



## Probe into the “Marriage” Relationship of “Outside Managers” and Family Firm

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### Abstract

In China, the try of family firms introducing “outside managers” usually results in a failure, which is caused by imperfect legal environment, and irregular professional managers’ team. This paper aims at probing into the possibility of win-win of “outside managers” and China’s family firms in perspective of their complicated relationship, in hope of “outside managers” winning survival in family firms for a long period, and improving family firms’ management level and market competitiveness.

**Keywords:** Family firm, “Outside managers”, Win-win

### 1. Introduction

The emergence and prosperity of private economy is one of wonderful achievements in China’s economic stage since the reform and opening-up policy. Till late 2008, China has 6,594,200 private enterprises, accounting for 70.91% of mainland-funded enterprises (Xinhua net, Apr. 21<sup>st</sup>, 2009), which far surpasses the number of state-owned enterprises and foreign-funded enterprises. However, according to an investigation done by China Non-governmental, no more than 800 private enterprises belong to the large-sized type, almost accounting for 0.004% of the total number. The smaller the enterprise scale, the stronger the tendency of family management is. Apparently, China’s private enterprises are mostly family firms.

How family firms adopt professional management is an important issue. Professional management, in short, is to solve firms’ internal problems by “laws and rules”. Firms operate by procedures and rules. Positions are based on abilities and morals. Profits are from selling knowledge and services. Professional management needs professional managers. However, family firms can not get sufficient management talents. The short of professional managers has already become a bottleneck restraining the growth of many family firms in China. From this point of view, family firms are not only the largest customers of professional managers but also the largest suppliers.

### 2. The conditions of “outside managers”: two types of cases

An effective combination of human resources, financial resources, network resources, culture resources and family firms’ internal capital stock will benefit the development of China’s family firms. Although family firms are not necessarily in a lower efficiency (Xiaoping Chu, 1999), outer human resources, namely “outside managers”, can help to improve the competitiveness of firms, under the condition of severe market competition and short of human resources of families. Practices prove that to introduce “outside managers” means both chances and risks for family firms.

In Joicare Pharmaceutical Group, 74.18% of shares are controlled by family members totally. In 1995, its main product “Taitai Oral Liquid” runs popularity. The fast growth brings about new challenges to management. Baoguo Zhu, the board president, introduces outer human resources by following the principle of “ability-position match”, and appoints some “outside managers” who possess experiences of managing trans-national companies and understand China’s conditions, constructing a regular and effective management system for Taitai Pharmaceutical. As a result, during the depression period of health products from 1995 to 1998, Taitai Pharmaceutical still keeps the sales of nearly 660 million Yuan, and turns into one of pharmaceutical enterprises that are most profitable and develop fast. Although some “outside managers” introduction cases are successful, most family firms that introduce “outside managers” result in

failures.

In 1997, after Lanzhou Huanghe Enterprise Co. Ltd re-employs Yanyuan Wang who contributed a lot to the enterprise as it entered the market, the enterprise suffered a lot due to the serious decreases of stock price, internal conflicts, and frequent personnel changes caused by excessive empowerment. In 2001, in Guangxi Panshibao Co. Ltd, the professional manager Weizun Wang was accused of duty encroachment and commercial bribery because he criticized the enterprise owner for false accounting, which turned into the first case of China's professional manager. Besides, Jiqing Yao become a useless manager in Vantage. Zhidong Wang was discarded by Sina. Guangyu Huang, the board president of Guomei, changed the management level completely. All these cases serve as negative examples for "outside managers". So, what is the difficulty of combining "outside managers" with family-oriented private enterprises? What is the solution?

### 3. Puzzle: How to deal with the "marriage" relationship of two parties

Any team or individual as "outside managers" has to understand and deal with following issues properly if the team or individual hopes to gain achievements in family firms, no matter how the ability of team or individual is.

#### 3.1 "Outside managers" and entrepreneurs

Entrepreneurs as the direct boss of "outside managers" select the "outside managers" on one hand. On the other hand, they may become barriers of influencing "outside managers" negatively.

##### (1) Different thinking

Family firms possess a struggling spirit and practical nature. But they do not own sufficient knowledge. Therefore, they need "outside managers" who have rich knowledge and excellent work abilities. However, different views to enterprises' objectives and situations, marketing, and performances may lead to a separation at last. The case of Skyworth is a proof. Besides, entrepreneurs are inclined to avoid risks. Their long-term reform plans may conflict with "outside managers" programs because "outside managers" can not understand the situation completely in a short period. They pursue for excellent performances in a contract term. So, that also serves as a vital reason for the failure of the "marriage".

##### (2) Empowerment risks

To empower "outside managers" is reasonable. But it may cause the decentralization of authorization in an enterprise. Therefore, two issues need to be solved. Firstly, it is the threats from opportunism after the decentralization of authorization. Secondly, it is the affirmation of relevant responsibilities. Meanwhile, because entrepreneurs are worry about losing the real control over enterprises, they may fail to execute a full empowerment. Three sampling surveys on private enterprises in China during past ten years show that most private entrepreneurs are the leaders of enterprises (see Table 1). Although the percentage is decreasing more or less, it is always above 90%. The centralization of entrepreneurs are common.

##### (3) Information leakage

Presently, the market legal system is powerless. The imperfect information and contracts may lead to enormous costs for negotiation, resolution, incentive, and restraints once things happen. Therefore, as family firms are trying to introduce "outside managers", they have to make balance between moral risks and opportunism. Mingshan Yin, the chairman of Chongqing Lifan Group, suffered a lot, including psychological hurts and losses of enterprise resources, due to the opportunism of "outside managers", which caused defects in information management. So, owners of family firms improve their consciousness of protecting firms' information. As for some vital information, family firms almost exclude "outside people" completely. The process of enterprises releasing information tends to be lower, which deepens the degree of information asymmetry between "outside managers" and family firms.

##### (4) Moral deficiency

Some "outside managers" are lack of dedicated spirit and professional morals. Besides, the professional managers market is irregular and non-occupational in general. These factors cause the absence of trust between family firms and "outside managers". In the cooperation of "outside managers" and family firms, "outside managers" do not trust the calculation tools and even have different recognitions to the fulfillment of expected return, which ruins firms' trust mechanism, resulting in that some family firms resist the participation of "outside managers" as a group. John Groene Wegen divides the "integrity", as an attribute of individual behavior, into "personality integrity" and "environment integrity". Even if a person is short of personality integrity, he or she may possess the environment integrity gradually due to the influences of families. From this point of view, the non-integrity of "outside managers" makes family members' environment integrity tend to be more valuable.

#### 3.2 "Outside managers" and family members

Family firms are based on "families" and "feelings". Therefore, they usually treat non-family members differently. In

specific, they may resist, be against, and confront the outside people. In addition, “outside managers” usually occupy important positions in family firms. They can govern some family members, which exerts direct or indirect impacts on family members’ interests. Family members are worry about the betray of “outside managers”, which will not only harm family firms’ interests but also threats family members’ safety. As a result, family members may understanding the behaviors of “outside managers” irrationally, which will affect the performances of “outside managers” seriously.

### 3.3 “Outside managers” and enterprises’ original employees

As “outside managers” enter a family firm, they are new employees and bosses for original employees. “Outside managers” serve as a threat for original employees’ rights and a challenge for their work habit. Therefore, original employees will resist and exclude “outside managers” naturally. They usually behave against with “outside managers” in order to maintain their rights and positions. So, “outside managers” have to meet these kinds of challenges as they join in a new family firm.

### 3.4 “Outside managers” themselves

Presently another prominent issue is the non-professional nature of “outside managers”, together with the contradiction between psychological contract issue and family firms. The “non-professional” means managers usually do not possess fixed goals. In *Enterprises’ Entrepreneurs ----- Contract Theory*, Weiyang Zhang thinks that people with high abilities but less wealth will be employed by capitalists as managers. Here, the managers are “outside managers” in this paper. Based on experiences of working in family-oriented private enterprises, these managers will create their own business once there is a chance. So, their goals are not fixed. The transformation cost of creating a venture and being managers are lower, which directly causes the instability of managers market. Xinchun Li names it as “a market failure of managers market”.

## 4. Ways for positive combination

The maturity of professional manager team and the standardization of legal market is a gradual process. Therefore, it is normal for problems appearing as introducing “outside managers”. We should not stop the introduction merely because of several failures. And we should not wait just because of the imperfect outer environment.

### 4.1 For “outside managers”

The “world No.1 CEO” Jack Welch introduces the three principles for GE recruiting talents in his autobiography: insist on integrity, emphasize on performance, and thirst for reform. The author agrees that the three principles are also three important factors for “outside managers” creating splendid performances in family firms.

#### (1) Give priority to integrity

Market economy means law-governed economy and moral economy. The morals and professional ethics of “outside managers” are the essence, which can generate added-value for “outside managers”. Guomei emphasizes on “morals first, abilities second” in recruiting new employees. Zhongbao regards professional managers’ morals and personal fames as the No.1. “Outside managers” should improve the morals, enhance professional consciousness, and try to gain trust of entrepreneurs by their sincerity, integrity, and loyalty.

#### (2) Emphasize on performance

All enterprises aim at gaining profits as they introduce “outside managers”. However, due to the limits of knowledge, information, and wisdom, “outside managers” can not solve all problems properly. “Outside managers” should take “being others’ managers” as their occupation, solving problems for entrepreneurs as their responsibilities and obligations. Market value is the life of professional managers. If without performances, professional managers will be discarded by the market.

#### (3) Reform

The management team formed by internal members has similar ideas toward corporate culture and values, which may influence the innovation, especially the strategic innovation. Innovation is the soul of enterprises. The coming of “outside managers” breaks the original rules of enterprises and brings about new thoughts and methods. “Outside managers” should make reforms bravely and be good at making innovations. Besides, with the precondition of accepting enterprises’ former cultures and pursuing for similarities of cultural ideas, “outside managers” can put forward new suggestions for enterprises’ defects and strategic programs, helping enterprises to develop properly.

### 4.2 For family firms

As “outside managers” improve themselves, family firms, especially the owners should create a positive environment for “outside managers”. According to Maslow’s hierarchy of needs, the author thinks that owners of family firms should follow these principles as follow.

## (1) Physiological needs ----- offer reasonable salaries

Generally speaking, as enterprises introduce “outside managers”, they give higher prices. Therefore, “outside managers” feel satisfaction in the physiological aspect. As for equipped welfare, enterprises should apply a multiple distribution way, leveling the salaries, actualizing more selective and practical welfare package, absorbing and retaining the elite “outside manager” team. Meanwhile, build a long- term salary program based on annual salaries and execute the payment with basic salaries and rewards. By this way, it can satisfy the psychological contract of “outside managers” on one hand. On the other hand, it can decrease risks of enterprises in recruiting new managers effectively.

## (2) Safety needs ----- build a long-term development strategy view

Owners of family firms should establish the management mode. If they adopt an American traditional mode, firms need an excellent executer. If they adopt an English turnover management mode, firms’ owners should take the chairmen position, similar to the Jinyi Group, influencing and supervising the performances of “outside managers”. As for the second mode, firms should actualize a complete empowerment. Otherwise, professional managers can not exert the comprehensive effects or carry out the policies thoroughly.

## (3) Social needs ----- assist to coordinate interpersonal relationship

Firms’ owners should assist to coordinate the relationship between family members and “outside managers” in purpose, applying an open, regular, and transparent performance evaluation and salary system, and emphasizing on talents instead of bloods. Meanwhile, build the authority of “outside managers” among firms’ employees and empower “outside managers” fully. Besides, to construct a fair competition pattern for positions can help “outside managers” to gain success in private firms.

## (4) Esteem needs ----- respect the authority of “outside managers”

To be people-oriented means to understand people, respect people, and treat people kindly. For firms’ daily decisions and daily management, respect the professional suggestions of “outside managers”. Provide sufficient personal cares and professional respects for “outside managers”. Form an open decision-making mode and exert the intelligent effect of “outside managers”. Maintain an open and transparent “political environment” and effective information channels. Trust “outside managers” and empower them. Do not interfere into the management too much. Disclose necessary information. Protect the professional authority of “outside managers” and help them to exert their abilities completely.

## (5) Self-actualization ----- create a suitable development space

First of all, make up modern enterprise management rules. Secondly, build a power restraint mechanism and an effective incentive mechanism. As owners of family firms, do not trust anyone completely. Just make best use of the abilities of people. In games of loyalty and trust, by applying some restraint institutions, including monthly reports, meeting supervisions, financial audit, daily business regulation, and financial tracing approval, defend against the harms of opportunism. With the precondition of perfect supervisions, empower “outside managers” fully and improve their senses of being trusted. Thirdly, perfect the professional development system, expand the professional development space and platform, and program the professional career for “outside managers”. Offer more opportunities for “outside managers” learning and development.

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Table 1. Whether interviewers or enterprise investors are engaged in enterprises' business management / administrative management (unit: %)

Time	Yes	No	Total	Number of samples
1993	97.8	2.2	100.0	1338
1997	96.4	3.6	100.0	1485
2000	96.8	3.2	100.0	2960
2002	96.0	4.0	100.0	3111
2004	92.4	7.6	100.0	2923

Source: Sample surveys of China's private enterprises in 2000, 2002, and 2004.