The Emergence of Corporate Forms in China, 1872-1949. An Analysis on Institutional Transformation

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Introduction

Throughout human history, there has been only about a handful of organizational forms that one can choose from to conduct business. One can either conduct the business solely by oneself – the sole proprietorship, or conduct the business with someone else – partnerships. These two forms were by far the most common forms available until the sixteenth century, when a third possibility arose – a company chartered by the government. A company, in its historical primitive form, is an economic entity that usually involves a larger group of people as shareholders. This organizational form also involves some forms of regulation established by the government. In its mature form, it represents a legal institution in which investment is conducted through an organization, the company, with legal personality independent from the investors. Investment is divided into transferable shares and usually investors' liabilities are limited to the amount they have invested. It is also a totally new idea of property, which on the one hand, the ownership is dispersed and, on the other hand, the property could
exist indefinitely until it is legally dissolved. When companies become the majority of the economic actors, this domination represents the idea of turning widespread individual economic activities into a national economy, under the supervision of a state with centralized power. Modern economy is therefore becoming a ‘depersonalized’ economic system.

First developed in Europe, this form of business organization eventually diffused to other parts of the world until the mid-19th century, when companies of Western countries vigorously looked for markets worldwide. Corporate forms were widely recognized as business organizational forms, created through a joint stock arrangement, that were used both to consolidate capital and to disperse the investment risk. This modern organizational form was first used among high-risk businesses such as trading, banking and insurance, but eventually became widely used in large-scale manufacturing enterprises when enormous amounts of capital were needed. The idea of organizing the economy through companies, first spread out among European countries and America, was later on also adopted by most societies that had developed a modern industrialized economy. Human societies eventually experienced a globalization of the corporate economy.

Corporate Forms as Social Institutions

By seeing the company as a social institution, it has the following organizational characteristics: (1) Institution is a set of relatively stable arrangements for repetitive practices. (2) It needs rules and norms for
governance to create stability and order. (3) These rules and norms, both formal and informal, constrain individuals’ action within the field or domain of the institution, but at the same time, facilitate individuals to re-enact the same actions as repertoire. (4) These socially constructed rules and norms are phenomenological because they are most of the time taken for granted by those who participate in the institution (Zucker 1983). This perspective suggests that our understanding of an institution, including economic institutions such as a company, should have a focus on a social process that is internal to the institution itself. External conditions, such as economic competition, are relevant, but the reaction to these conditions is in turn shaped by the pre-existing norms and rules that were set up by the social process. If corporate form is indeed a social institution, how should we understand the transformation of it? How was corporate form as a way of doing business invented and transformed, and how was this Western idea dispersed to other parts of the world? Did the company, as an economic institution, develop the same way in every country that adopted it?

Historical Institutionalism and Institutional Transformation

Historical institutionalism suggests that the institution is the product of concrete historical processes where timing and sequence of events are consequential (Thelen 1999; Mahoney 2000; Mahoney 2001a; Mahoney 2001b; Pierson 2000). Institution transforms when critical events happen and redirect the course of development. This redirection, while being constrained by past
trajectories, will eventually settle and ‘reproduce’ itself as the new path, until the next critical event(s) happen which will then make another change. Once the initial conditions of the new path or development become self-reproducing or self-reinforcing, this direction of development will have less chance to be re-directed to another trajectory. It becomes path dependent. Once a path has been set, there will be a ‘lock-in’ effect, that it will become very difficult to be re-directed to a different path.

The usual way to explain path dependency is either the economic argument of increasing return (Arthur 1994) or the sociological argument of institutions as culturally shared scripts (Abbott 1997; Powell and DiMaggio 1991). These two versions of path dependency, however, will be inadequate to explain social change, since the path, according to these two explanations, once shaped, become difficult to change (Thelen 1999). Historical institutionalism suggests that changes could occur during the occurrence of ‘critical junctures.’ Critical Junctures are events that could initiate a break through from the existing path and allow changes to a new path of development. When significant events, or to the extreme, a crisis occurred, the path would become unstable and could be redirected to a different trajectory. The contingent combination of conditions constitutes the ‘initial conditions’ for further development — making a development that breaks away from the original path. Critical junctures created an unstable situation which would cause a possibility of change. Pre-existing conditions and other contingent factors of a certain setting are combined into a
particular ‘configuration’ which eventually constrain the choices of changes as the reaction to the particular critical juncture (Katznelson 1997).

Evidently, the diffusion of corporate forms around the world as an idea of organization did not create an isomorphic result. While the organizational form could be the same – with a board of directors, shareholders, managers, etc – apparently, the operational logic of the corporations was always socially and culturally defined. Historical institutionalism would suggest that even experiencing the same critical event that would lead to the adoption of corporate forms, the outcome could be different because of the particular configuration and the interactive outcome under each setting. Accordingly, given similar economic motives, the different institutional configurations in different societies could have generated different forms of corporate governance that are distinguished from each other (Fligstein and Freeland 1995; Guthrie 1999).

The China Case

Since the mid-19th century, the presence of foreign economic powers in China changed Chinese economic life permanently. Competition created by the foreign power pushed both the Chinese state and the business community to respond. Western ideas on how the economy should be run, along with many other Western ideas, were introduced into China and have been imitated since then. In 1872, the China Merchants’ Stream Navigation Company, the first Chinese owned company that was modeled on Western corporate forms, was established in China. New business organizational concepts such as board of
directors, shareholders, general meetings, limited liability, and so forth, were introduced into China and gradually changed the contours of commercial life in China.

My goal in this study is to reveal that the Chinese merchants did not simply adopt the corporate forms and use them to engage in the modern economy, and they were not simply being guided by the Western tradition-based Company Law. Rather, Chinese merchants, and later entrepreneurs, were using the joint-stock company as a way to bundle pre-existing social relations, traditional Chinese business practices, and nationalistic ideologies into a more useful organizational format that allowed for the accumulation of capital. The analysis offers a way to understand how continuity in Chinese social organization was maintained in the face of economic transformation, and shows how pre-existing social relationships were embedded in the adaptation of modern business rationality.

Pressures for increasing economic competitiveness of the Chinese business community in lieu of the economic invasion of foreign capital was the ‘critical juncture’ that forced the Chinese society to formulate a solution to solve the ‘crisis.’ The social consensus at that time was a demand for a change of the organizational structure of the economy, even though general comments on this transformation – the adoption of Western corporate forms – are that it was not as successful as it should have been.
The Argument

While I do not intend to neglect political and economic factors, I argue that, besides these factors, there were more important social dimensions determining the transformation. The critical juncture that initiated the transformation of the Chinese economic institution was the strong presence of foreign capital in the mid-19th century. This external factor became the significant cause of the eventual break down of the traditional mode of economic organization, and the replacement of it with the modern, Western, mode of organization. The path that took off from this juncture and developed into a ‘legacy’ (Collier and Collier 1991) was constrained and shaped by the particular historical configuration in China during that time (Katznelson 1997). At least three factors contributed to these organizational changes in pre-1949 China: (1) The pre-existing institutional configuration of Chinese business, (2) state - business community interaction, and (3) the social construction of an ideology of commercial competition and what was a company. While analytically distinctive, these three factors interacted with each other and created the contextual base in 20th century China for the emergence of Western style corporations, and eventually created a new “social system of production” (Hollingsworth and Boyer 1997).

Pre-existing Institutional settings

From an institutionalist perspective, the process by which the corporate forms emerged is embedded in preexisting institutional configurations. While the ‘form’ could be copied from the West, the actual operation of the corporations
would be different if economic activities in China were embedded in an institutional history different from the West. Faure (1994) insightfully suggested that what we will find out is that tradition-bound attitudes were not replaced by the idea of share holding – the most essential feature of a modern company. Rather, it was share holding that was being absorbed into the Chinese business tradition. A blending of old and new elements did occur during the period of transformation.

Differences in institutional settings between China and other societies are obvious. Economic transformation in Europe, for example, was historically based on a very distinctive institutional 'path' that China did not pass through (Collins 1980; Duplessis 1997; Hunt and Murray 1999). Without a similar institutional base, companies in Chinese would have been developed from a different trajectory. Many studies on the traditional Chinese business world suggest that a different set of criteria on 'ways of doing things' had been institutionalized (Biggart and Hamilton 1997). One prominent organizational feature of the traditional Chinese business world is its network forms of organization. While network forms of economic organization can be found in different times and spaces (Cookson 1997; Håkansson and Johanson 1993; Saxenian 1994; Uzzi 1996; Uzzi 1997), it is evident that networks are far more easily developed and more effective in a stable and predictable manner in Chinese societies, where personal trust and norms of reciprocity are highly institutionalized. It served as one of the most important organizational principles of the traditional Chinese economy (Jones 1974; Rowe 1984; Lai 1994).
State-Business Interaction

The path of economic development in China is very much a development without much state intervention. The Imperial state controlled a few monopoly businesses (e.g. salt), but left daily commerce out of her hands most of the time. Therefore, the original economic institutions in China reproduced themselves with little interference from the state. The presence of foreign economic power that was backed up by their states became an external factor that distorted the original path of Chinese economic development. The institution that reproduced the ‘stateless’ economy (Hamilton 1996) now had to transform itself into a different institution that required extensive participation of the government.

While organizing one’s business in modern corporate forms seems to be a personal choice, the extent to which the state is involved is at the same time very crucial, especially when we observe these personal choices would eventually transform the institutional structure on a national level. An efficient state is required for implementation if we see the corporation as an entity that could acquire its legal status only by registering with the state according to the company law. The state, therefore, is the crucial institutional actor that is directly related to the formation of corporate forms.

Compared with Japan’s modernization experience, the positive role of the state in China was minimal in terms of economic policy making (Chu 1994; Westney 1987; Yan 1999). This however doesn’t mean that the Chinese government, be it the Qing Dynasty or the Republican government, played no role in defining the social relations in and among corporations. The state still had
the legitimate power to use company law and other institutional tools to define how firms should organize. On the other hand, the business community was not a passive receiver of state intervention. The community had continuously interpreted and redefined those “external constraints.”

Social Construction of Commercial Competition

The presence of foreign capital had a significant impact on the development of corporate forms in China in at least two dimensions. First, to a certain extent, the presence of foreign companies ‘framed’ the way the Chinese understood corporations. Since the late 19th century, there was a shared belief that in order to strengthen China, commerce in China had to be developed and modernized, and in order to develop commerce, the economy should be organized along the lines of the Western style corporation (Guo 1995; Zhu 1996). In the eyes of the Chinese, it was the organizational format of the Westerners that created the competitive edge. The limited liability company became accepted as the only ‘legitimate’ form of organization chiefly among ‘modern’ businesses such as textile and spinning, railways, mining, banking, and so forth. Foreign companies in China during that time were used as a model for how a company should be operated. However, while the Chinese were imitating the organization of Western companies, their ideological understanding of the whole learning process was shaped by Western domination. The fact that imitation occurred as part of a commercial ‘war’ significantly narrowed their perception of the organizational features of a corporation.
These three dimensions became the configurative setting of China during the period of institutional transformation. The eventual legacy of the transformation in China, as shaped by the particular configuration, was inevitably different from those societies with different historical configurations. One crucial difference between China and Japan, for example, is the timing of the political reform in the two countries. Japan had the Meiji Restoration in 1862 and had built a more efficient Western-modeled government since then. Besides a few attempts to reform the government, the Imperial Qing in China never transformed herself into a modern state. The 1911-12 revolution had overthrown the Qing dynasty but then had led China into decades of chaos, followed by continuous warfare until 1949. The Chinese state never had a chance to perform the same roles as the Japanese state had in the country’s development. Also, the modern banking system, which was very important for the development of the economy, was set up in 1872 in Japan but the same institution did not develop in China until 1898 and never functioned well. All these differences in the “sequence of events” created a distinctive historical configuration for China at the turn of the last century.

Western Corporate Forms and the Chinese Economy

At least up to the end of the nineteenth century, the majority of Chinese businesses were mediated by personal networks backed up by personal trust. The particular patterns of social relations and the social logic behind them become the social foundation of the network economy in China. The use of
social logic, therefore, provides an institutional foundation for economic transactions in the Chinese business setting. Characterized by a flexible, cooperative and long-term social orientation, the social logic of the Chinese – the *guanxi* logic – is embedded in the daily business practices of the Chinese business community, past and present.

This stable institutional setting was soon challenged by the arrival of foreign companies since the late 19th century who traded, and later manufactured, goods in China. The business settings had since then been changed and required new adjustments for the Chinese business community to survive. It was during a time when the Chinese government was involved very little in regulating the economy, and had left this responsibility to ‘private’ organizations such as *huiguan* and *gongsuo*.

At that time, China had already developed some advanced business institutions and practices well before her contact with the Western institutions. The traditional mode of business practices was effective enough in the face of increasing commercialization of modern China, until they met foreign capital with a rather different way of organizing. It is obvious that the traditional modes of organization used by Chinese merchants could not create the kind of wealth Western capitalists were creating at that time. This moment became the ‘critical juncture’ for the Chinese economy to be redirected to a different path of development. The Chinese considered copying the Western way of business organization, with the hope that the economy could be as strong as the West.
Compared with the China case of imitation, the British ‘invented’ most of the ideas of this new form of business organization – the corporate form. This invention, however, did not come out from any necessary conditions, but by and large, was a rather contingent outcome of a series of historical conditions – a continuous and high speed growth of the economy, which in turn created a general public with surplus wealth looking for investment opportunities. This high level of wealth among the general public also, unexpectedly, reinforced the growth of private firms, and contributed to the later under-development of larger public firms. The very long tradition of litigation in Britain also helped to develop an economy that functioned through interactions between firms in an impersonal manner.

The Japan case, on the other hand, represents a case of imitation. The imitating process, and the outcome of it, however, turned out to be different from the China case – which was also a case of imitation. The same process in two different societies, resulted in two different outcomes, largely because of their differences in their institutional settings. The existence of an effective state apparatus seemed to be crucial, playing a key role in the institutionalization of the corporate forms in Japan. This new form of organization, while being copied in a pretty accurate way, eventually became a vehicle to facilitate the further development of the traditional patterns of business organization. Corporate forms, in Japan, were used more as a new tool for control than as a tool to consolidate capital.
The China case represents yet another scenario. With the Imperial state, and later, the Republican state, being unable to regulate the economy effectively, the institutional transformation of the Chinese economy was, most of the time, in a self-regulating status. Without an applicable Company Law and the related institutional support long after the introduction of corporate forms to China, this new institution was forced to adapt to the pre-existing traditional institutional setting when it attempted to gain legitimacy from the business community. I argue that the traditional practices were allowed to co-exist with the modern business practices for a long time. This co-existence provided an opportunity not just for the survival of old practices, but also for interpenetration of influence between each other. Domination of the nationalistic viewpoint on what a company could do also created a side effect by not encouraging the understanding of what is a company from a less ideological and more economical point of view.

While considered as an efficient way to accumulate capital in other parts of the world, ironically, China’s social-economic context, with the scarcity of capital, did not have enough wealth to push forward a ‘stranger’ economy. Idle capital didn’t really exist, or there were better places for it to go. The institutional foundation for impersonal investment in China, therefore, was never developed. Impersonal investment practice was simply not something that needed to be developed. Businesses that needed a large size of capital at the end had to depend on traditional mechanisms to generate the needed capital. Many
traditional business practices eventually continued to be used simply because they had never been replaced.

**The hybrid of Old and New**

The idea of ‘joint-stock’ was not totally new to the Chinese. The only new component was the size of this ‘joint-stock’ venture. Some of the features of a modern Western company, such as shares of equal value, profits divided according to the number of shares one’s owned, separation of management and ownership, already had wide understanding among the Chinese traditional business community. What the Chinese were not familiar with, and arguably the more important features of corporate form, were features such as the juristic personality of the company, limited liability and the regulatory role of the state through company law and other legislation. Even more significant, there was a lack of institutional foundation for impersonal exchange in the traditional Chinese business practices, which were essential for the advancement to a modern economy.

For the Chinese business community, the corporate form was supposed to be a better form of business organization, but the greatest advantage that could be experienced in China was the ability of the company to accumulate a larger amount of capital. Other advantages, for example, the legal protection, were either not of their concern or did not exist because of the inefficient state. The legitimacy of corporate forms, as understood by the business community, was
that this form of business organization, as different from all the traditional forms in China, had the ability to ‘house’ a very large amount of capital.

The progress of replacing the traditional business organization – sole propriety and partnerships - did not just interfere by disregarding the legal elements and therefore the company law, the process was also impaired by the lack of a supportive institutional matrix that was crucial to the development of a corporate economy. In the Western legal development, company law was only part of a larger legal matrix that was used to facilitate economic activities. Besides the company law that defines the organization and operation of corporate forms, stock market, banking and insurance, Western double entry accounting, and other legal elements like the bankruptcy law were also crucial components of this supportive institutional matrix. All these, however, were either underdeveloped or missing during the transformation of the Chinese economy. Without a full range of development of a larger institutional matrix, traditional business practices were reinvented under the new rules of the modern business organization. The new ‘Western’ institution was just being put on the top of the existing institutions. The foundation was the same even though the external structure of the organization had changed.

There could be a few reasons why the Western corporate forms didn’t replace the old system. When the idea of Western corporation was introduced to China, it was confronted with an existing system that was mature and well functioning. Obviously, it could not help the Chinese to industrialize the economy, but other than that, it was a functional system. When the system had
been around for such a long time and was well established, it became difficult to
totally replace an old system. Any change, if any, would be path dependent. At
the same time, the establishment of the Western system in China eventually took
more than a few decades, so there was a long period of time that the old system
and the new system co-existed, and in many ways, the old system seemed to be
working fairly well with the new system, sometimes even complementary with
each other. A good example was the relationships between the Western firms
and banks and the Chinese native banks. They were depending on each other
for their business for more than a few decades.

Historical institutionalism suggests society could change when the original
path was being disturbed, either by external or internal factors. This change,
while contingent on its occurrence, will be subjected to the influence of the
configuration of variables that are pre-existing. The path of development will be
shaped by those initial conditions when the change happened. In the case of
China, this pre-existing action framework would be used as the medium for
diffusion of new ideas. New ideas were interpreted and digested with the help of
old ideas. When tradition has a chance to be re-invented, the happening of
social change would therefore be more unlikely to converge in the same
direction, than to diverge on different paths. The diffusion of institutions, even
with surface similarities, the meanings and operational logic behind it could
remain informed by distinct local understanding in each society (Ruskola 2000).

Societies could have different paths of development. Each development is
path dependent, with the result that each development carries its own
characteristics. Corporate governance, for example, differs among various social contexts. There is a Chinese way, but also a German way, a Japanese way, and an American way. These different ways of doing things, however, should be understood more as outcomes of contingent configurations of historical events and factors each society has experienced, rather than as essentially unchangeable elements of these cultures. The Chinese, with the right combination of factors, could have developed business corporate forms that are comparable with the West. On the same token, should the legal system be more accessible and effective, the Chinese would be less dependent on personal ties to solve problems and less litigious than their Western counterparts. Distinction between dichotomies such as East and West, traditional and modern, therefore, may not be as useful as we thought.

The diffusion of ideas would be more successful if the new ideas can serve local needs better than the pre-existing ones. It is not necessarily that the idea is going to serve the same need in every place; rather, the same idea could be used for different purposes within different contexts, and it will survive and develop so long as it is useful to the new environment. The part that is useful to the context will be adopted and integrated into the pre-existing framework. Those that are not useful and are in contradiction with the existing system will either be discarded or modified. Transformation is, therefore, always a matter of degree, and there are many possible forms in between.

My research shows the process through which the Western-modeled business organization – the limited liability company – was transplanted into
China. I argue that Chinese companies, like companies in other societies, were created, as a way to meet external constraints, by the social interaction of different actors within a particular pre-existing institutional field. When the institutional field, the actors involved and the external constraints are different, the outcome is different. Political and economic factors matter, but they only represent external factors. How people organize to respond to external constraints cannot simply be reduced to the nature of the constraints. The particular process on how the society formulates reactions to those external factors is far more crucial in explaining the institutional outcomes. People do not just respond passively to external constraints. Their responses are a result of 'subjective' interpretations of the constraints and are limited by the institutional constraints that already exist.

This analysis is not to suggest a distinct difference between the West and the rest, or China and the rest. All cultures and societies share something in common one way or another. In terms of initial factors, there were many similarities between Western Europe and China (Pomeranz 1997), the differences, however, were in the combination of those factors, plus the few differences, that eventually created two different configurations. China, for example, did not have the same geopolitical competition as in Europe which could push more vigorous reform. Competition between the French and the British governments, for example, did not just stimulate innovations, which eventually led to changes, but also encouraged inventions on institutional arrangement to diffuse between them (Freedman 1979). Also, in terms of timing,
the external issues that China was facing in the late nineteenth century were already very different from those that were faced by Western Europe, and in particular England, a century ago.

While it is always possible to compare two regions or cultures on a certain factor (or even a few factors), an overall comparison of all the factors is simply not fruitful since the differences in historical outcomes between China and England, for example, are not about what factor China or England had or had not. More significantly, it is about the overall configuration of all the conditions, which is more important in creating different consequences. The existence of traditional or pseudo-traditional institutions along with the emergence of new “modern” institutions in China during the transitional period was not a unique experience. England, during her early industrialization period, had also gone through a similar situation. The lack of certain conditions, combined with a difference in sequence and timing of events, however, resulted in different historical configurations in the two countries.
References


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