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Ownership Structure of Chinese SME's and the Challenges it Presents to Their Growth

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Abstract
We present a study of ownership and governance structure in the growing Chinese entrepreneurial SMEs sector. The study examines the structures that are embedded in the traditional Chinese values and culture, as well as the institutional environment for Chines SME's and the limitation they present towards the growth SMEs in China. Our findings suggest that Chinese SME ownership, and ownership transition appears to be stable and supportive of SME growth. The external institutional environment, however, is a limiting factor for the growth of Chinese SME. This results in the structure of dominant shareholder that seems to be a suitable construct for most SMEs under the current institutional environment of China. The first phase Chinese SME's go through is to define unequivocally the role and the responsibility in the organization of family members. We conclude this paper with the implications and suggestions for future research.

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We present a study of ownership and governance structure in the growing Chinese entrepreneurial SMEs sector. The study examines the structures that are embedded in the traditional Chinese values and culture, as well as the institutional environment for Chines SME's and the limitation they present towards the growth SMEs in China. Our findings suggest that Chinese SME ownership, and ownership transition appears to be stable and supportive of SME growth. The external institutional environment, however, is a limiting factor for the growth of Chinese SME. This results in the structure of *dominant shareholder* that seems to be a suitable construct for most SMEs under the current institutional environment of China. The first phase Chinese SME's go through is to define unequivocally the role and the responsibility in the organization of family members. We conclude this paper with the implications and suggestions for future research.

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1. Introduction

In smaller companies, the entrepreneur is often the figure that guarantees the critical competencies: the coalition coincides with him or her (Smith &Miner, 1983). As long as the entrepreneur's physical and mental resources can handle management complexity, the governance structure is not a relevant issue. In fact, the entrepreneur works out the strategic and control functions as well as the synthesis of interests, those social and economic networks that are vital to the company (Ward, 1991, 1997).

The need for development of the business generates the delegation process. A key internal constraint for the growth of SMEs is a reluctance or inability of owner managers to diversity control over business functions to professional managers (Storey, 1994). When this resistance is overcome, the coalition increases and the first governance issues arise (Gubitta and Gianecchini, 2002). In China, the ownership structure and transition cannot be taken for granted to be a natural process. After a period of rapid development, Chinese SMEs are facing growth issues associated with introducing capital and managerial resources, which can be rooted form the improper governance structure.

This paper attempts to contribute to our understanding of the ownership structure of SMEs under the institutional environment of China, which has a long history but scarcity of open market economic experience. The following research questions were formulated for the study:

-*Does firm Ownership structure influence the growth of Chinese SME's?*
-*Do changes in ownership pose difficulties for fast growing SME's?*
-*What is the role, impact of the institutional environment in China on SME growth?*

Reliable information on the problems and constraints facing Chinese SMEs is difficult to find from existing data sources. We therefore carried six interviews, and this paper is based on the results of these interviews. Nearly all of the enterprises in our sample admit that many management problems can probably be traced back to highly centralized ownership structure. But the process of ownership diversification is almost slack which doesn't coincide with the rapid development of SMEs.

In this paper, we think that institutional change is crucial and determinant to the evolution of ownership structure of Chinese SMEs. We specify the settings of China's business tradition, values and institutional environment, and explain why the existing of dominant shareholder is a suitable selection for most of the China's SMEs, which can somewhat, explain the gap between the practice and theory.

2. Literature Review

Mainstream research on corporate governance is based on the separation of ownership (shareholders on the one side) and control (managers on the other side) in the large , publicly traded firms where ownership is distributed among an extremely large number of an anonymous shareholders (Berle &Means , 1932). The SMEs were always regarded as generally "classical enterprise", in which the owner and the operator were not separable, so the Corporate governance of SMEs was neglected in reason. (Ouyang wenhe and)

Along with the content of corporate governance continuously extending, the corporate governance of SMEs were getting increased attention. ( ) Whereas, most SMEs research focuses on how to improve the decision-making process and ensure coordination, then the executive board issues are often created. ( ) As for the Change in ownership, are always not the emphasis of research. Because this process can be moderate, for example in the internal transfer of shares among the family members, or they are more considerable when a stake of company's proprietorship shifts to external investors or when a separation between ownership and management effectively takes place within the firm (Schillaci and Faraci, 1999). Among these few but valuable literature, Paolo.G and Martina.G (2002) utilize the New Theory of Property Rights to analyze corporate governance models in SMEs and offer a definition of flexibility of the coporate governance systems and organizational structure. Schillaci C.E. and Faraci R. (1999) found that changes in firm family ownership are not homogenous and the consequences of such modifications are also different in terms of governance devices, decision-making process and strategic competitiveness. They defined such patterns of change as "institutional transition" processes due to external and internal pressure for organizational change of SMEs. Although these literatures enlighten the research on the process of ownership transition, the above-described theories partly lose their strength when applied to the China's SMEs because there exist huge difference between China and western countries in external mechanisms for corporate governance.

In China, the majority of the corporate governance literature focus on the large listed companies, there is a dearth of research on smaller organizations. ( ) However, Ouyang and Du (2005) compare the corporate governance of SMEs between European Union and China. They summarize the character difference, which need to further empirical tested. Wang and Cui provide and test an evolution model of corporate governance for private enterprise. They conclude governance system in a way that fits the specific organizational context and use institutional theory to help explain the ownership structure of China's SMEs. Deng and Yu (2003) analysis the ownership structure changes of China's private enterprises and give some advise on how to built a dynamic ownership. But all these researches seldom ground their theory on empirical test and hence extract concrete results. So there is still much room to improve our understanding of this changing process for the growing SMEs. This paper pays attention to the ownership structure change of China's SMEs from an institutional and transaction cost aspect, which can better understand the problems facing the growing SMEs.

The reminder of this paper starts with a descriptions of the ownership situation in the China's SMEs as a governance mechanism. The next section we analysis the institutional environment of China, which can explain the emergence of dominant shareholder of SMEs, and followed by concluding remarks and future research directions.

3. Problematic Ownership Structure in China's SMEs

3.1. Existence of Dominant Shareholders

Limited liability companies registered before the adoption of new Company Law in 2006 are required to have 2-50 investors, whereas, according to *A Report on the Development of China's Private Enterprises (2002)*, over one seventh private limited liability companies virtually have only one investor, and it's so common a situation that the biggest shareholder owns more than 90% of an enterprise.

Three types of situations caused this. The first is the natural outcome when start-up process began. In China, when SMEs get started, they tend to run the business in the form of a limited liability enterprise, through which on the one hand they can fully exploit the rules of limited liability to avoid operating risks, on the other hand, they can improve the image of the firm. In order to meet legal requirements this single investor runs a virtually one-man company within the system of "nominal shareholders" where other shareholders are usually the trustees of the investment of the real shareholder. It means there is only one investor, which is in turn creates several problems. Besides the dissensions between the real owner and the nominal shareholders, it is clearly that all the corporate governance mechanism means nothing to a virtually wholly funded enterprise.

The second situation is that family members start up the business together. In China, there is a traditional cultural propensity to do business with family members and those in the same region with whom one has Guanxi, or with those outside with whom one has no connections but can trust (Chen, 2001;Tedding, 1990).Placing their ownership under a special relationship (such as blood, kinship or geopolitics) and from the very beginning, there hasn't been a clear line of ownership among family members. Family members usually put their family disciplines first instead of market rules. It means there is a tendency of centralization of management by the powerful man within the family. Yet a long-term development requires specific allocation of property and interest for different players，even we see the entire family as a single party of interest. The result of balancing each other is always the isolation of ownership or consolidation of despotism.

The third situation is that in the start-up there are several real investors sharing ownership in accordance with their investment. But with the firm growing and the not-so-clear separation of responsibilities and rights at beginning, they gradually go different ways in evaluating their capabilities and contributions, which will surely generate various conflicts of interest among the shareholders. Their ownership shares are approximately the same, as a result of game among the shareholders, the organization will split or some shareholders will quit. Centralization of the ownership is unavoidable, which will lead an existence of dominant shareholders. In the economic transition period, the disorder of spirit values will prick up this trend.

The emergence of a dominant shareholder affect the corporate governance of SMEs: the supervisory systems such as board of directors established merely meet legal requirements, and there is hardly any evidence of supervisory boards or non-executive board playing a proper role. Based on this kind of ownership structure, it inclines to cultivate an atmosphere of autocratic decision-making style and lead the big shareholders to seize the territory of small ones, which will hamper the introducing of new investors. This will obviously result in the slack of ownership transition.

3.2. Involvement of Family Members

Even though some China's SMEs are not textbook family-owned as far as ownership is concerned, they still place family members on different levels of the organization. For important positions such as finance and purchase, family members will be preferred for the reason that there is usually business "privacy" within the firm. The newcomer is likely to take this "privacy" as hostage, which makes the surplus loss of agency cost highly unstable and more risky. (Li and Ren, 2002) By choosing a trustworthy family member to take the job, the firm found the best way to reduce agency cost. So far as common positions, if the applicants are rather similar with each other, those from within the family are also preferred. However, it is an innate problem for family enterprises to be troubled by nepotism and xenophobia. Family members take the dominant role in their enterprises, which lagged the level of specialized management.

There is another particular case called the quasi-family phenomenon. In China almost any developed SMEs has a group of loyal employees who have been following the boss for several years and are completely familiar with everything in the company. However, although they occupy important positions, they usually fail to change or adapt to the growing business, which makes them parties of vested interest. On the one hand, they hold back the company from moving forward, but on the other hand, they maintain it to be what it is.

In a sum, many China's SMEs are full of patriarchal atmosphere and far away from the modern company culture. This hampers the process of opening important positions to professional managers. Even if the professional managers were introduced, they must pay more attention to solving the conflicts among parties of interest. Nevertheless, the fact that so many parties are seriously involved makes this goal hard to achieve in daily management, reducing or completely counteracting the power of the manager. The ownership changes caused by managerial stock ownership are very difficult to realize in Chinese SMEs.

3.3. Interposition of Rent-seeking beneficiaries

In economics, rent seeking is the process by which an individual or firm seeks to profit through manipulation of the economic environment rather than through trade and the production of added wealth. The phrase rent seeking itself, however, was coined in 1973 by Anne Krueger in a paper. In transitioning economy rent seeking has become a serious social problem caused by a lack of power-balancing mechanism and the bureaucratic interference.

There are many ways of rent-seeking, legal and illegal. Companies can strive for favorable treatment from the government by way of negotiation and lobbying, or preserve their monopoly with special policies. The personal capabilities and social relationship of the enterprise owner will determine the firm ability to gather scarce resource, ultimately affecting its business performance. At the same time, some officials abuse their power to set up rent to exact fees or collectively carry out bribery activities. Under the circumstance in China, the rent seeking beneficiaries are not only government officials. In fact, they involve all individuals who have a say in resource allocation during the transition period, including the authorities in state-owned financial institutions and supervisory bodies, their relatives, classmates, and friends who all play a role in how to divide economic resources.

There is an ongoing trend in the corporate governance of China's SMEs that it gradually moves from the family-owned governance to rent-seeking beneficiaries aligned-governance. This is partly because the owners of SMEs are usually feeling the heavy pressure of the external environment, therefore they want to internalize or institutionalize the rent-seeking forces from outside in order to form joint governance with all parties of interest. (Ouyang, 2005) In another word, these entrepreneur actually are willing to let rent-seeking benieficiaries with the power of resource allocation be the shareholders, even though the shares might be given for free. However, this kind of shareholding is not recognized legally and can be treated only with secrecy in the form of private promises from the owner to the rent-seeking beneficiaries. Accordingly, the money spent to cope with the rent-seeking beneficiaries should be included in the business cost of the entire enterprise, which cannot be audited normally. The rent-seeking beneficiaries' shares are often registered under the name of the owner and this secret making it extremely hard when changing ownership structure.

4. Institutional Environment for China's SMEs

Institutions are "the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction" (North 1990). Davis and North (1971) divide the new institutional economics into two parts--the institutional environment and the institutions of governance. While the institutional environment is the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution, an institutional arrangement is an arrangement between economic units that governs the ways in which these units can cooperate and/or compete. And what is the relationship between the institutional environment and institutional arrangements? Williamson (1991) argues that we can treat the institutional environment as a set of parameters, changes in which elicit shifts in the comparative costs of governance. That is, A governance model should be defined as an articulated system, consistent with formal and informal rules. Peng and Health (1996) argued that understanding the wider institutional environment is crucial to comprehending the rules under which firms must operate. Many of the shortcomings in the actual practice of corporate governance in China derive from weaknesses in the institutional environment as well as from peculiar cultural traditions. Before we attempt to solve the problems of SME deeply rooted from ownership structure, we need to analyze the Chinese institutional environment first.

4.1. Formal institution

4.1.1.Weakness in legal system

A sound and strictly enforced legal system is one of the critical prerequisites of a successful transition of ownership structure in Chinese SMEs.

There still exists some unsound part of legal system lies in the motive of the legislation. The first is Company Law. The need of nonstate actors for a convenient form in which to conduct business occupies a very low priority in the minds of state policymakers, and the Company Law is thus clearly concerned more with regulating and suppressing than with fostering and nurturing. Probably the most common complaint about the old Company Law adopted in 1994 is that the limited liability companies should have 2-50 shareholders, who must debate policy at shareholder meetings and vote after serious consideration of the issues. This regulation accords with neither the business reality nor the national customs, which can't be executed root and branch because of the high transaction costs. Therefore it brings about a lot of interference as mentioned above. However, the new Chinese Company Law allows people to open one-investor limited liability companies. It will be more suitable for the Chinese SMEs.

Another prominent problem is the lack of a well defined property rights-based contract law. Nee (1992) observed that hybrids in reforming state socialist societies lack a well-specified structure of property rights and, effective autonomy. As it is put by Professor Zhang Weiying, "a stable and clear institution of property right is the foundation of trust" (2003). Therefore, the socialist hybrids must rely more on personal ties than on legal contracts to provide assurances that the terms of a transaction will be met by both parties (Carroll, Goodstein, and Gyenes, 1988). Poorly defined property rights will further increase the transaction costs.

The judicial efficiency and independence of judiciary are also seriously disturbing the China's SMEs, which means the power to enforce the contract is weak. Even if a contract is complete, high transaction costs still occur when enforcement is not sufficiently effective. When disputes emerge, both the financial and mental lawsuit cost is very high.

In China, a market-oriented reform only started about two decades ago. Under the central planning system, as Kornai (1992) points out, with plenty of bureaucratic controls and regulations, there was little need for formal laws to define exchange relationships among economic actors. Undoubtedly, conducting administration according to laws and sticking to rules represents a rather rigid challenge to the Chinese governments at various levels that are accustomed to issuing administrative commands and unfamiliar with law-based administration.

SMEs operating in an environment characterized by property unprotected and contract uncertainty where the legal framework for the enforcement of contracts is not well developed, hence the importance of trust embedded in particularistic exchange relations such as kinship or ethnicity in protecting contracts.

4.1.2. Scarcity of Capital and Managerial Resources

It is a known fact that it's difficult for Chinese SMEs to do their financing. One of the reasons for this comes from the nature of SMEs. It's an international economic phenomenon because SMEs have weak governance structure, inadequate information sharing, high business risks, shortage of necessary mortgages that easily lead to the problems of adverse selection and moral hazard.

Another reason is that the Chinese banking system, although considerably reformed in a number of respects, is still not a real commercial banking system and nor does it constitute an efficient debt market (Yu and Ju, 1999). Although we have witnessed some substantial improvement in the marketization of interest rates, this floating range is still not enough to make up for the risks it brings that can only be compensated by methods such as compensatory surplus, charges incurred by deferral, etc. Joining the list are the extremely complicated application procedures with its prolonged time, which make the implicit cost of SMEs carrying out financing skyrocket. Besides, the two-track transformation and the ownership discrimination it gives birth to have made it impossible for private enterprises, the majority of SMEs, to get necessary financial support, outrageously stimulating the rent-seeking motives from within the banking industry.

Meanwhile, in fields such as credit underwriting mechanism, venture capital and property trade market, they are still not mature enough, which makes these areas play a negligible role in their economic activities.

All these restrctions mentioned above have seriously narrowed down the avenues for the SMEs of financing, bringing about a vicious cycle caused by internal financing and close ownership.

What's more, the market of professional managers is a very special kind of human resources market. On some level, this can be seen as a labor market of "professional" entrepreneurs, involving the discrimination and motivation of the entrepreneurial spirit and the re-allocation of surplus rights of the company. This market in China is highly unstable because the cost of them transferring from ownership to management is rather low. Another problem is that when the ownership structure of the firm is not successfully improved, and the motivation and regulation mechanisms not established, there is a huge risk in transferring the administrative power because the manager may make full use of the resources to set up a network of internal control.

Due to the lack of formal institutional support in capital market and managerial resources, there are very high and sometimes even unconquerable barriers to hierarchies in the Chinese economy. Peng and Heath (1996) have observed that firms in planned economies in transition do try to internalize the transactions.

4.1.3. Lack of Market Competition Rules

One of the impressive achievements of the Chinese reforms is that market competitive forces have been introduced into the economic development. However to the date Chinese market is is still not completely open for competition, Many firms can partially disclose, distort, and even forge information for transaction or taxation purpose with low risk of being caught. Furthermore, the overall market condition has been unstable and often been exposed to government interventions. In addition, a stable supply of many raw material can not be easily guaranteed, which increases uncertainty and adversely affects the production of many other firms.

As nonstate owned enterprises, the SMEs find themselves trapped in a rather weak position. Owners of these companies are usually not able to cope with the excruciating restrictions only by themselves. They must carry out business activities with the help of external forces and their connections with high powers in order to acquire scarce resources or occupy the status of monopoly or evade necessary taxations. Sporadic opportunists will not pose a grave threat for the overall mechanism, yet the whole market as an opportunist will virtually abolish all the rules. Gresham's Law has it that "bad money drives good money out of circulation," which is exemplified in all the unethical and illegal means adopted by Chinese companies to fight for a fair competitive status, ultimately, in return, instigating the rent-seekers, destroying market orders and holding the enterprises as hostages who are being blackmailed of their "business privacy". This reason can to some extent explain the irregular behavior of SMEs on their fast track of growth that even if the administrative level is becoming an obstacle, the company is still reluctant to open critical positions to professional managers from the market and to replace the old employees who are no longer suitable for their jobs.

Ignorance of legal restrictions and irregular methods certainly provide a amount of support for the company to reap profits in the short-term, but their messing with market rules and alternating the foundation of cooperation have buried time bombs for their development in the long run, and in the mean time, set a huge obstacle for the transformation of ownership structure faced with unstable and unfathomable risks in the future.

Market economy is often called nomocracy economy because only through observing rules and being honest can business efficiency be improved. Obviously, market economy requests strict prevention against cheating behaviors in commodity production and exchanges. Therefore, the government undertakes a heavy supervision and administration task of maintaining market order.

4.2. Informal Institution

Cultural characteristics play an important role in inducing evolution of corporate governance (or institutional change). Especially China is an ancient country with over 5,000 years of civilization history and its history and culture tradition is completely different from that of modern western countries. Traditional Chinese values have an enormous influence on establishing formal institutions.

4.2.1. One-man and Insider Rule

Ever since Liang Shuming raised the idea of "ethical society" and Fei Xiaotong the theory of "Chinese hierarchy", the academic circle has basically come to a conclusion that traditionally China has long been affected by Confucian value system, institutional change has vivid family characteristics. A clan is a group of people of the same ancestor and common estate that are based on confidence, acceptability, construction and support between each other, and conformity that is rationalized genealogically (Mofei, 1994). The nucleate and essence of clan power is paternity. Patriarchy is based upon paternity and the amplification and extension of it. It is an ingrained tradition of recognizing the norm of an authoritarian leader within the organization or clan.

Chinese patriarchy not only agrees to the need of highly centralized despotism polity, but also gets the support of traditional Confucian cultural value system that is penetrated so that it is normalized, legalized and theorized.

Prevalent also in Chinese culture is a tradition of insiders vs. outsiders with a built-in convention of secrecy among insiders. Family or clan members, as "insiders", are expected to bear collective responsibility in promoting and safeguarding the interests of the unit. The interests of outsiders are either secondary or irrelevant. Conflicts within the unit are resolved not through the intervention of an external agency, but internally and confidentially through arbitration by the clan elder or recognized leader of the organizational unit. Actual Chinese corporate governance practice appears to be replicate Chinese social, cultural and political traditions. When such an ethic conception diffused and penetrated into social and political fields, a social control system characterized by patriarchal clan and family system, commonly known as individual governance and ethic governance, was formed. Therefore for a long time, in China social conflicts were mainly adjusted on the basis of Confucian ethics and morals and laws just played a secondary role.

Under this culture, the SMEs are always operating on the bases of family authority and internal loyalty. If the corporate governance is not restructure yet, handing over the control right means transferring the authority which will be utilized by the manager to form a insider control.

4.2.2. Society of Guanxi

The Chinese is a nationality paying much attention to sentiment. Today, people still cherish the ties with family members, friends, and native people. Emphasizing sentiment tends to sacrifice rationality because sentiment is irrational in nature. This creates some disharmony with the rationality, order, and nomocracy requested by industrialization.

Having been living over ages in the traditional atmosphere of a pragmatic culture and the "society of guanxi" in everyday life, the Chinese has an apparent behaving pattern that they pay much more attention to handling communications and relations with other people in a flexible way rather than those strict disciplines. This mental and behavioral pattern will have a huge impact on the ongoing establishment of a legal system for the market economy.

Guanxi literally means "relationships". Yang (1994) states that"Guanxi can also hasthe sense of 'social connections." In the Chinese business world, however, it is also understood as the network of relationships among various parties that cooperate together and support one another. The development of a guanxi web depends upon whether some attributes or a guanxi base e.g. clanships; friendships, schoolmates, teachers and students exist among individuals. The extent of guanxi cultivation among individuals depends upon their positioning within a frame that is based on some social unit classifications. The social units may be family, work units and social network. Outright bribery may be good enough to get a business transaction done on a one-off basis, but it cannot produce interpersonal attraction that is defined as emotional relationship (Simons et al 1970, Tsang 1998). One of the major purposes is to generate "ganqing" and become an insider of a group; then all deals become easy.

"Guanxi" cannot be simply attributed origin to cultural factors such as Confucianism or collectivism. Xin and Pearce (1996) clearly argue that guanxi is the product of a specific institutional environment.

They suggest that Chinese private-company executives operating without the structural protection of governmental support develop guanxi as a substitute for the formal institutional enviorenment.

Purely relying on guanxi to establish a long-term business relationship may be risky. The most critical problem exists when the cooperation is not a team at all, but rather a constellation of persons pursuing their own benefits. In the face of major environmental shifts, such teams are slow and generally maladaptive. Guanxi may even become worthless or turn into a liability once the partner loses power.

When a society such as the current Chinese business society is becoming more and more mobile, tight and extensive networks will be more difficult to establish and maintain. Loosening networks will induce more opportunism, since deviations are more difficult to be detected, and social sanctions are more difficult to be carried out effectively. Under such conditions, growing SMEs will face more difficulty in establishing and maintaining, which will inevitably entail higher transaction costs.

4.2.3. Trust-based Informal Contract

Chinese culture roots from Confucian value system, therefore it embodies characteristics such as the family and guanxi value that are constricted by informal institution of a vertical social structure (informal contracts); while western culture is based on individualism of liberty and equality, therefore emphasizes more on formal constrictions (formal contracts).

According to Hayek's view (Hayek ,1945) the information structure of low context culture corresponds to the characters of knowledge of specific time and place and thus its content lacks systematization and normalization and is difficult to communicate in words . Only when the specific situation of that time and that place can the information be better understood and grasped.

Modern corporation theory views corporation and market as a series of contracts. The economic body's trade behavior (approach to the market or firm) is decided by transaction costs. The choosing of the ways to organize the corporation or market is based on its transaction cost. For Chinese, because of low normalization and decentralization, the information communication is severely constricted, which makes their business is usually carried out within a rather small circle where most of their trade partners are acquaintances.

Trust fills in the gap created by contractual incompleteness; this means that even though the terms of a contract can be ambiguous__ that is , they do not clearly explain rights and duties of the parties in different situations _trust overcomes this incompleteness and the parties behave as if the contract was exhaustive (Easterbrook & Eischel, 1991). Trades based on personal relationship that don't need official contracts are usually very efficient, so the reduced transaction cost within a small circle is acquired. When doing business on a large open market, Chinese are not used to bonding with outsiders and strangers for friendly business connections. The Chinese are not good at establishing a nonpersonal, contract-based, equal-footed and official cooperative relationship, which is reflected in the field of internal construction where Chinese companies don't do well in professional management and the establishment of a large expandable and replicable modern bureaucratic organization.

Along with the transitioning Chinese economy, the definition and protection of property rights is an expensive process that needs a long way to go. In fact, what the challenge we are really facing with is to set up a foundation of trust and transform our company culture from guanxi-oriented to rules-oriented. China's special institutional environment--there are high barriers to both markets and hierarchies for SMEs. The development of SMEs cannot escape from the Chinese culture and the current institutions.

5. Conclusion and Future Research Directions

We have analyzed the phenomenon of China's SMEs from an institutional perspective and with a focus on ownership and governance. Under certain conditions, the institutional support for both market transactions and internal hierarchies is so underdeveloped that the transaction costs become prohibitively expensive. Uncertainty has been deemed one of the main obstacles to change the ownership structure of SMEs.

As a result of all these causes, the private-owned enterprises have chosen the highly centralized family style to be their ownership capital structure. Property right is the result instead of the precondition of the game (Wang Dingding, 1996). the centralization of ownership is not only the start point of many Chinese SMEs but also the result of the SMEs trying to economize on transaction costs under the Chinese institutional environment. Change in ownership is a dynamic evolution, which, however, is restrained by external institutional environment to appear to be ultra-stable. The changes in the corporate governance system are often more slow than necessary and, in some cases, are not even made at all. This mismatch, even if transitory, could stop the growth of family firms (paolo Gubitta, Martina Gianecchini).

In situations where legal and market institutions are still relatively underdeveloped and the playing field may not be level, and where the external mechanisms of corporate governance are subsequently fairly weak and ineffectual, these internal safeguards are particularly important. So we should improve the ownership structure of China's SMEs by combining the modern market rules and the traditional Chinese culture.

First, it must be admitted there is much difference in knowledge and capability among people. Individual should be stimulated to start a new enterprise and be encouraged to utilize all of accessible resources abiding by the law. The Existence of dominant shareholder may be the suitable arrangement for most of the SMEs in China.

Secondly, be sure not to consider the family firm is lagged, the ownership and property rights should be unambiguous: they ought to be owned by clearly defined (legal) persons. It means that there are clearly identifiable residual claimants bearing residual risks among related family members.

Thirdly, the work should center on improving the internal management of SMEs and training a lot of talents with high expertise so that the SMEs can have higher competitiveness. SMEs should rely on not the network-based but the rule-based development.

All in all, Adjust government functions to provide a sound regulatory environment for SMEs. In this stage, to great extent the development of Chinese economy still relies on the depth of system reform and the basic symbols will be government function transition.

Although we have analyzed the SMEs' ownership structure in Chinese context, much work remains ahead. We have examined primarily from a new institutional and transaction cost perspective. By incorporating knowledge views into our theory, we may be able to better explain the complexity and richness of ownership transition. An empirical test is also in badly need to be introduced. Then we can examine how and in what situations ownership centralization of SMEs is generated, developed, and eventually diminished; by what types of institutional the depth and stability of ownership centralization is affected; how changes in the institutional environment induce changes in ownership structure of SMEs etc. In sum, with more efforts to be made in future research, we can expect to see a more comprehensive and concrete suggestion on ownership transition of China's SMEs.

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