

Analysis of Challenges and Countermeasures in Family Business of Succession during Economic Transition Period: An Empirical Study in Zhejiang Province of China*

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Abstract Successful intergenerational succession is the key to continuous development of family businesses. To study family business succession, a total of 412 family businesses in Zhejiang province have been investigated. According to the survey data, it can be found that family businesses show several characteristics: Educational levels of family business owners have significant improvement; power transfer of family enterprises among generations will peak in the next 5th or 10th years, etc. With regard to factors influencing successful handover of family businesses, most business owners consider qualifications of successors as the key. Besides, they highlight the importance of changing management methods in different times. To promote successful succession and sustainable development of family businesses, it is necessary to adopt some measures such as build new management teams in the family business, establish credit evaluation mechanism for enterprises and professional managers, finish holistic inheritance of family business property through “monetary value distribution method”, impose laws and regulations on estate tax; and enhance the comprehensive competitiveness of successors.

Key words Economic transition; Family business; Succession; Sustainable growth

1 Introduction

Sustained economic growth in Zhejiang over the past three decades can be attributed to regional preemptive advantages in reform, i.e. the rise and rapid development of private economy, and leading systems and mechanisms. Zhejiang's private enterprises, the main part of private economy, mostly exist in the form of family businesses. However, at present, most family businesses are still controlled by the first generation of entrepreneur. Therefore, during the upgrading period of economic transition in Zhejiang province, how to ensure successful intergenerational succession of family businesses has become one of the main problems the government and enterprises should solve.

In the West, the academic circles set about studies of family businesses in the 1950s. During the process of their studies, more and more research achievements have been made and the theory about family businesses has constantly been enriched. However, intergenerational succession has remained the focus of this research subject. For example, when (Dyer Jr. and Sanchez 1998) were analyzing the 186 research papers on family businesses which were published between 1988 and 1997, they found that nearly 18.28% of them (data from the author) were about family business succession. Besides, (Chua etc 2003) found that among the 190 research papers on family businesses publicly released between 1996 and 2003, 22.2% of them focus on family business succession.

In China, researches into family business succession are mostly qualitative researches. In addition, China's modern family businesses have only a short development history. No supporting theory has yet been built for the studies of this subject. What is more, the present studies are mainly case studies through interview and there are few systematic quantitative studies. Therefore, we visited and investigated (in the form of questionnaire survey) the family businesses in Zhejiang province, a place well known for advanced private economy. Based on results of questionnaire surveys and existing research achievements at home and abroad, this paper discusses the new features shown in, challenges faced by, and countermeasures proposed for family businesses during economic transitional period, which provides useful reference for their sustainable growth.

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2 Research Method

Having referred to studies by Zhang Bing (2004), Starvou (1998), etc, this research adopts interviewing and questionnaire survey as its research method. As for the former research method, we have conducted 2-3 hour interviews with owners of 15 large family businesses in Wenzhou during which relevant questions were raised and existing problems in the questionnaire are solved, making the results of questionnaire survey more accurate and scientific. As for the latter research method, each questionnaire is divided into two parts: The first part is about the general situation of the investigated enterprise which include 26 items while the second part is about the factors influencing family business succession which include 32 items. Seven-class Likert scale is adopted for the scoring of each influencing factor.

Based on the data in Statistics Yearbook on Non-State-Owned Enterprises in Zhejiang Province for 2007, we figured out the percentages the numbers of private enterprises among industrial enterprises above designated size in each city accounting for in that of the whole province. They are respectively 25% for Hangzhou, 21% for Ningbo, 9% for Jiaxing, 3% for Huzhou, 9% for Shaoxing, 2% for Zhoushan, 12% for Wenzhou, 9% for Jinhua, 2% for Quzhou, 6% for Taizhou, and 2% for Lishui. From 2007 to 2008, we had visited a total of 608 family businesses in Zhejiang province. The numbers of enterprises in each city we had visited are roughly based on the above-mentioned percentages, i.e. 91 in Hanzhou, 75 in Ningbo, 63 in Jiaxing, 25 in Huzhou, 66 in Shaoxing, 35 in Jinhua, 4 in Quzhou, 45 in Taizhou, 12 in Lishui, and 196 in Wenzhou. After the random survey, a total of 435 questionnaires were returned among which 412 were valid and 23 were invalid. The recovery rate was 71.5% and the valid response rate was 67.8%. From these questionnaires, we can basically know about intergenerational succession of family businesses in the whole province in times of economic transition.

According to the questionnaire survey and field visit, the family businesses in Zhejiang show some new features in succession and sustainable growth. At the same time, there exist some obstacles to sustainable development of family growth. They include the following:

3 Descriptive Analysis

3.1 Family business owners are better educated

Table 1 Ages of Business Owners				Table 2 Education Backgrounds of Business Owners			
Age (years old)	Frequency	Percent	Valid Percent	Education Background	Frequency	Percent	Valid Percent
Below 35	68	16.5	16.6	Primary school	13	3.2	5.0
35-39	69	16.7	16.8	Middle school	83	20.1	31.8
40-44	99	24.0	24.1	High school	73	17.7	28.0
45-49	92	22.3	22.4	Junior college	45	10.9	17.2
50-54	61	14.8	14.9	Undergraduate	44	10.7	16.9
Above 55 (including 55)	21	5.1	5.1	Postgraduate	3	.7	1.1
Subtotal	410	99.5	100.0	Subtotal	261	63.3	100.0
Missing	2	.5		Missing	151	36.7	
Total	412	100.0		Total	412	100.0	

Source: Questionnaire survey by the author (the same below)

The owners of the 412 investigated family businesses are mainly aged from 35 to 55. People with an age difference of five years are put into the same one age group. The number of each age group accounts for 20% of the total number. On the whole, the ages of family business owners follow a normal distribution (Table 1). During the investigation, the numbers of business owners with University or college-level of education, post-secondary level of education, and high school level of education account for 16.9%, 17.2%, and 28.0% respectively of the total. However, according to the results of survey conducted by Zhejiang province SME Board of the education background of owners of small provincial enterprises, these figures are respectively 46.1%, 15.2%, and 6.2%^①(Table 2). These investigation results indicate that: in recent years, education levels of private enterprise owners in

^① Wu Jiayi, Shen Jinhua, Gao Jianming, Ying Yunjin, Wang Guoyong. Analysis Report of Questionnaire Survey for Small Industrial Enterprises in Our Province[R]. Survey and Countermeasure, 2006, (07)
<http://www.zjsme.gov.cn/newzjsme/list3.asp?id=8189> (In Chinese)

Zhejiang have significantly improved.

3.2 The peak time of baton handover in family businesses will be the next 5th or 10th years.

According to statistical sample, intergenerational succession does not happen in 83.3% of family businesses in Zhejiang (Table 3). Power transfer of enterprises among generations will peak in the next 5th or 10th years. The numbers of family businesses undergoing baton handover in the next 5th or 10th years will account for 16.2% and 31.3% of the total respectively (Table 4). The added number of family businesses undergoing baton handover in the next 5 years will account for as high as 33.1% of the total.

Table 3 Generation of Family Businesses

	Frequency	Percent	Valid Percent
Business founder	339	82.3	83.3
The 2nd generation of business owner	67	16.3	16.5
The 3rd generation of business owner	1	.2	.2
Subtotal	407	98.8	100.0
Missing	5	1.2	
Total	412	100.0	

Table 4 The Year When Management Power of Businesses will be Transferred

Year to Come	1st	2nd	3rd	5th	6th	7th	8th	10th	15th	16th	20th	25th	30th	35th	40th	50th	Subtotal	Absence	Total
Frequency	12	14	20	44	3	3	3	85	24	1	36	7	14	1	3	2	272	140	412
Percent	2.9	3.4	4.9	10.7	0.7	0.7	0.7	20.6	5.8	0.2	8.7	1.7	3.4	0.2	0.7	0.5	66	34	100
Valid Percent	4.4	5.1	7.4	16.2	1.1	1.1	1.1	31.3	8.8	0.4	13.2	2.6	5.1	0.4	1.1	0.7	100		

This figure is consistent with the conclusion of foreign researchers who predict that around 40% of family businesses will undergo baton handover within the next 5 years, no matter when the relevant investigation is conducted (Zhang Bing, 2004)².

3.3 The criteria to judge intergenerational succession become more rational

Among the criteria used to judge business succession, objective indicator is more valued by most enterprises, i.e. the differences in business performance before and after baton handover. The weight of this indicator accounts for 64.4% of all. The weights of subjective indicators, satisfaction degree of business owners and satisfaction degree of their family members, only account for 10.4% and 7.5% respectively. It should be noted that the weight of the owners' employee recognition (17.1%) is larger than that of satisfaction degree of their family members (Table 5). This reveals that the family business owners become more rational when making important decisions.

Table 5 Criteria to Judge Business Succession

	Frequency	Percent	Valid Percent
Satisfaction degree of family members	29	7.0	7.5
Satisfaction degree of business owner	40	9.7	10.4
Business performance	248	60.2	64.4
Recognition of business employees	66	16.0	17.1
Others	2	.5	.5
Subtotal	385	93.4	100.0
Missing	27	6.6	
Total	412	100.0	

3.4 Succession planning is not much valued

During the survey, it was found that most family businesses did not realize the importance of succession planning. Only 6.7% of enterprises had worked out formal written succession plans (Table 6). Most enterprises had not chosen the future successors of enterprises. Therefore, once the business owners have accidents, the businesses might cease to grow or even perish. One reason why business owners had not formulated succession plans is that they thought the potential successors were so young that succession plans are unnecessary. The number of such business owners accounted for 47.3% of all

the owners who had not formulated succession plans (Table 7). This can reflect that most family business owners lack the awareness of making succession plans.

(Gersick etc 1998) believe that a well-advised succession plan can determine to a large extent whether the family business of the first generation can be successfully passed down to the second generation². In China, since the contemporary family businesses appeared relatively late, scant consideration has been given to their future succession. Therefore, it is absolutely necessary to design a set of comprehensive succession plans when the family businesses gradually enter into intergeneration succession period.

In western countries, the founders of large family businesses usually, early during their management, include candidates of the family businesses' future successors into the list of their successors, consciously foster them, and work out detailed succession plans for them. For example, in the United States, the founders of family businesses tend to hire professional managers during the early period of enterprise development. When they retire, they and their successors only sustain minimal ownership. The professional managers nearly fully control the ownership of the enterprises.

Table 6 Preparation of Enterprise Succession Planning Table 7 Reasons for No Written Succession Planning

	Frequency	Percent	Valid Percent		Frequency	Percent	Valid Percent
I've never thought about the issue of selecting successor.	94	22.8	23.4	The business founder are not old enough to establish succession plans.	155	37.6	39.4
I've thought about the issue of selecting successor occasionally.	95	23.1	23.7	There is no need to establish succession plans at present.	31	7.5	7.9
I have preliminary ideas and plans of the issue of selecting successors.	136	33.0	33.9	The business owner is not familiar with the contents and procedures of succession plans.	115	27.9	29.3
I've carefully planned for the issue of selecting successor.	49	11.9	12.2	The business owner has not realized the importance of succession plans.	26	6.3	6.6
We have established formal written succession plans.	27	6.6	6.7	The enterprise scale is too small.	56	13.6	14.2
Subtotal	401	97.3	100.0	Others	10	2.4	2.5
Missing	11	2.7		Subtotal	393	95.4	100.0
Total	412	100.0		Missing	19	4.6	
				Total	412	100.0	

4 Challenges Faced by Intergenerational Succession of Family Business during Transitional Period

4.1 Transition from “personalization” management to “impersonalization” management

To the outside, family businesses have clear-cut definitions of property rights. However, to the inside, the property right boundaries are not clear, which may easily cause enterprise managing conflicts to be entangled with family conflicts. As a result, financing required for further development of enterprise will be limited. The progress of transition from personalization management to impersonalization management IN modern enterprise system is impeded. Therefore, it is widely accepted by the business owners that enterprises need to standardize management. One way to weaken impersonalization management is attraction of managers from the outside. Data show that active transition to impersonalization management is the main reason why business owners introduce professional managers from the outside. Nearly half, to be exact, 48.9% of business owners introduce professional managers for this reason; 22.1% of business owners introduce professional managers because there is no suitable candidate in their families and they have to do so; and 13.2% of business owners introduce professional managers when they plan to retire. See the following for other reasons (Table 8).

Table 8 Reasons for Introduction of Professional Manager outside the Family

	Frequency	Percent	Valid Percent
The business owner decides to retire	52	12.6	13.2
There is no suitable candidate in the family	87	21.1	22.1
To standardized enterprise management	192	46.6	48.9
To perfect legal and credit system	24	5.8	6.1
To perfect professional manager market	28	6.8	7.1
Others	10	2.4	2.5
Subtotal	393	95.4	100.0
Missing	19	4.6	
Total	412	100.0	

4.2 Absence of social credit and high enterprise agent costs

At present, China is still in the transitional period. Absence of social credit restricts the transition of enterprises from family enterprises to “manager” enterprisers. Traditional credit rules are seriously broken; establishment of legalized credit system is still in an exploration stage; what is more, evaluation mechanism of professional managers have not been built in China, i.e., there is no real professional manager market (Yu Xiangqian, 2007)³. During the employment of outside professional managers, 40.8% of business owners are most troubled by the reality that it is difficult to hunt for top managers; 28.5% of business owners are worried about the loyalty senior talents; 14.1% of business owners are afraid that the introduced talents do not recognize the culture or value of the enterprise especially of the family businesses with unique cultural background (Table 9). The contributing reasons, the author believes, are: 1. In China, restrictions over social morality are relatively loose. The trust levels among persons with no kinship are very low (Fukuyama, 2001)⁴; 2. When the property rights of family businesses can not be fully protected, the managers who act as the agents of the business owners may inevitably have different goals and interests from the business owners; the information they master may be asymmetric. Besides, if not enough restrictive measures are not adopted for the managers, the agent costs will surely rise. That means practical implementation basis of principal-agent system in today’s China will be lost. That is, separation of ownership and control is more a development tendency or a special case than a law.

Table 9 Difficulties in Recruitment of General Manager from the Human Resources Market

	Frequency	Percent	Valid Percent
It is difficult to hunt for senior management personnel.	156	37.9	40.8
The loyalty of senior talents to company is worrisome.	109	26.5	28.5
Senior talents ask for too high pay.	26	6.3	6.8
The introduced talents do not get along well with family members.	29	7.0	7.6
The introduced talents do not identify corporate culture or value.	54	13.1	14.1
Others	8	1.9	2.1
Subtotal	382	92.7	100.0
Missing	30	7.3	
Total	412	100.0	

4.3 Irreplaceableness of business owners’ human capital

(Schultz 1980) calls the ability shown from the condensation of the labor’s knowledge, skills, qualification, experience, and proficiency as human capital⁵. The human capital owned by entrepreneurs is called entrepreneurial human capital. Schultz points out that an individual can not sell or donate his human capital to others. His human capital can only be used or secured by himself in his lifetime (P73). Thus, irreplaceableness of entrepreneurs’ human capitals largely affects whether enterprises can continue to grow after the succession of business right.

Table 10 How to Plan for Children’s Jobs Shortly after Their Graduation

	Frequency	Percent	Valid Percent		Frequency	Percent	Valid Percent
Yes	83	20.1	20.6	Family business is only one of children’s occupational choices	75	18.2	25.1
No	320	77.7	79.4	Have children cultivate their abilities in other companies first	80	19.4	26.8
Subtotal	403	97.8	100.0	Encourage children to start their own businesses	139	33.7	46.5
Missing	9	2.2		Others	5	1.2	1.7
Total	412	100.0		Subtotal	299	72.6	100.0
				Missing	113	27.4	
				Total	412	100.0	

With constant changing of times and continuous development of enterprises, enterprises have different requirements of the human capitals of entrepreneurs. Though the successors of the second generation are not required to have the same courage, insight, and personnel charisma as their parents, they should master knowledge about scientific management and have good communication skills with both internal and external people. To equip their children with such knowledge and skills, 79.4% of business owners do not ask their children to join their family businesses shortly after they graduate from school (Table 10): 46.5% of business owners encourage their children to set up their own business; 26.8% of business owners have their children cultivate their abilities in other companies; 25.1% of business owners respect their children’s occupational choices (Table 10)

4.4 Conflict between succession of property rights and succession of business rights

According to Lansberg, for business owners, the best way to fulfill their eternal wishes in their businesses is to pass on the undertaking they establish and run all their lives to their next generations. It is a kind of human nature to leave property to offspring (Lansberg, 1999)⁶. In most cases, family business owners tend to divide business succession into transfer of stock rights (ownership) and transfer of business rights. Regarding transfer of ownership, under the influence of oriental traditional thoughts, most business owners transfer the ownership of enterprises to their family members. Though 45.3% of business owners think their children’s abilities should be made as the main criterion during share distribution, 36.2% of them distribute stock rights according to the criterion of “equal proportion”, which should be attributed to the influence of traditional thought “Family's Property Divided Equally by Sons”(Table 11). However, regarding succession of business rights, 88.6% of business owners make “character and ability” as the criteria (Table 12). This reflects that the incumbent business owners are more concerned whether the family businesses can maintain long-term or sustainable growth when selecting business managers.

Table 11 Criteria for Stock Rights Distribution among Children

	Frequency	Percent	Valid Percent
Equal proportion	143	34.7	36.2
Handover to eldest children	17	4.1	4.3
Ability	179	43.4	45.3
Fondness	32	7.8	8.1
Others	24	5.8	6.1
Subtotal	395	95.9	100.0
Missing	17	4.1	
Total	412	100.0	

Table 12 Criteria for Business Rights Handover

	Frequency	Percent	Valid Percent
Elder sequence	12	2.9	3.0
Fondness	34	8.3	8.4
Character, ability	357	86.7	88.6
Subtotal	403	97.8	100.0
Missing	9	2.2	
Total	412	100.0	

“Succeeding to father’s chairmanship” is the mainstream model of intergenerational succession of family businesses in today’s China. If the sole successor of the second generation are not only capable but also willing to take over family businesses, intergenerational succession can be finished smoothly. However, if there is more than one heir to business property of the second generation or the only successor is not competent enough to inherit enterprise management rights, the succession of business businesses will meet grand challenges.

As to succession of property rights, due to the influences of many factors such as Chinese history

and culture, property rights in family businesses are distributed according to the principle of “Family's Property Divided Equally by Sons”, irrespective of their children's abilities. Such property division in the form of physical distribution is very unfavorable for the long-term development of family businesses. Unlike general physical properties, family business is valuable when it exists as a whole. Once it is partitioned, the enterprise operating costs will surely rise, causing the enterprise to die out in three generations. As to succession of management rights, the sole inheritor may be not competent enough to bear the risks of family businesses. So the problem that property can be inherited but the management right can not be inherited arises. In China, the current manager market is not mature enough. Transfer management right to managers without full consideration is unwise and impractical choice.

5 Conclusions

The results of many foreign researches on succession of family businesses show that western scholars has not yet drawn unanimous conclusions in this field till now. Besides, there is no indication that their views will converge in the near term. These also reflect the complexity of family businesses succession and the necessity to conduct in-depth studies of it (Yu Xiangqian, 2008)⁷. Researches in China about intergenerational succession of family businesses are mostly qualitative researches. In addition, China's modern family businesses have only a short development history. No supporting theory has yet been built for the studies of this topic. What is more, the present studies are mainly case studies through interview and there are few systematic quantitative studies. Therefore, we conduct questionnaire surveys to discuss ways of realizing successful family business succession through quantitative studies, so that family businesses can maintain long-term and sustainable development.

5.1 Building a new management team in the family business

Family businesses adopt the “succeeding to father's chairmanship” succession model. This succession model is in nature a model where not only old leaders transit to new ones, but also a new management team is gradually forming. If we say the first generation of business owners owe their success too much to personal charisma, extraordinary leadership and parental rights, their successor of the second generation should rely more on an outstanding team or think tank to advance further development of enterprises.

Mao Lixiang, the president of Fotile Group, hands over his chairmanship to his son Mao Zhongqun in the form of joint management. In 1995 when Mao Zhongqun returned to his hometown for new business, Fly Group (the former Fotile Group) was in tough period. However, Feixiang Group paved the way for the development of later established Fotile Group in many aspects including capital and market required by Fotile. After their joint effort, Ningbo Fotile kitchen ware co., Ltd achieved great success and the famous brand of Fotile kitchen ventilator was established. During their cooperation, Fotile Group greatly downplayed familial management. They introduced various kinds of talents instead from the outside. All the mid-to-top management personnel are postgraduates or undergraduates. They refuse to appoint their family members as management personnel. Besides, they coordinate relationship between the new and old management team through the prestige of the founders, and have senior members gradually withdraw from the core management layer. It should be mentioned that Mao Lixiang once apologized to his mother for not having allowed his younger brother to be a top management member in his company.

5.2 Establishing credit evaluation mechanism for enterprises and professional managers

To build trust mechanism, the specific measures that should be taken are to establish a unified information database for professional managers in the country as well as to reduce the costs incurred during the search of information about enterprises and professional managers. The businesses may input information about managers above department level especially their loyalty and abilities into the database so that their moral behaviors will be supervised and restricted by the market. More specifically, when a manager commits frauds, his fraudulent conducts will be exposed to the public by the information transmission mechanism. His credit will then be badly shaken. Since the calculation of the professional manager's further values of human capitals is based on his past performances, once they become discredited, their manpower capital will be certain to devalue. Therefore, since a heavy price will be paid if they violate professional ethics, the professional managers will surely restrict their behaviors. This also applies to the credit evaluation mechanism of enterprises.

5.3 Finishing holistic inheritance of family business property through “monetary value distribution method”

In China, either children's abilities or the traditional “equal division system among children” is made as the criterion of family business property, the enterprise assets will certainly be diversified,

eventually resulting in the loss of enterprise size effects. Thus, it is advocated that “monetary value distribution method” should be adopted to solve problems caused by equal partition of family property (Yu Gongwen, 2003)⁸. “Monetary value distribution method” refers to the method to figure out the total monetary value after evaluating all family business properties, and determine the monetary value of divisible properties for inheritors according to the number of them, so as to realize fair division of properties. After division, the property inheritors can decide how to use the properties at their own discretion. The inheritors who do not wish to run the business can choose to transfer their equities to their family members and take up the career they want; the inheritors who wish to join the family businesses but are not qualified enough can choose to go in for business activities by becoming the shareholders of the family businesses; and the successors who wish to join the family businesses and are competent enough can directly taken over the businesses. This property division method can help retain the families’ control over the businesses, establish clear ownership of businesses, realize separation of ownership and managerial power in the family businesses; and embody the employment principle of “Recruitment of competent personnel”.

If there is more than one inheritor of enterprise properties or the sole inheritor is not qualified enough to succeed to enterprise management rights and bear family business risks, the problem that properties can be inherited but management rights can not be inherited arises. On the condition that properties are transferred to direct descendants, the division methods adopted by CHINT Group can be learned from: Nan Cunhui, the president of CHINT Group advocates the founding of “Black Sheep Fund”. If the children of the business owners have the makings of an entrepreneur, the board of directors may hire them to work in CHINT Group. Otherwise, they will be provided for by the Fund established by the original of board of directors.

5.4 Enhancing the comprehensive competitiveness of successors by imposing laws and regulations on estate tax

“Estate taxes” is called “Robin Hood tax” in western countries. Only a very small part of people (very wealthy people) shall pay this kind of tax. In developed countries, only 2% to 5% of people have to pay estate tax. That is, only a small part of the wealthiest people is the payers of such tax⁹. With regard to fortune, many rich people in the world are most worried that their next generation will become unenterprising when they can easily possess a large fortune. In view of such possibility, the Rockefeller Family stipulates that any successor can not withdraw the inherited assets before he becomes 30 years old. However, the Bill Gates, George Soros, Warren Buffett, etc are active advocates of using estate tax.

Collection of “estate tax” can fundamentally solve the problem of large wealth gap in that the poor are likely to become rich so that they can enjoy equal right as the rich who has to pay estate tax to get access to various social resources and government resources. To the next generation who benefit from intergenerational succession of family businesses, the estate they inherit from their parents is actually unearned income. Such easily gained fortune often deprives some talents of their initiative, enterprising spirit, etc. Therefore, levy of estate tax can indeed reduce family assets in the short run. However, in the long run, the enterprises stocks may become more held by people outside the family and then professional managers may be introduced. In such enterprise structure, business productivity can be maximized.

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