in private enterprises: Founders want their children to succeed them, but 95% of children are not interested—China.
- Small and Medium Enterprise Agency. (2013). 2013 FY white paper on small and medium-sized enterprises.
- Teikoku Databank. (2012). COSMOS2 company overview file.
- Wang, Y. (2017). *A study on business succession in small and medium-sized Japanese enterprises*. Aichi, Japan.
- Xinhua Daily. (2011). Retrieved from <http://j.people.com.cn/94476/7674789.html>
- 2017 Chinese government PR material. (2017).