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D Research on Corporate Governance of Enterprise Groups

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Abstract

Over the past four decades, Chinese family businesses have exhibited adaptable management styles, enabling rapid growth from small-scale operations through the exploitation of market opportunities. However, with business expansion, the challenges of inadequate management have become increasingly conspicuous. The family governance model in the nascent stages of entrepreneurship is ill-equipped to meet the demands of sustained business growth, impeding the enterprise's long-term development. Consequently, the imperative of optimizing the governance structure of family businesses and instigating reforms in the family business system is self-evident. In order to comprehensively explore the reform of corporate governance structures, this study utilizes D Enterprise Group as a case study to thoroughly analyze the current state of corporate governance within the enterprise. Employing a combination of literature review, case studies, and survey methods, this investigation evaluates the developmental trajectory, current status, and key performance indicators of the company. Through this analysis, the study uncovers a number of issues within D Enterprise Group, including an excessive concentration of equity, a lack of intergenerational planning for family succession, an imperfect governance structure, an incomplete professional manager system, and organizational cultural deficiencies. To address these shortcomings, the paper presents well-founded recommendations.

Subject Areas

Business Analysis

Keywords

D Enterprise Group, Family Business, Corporate Governance, Intergenerational Inheritance

1. Introduction

Over the past four decades, Chinese family businesses have capitalized on market opportunities to achieve rapid growth [1]. However, this growth has brought about challenges related to inadequate management capabilities. As the economic market continues to liberalize, governance issues within Chinese family businesses are impeding their prospects for sustainable growth and alignment with international standards [2]. Hence, there is an urgent need to enhance and optimize the governance structure of family businesses, drive reforms in the family business system, and ensure alignment with the evolving demands of the market economy.

The release of the annual Fortune Global 500 list in 2019, saw 129 Chinese companies making the list for the first time, surpassing the number of American companies [3]. Notably, 19 enterprises from the Guangdong-Hong Kong-Macau Greater Bay Area were included, with over half of them being privately owned enterprises. This area is emerging as the most dynamic region in the Chinese economy, with a significant proportion of family-owned businesses. D Enterprise Group, a privately-owned company with its founder holding 97.86% of the company's equity and serving as the chairman and general manager, can be classified as a typical family business in Hong Kong, possessing the characteristics of family ownership and management [4].

Following years of development, D Enterprise Group has established five primary business sectors including trade, taxi operations, project investments, real estate development, and electronic research and development, with total assets of approximately 3 billion RMB. After overcoming the initial entrepreneurial phase, the company has entered a new stage. In terms of governance structure, ownership control and decision-making authority are mainly concentrated in the hands of the chairman. The company has formed a senior organizational structure consisting of the chairman and three vice presidents, and has established relevant talent recruitment, incentive, and organizational operation processes and systems. However, like many family businesses, D Enterprise Group faces a range of governance issues, such as talent loss and inefficient decision-making processes.

Against the backdrop of rapid development in the Greater Bay Area, exploring appropriate corporate governance structures will facilitate D Enterprise Group's progression towards a positive and healthy direction and provide valuable reference experiences for similar enterprises. Studying this common issue will also promote the upgrading and transformation of businesses, enhance their governance capabilities, expand their scale, drive employment, consumption, and generate widespread economic benefits. Additionally, it encourages more companies to focus on corporate governance within family businesses and elevate their management standards.

2. Research Method

Literature Review. Compared to other research methods, the literature review method is more convenient and effective. By consulting similar literature and research data, selecting and summarizing data similar to the paper, and conducting summary analysis, effective information can be obtained. This paper consulted a large number of theoretical works, literature, and materials related to corporate governance of family businesses, collected and searched for relevant excellent journals and papers, visited various academic websites, familiarized with related research results through various channels, summarized the relevant theories and information needed, and provided theoretical and practical guidance for the research of this paper.

Case Analysis. Taking the representative family business D Enterprise Group as an example, this paper conducted a detailed analysis of the current state of corporate governance through the company's experience and practices, exploring and summarizing the existing problems in the corporate governance structure, and identifying the main reasons hindering the company's development. By analyzing the reasons, identifying the existing problems, and designing a governance structure suitable for the company, this provides a reference for improving the company's governance structure and constructive suggestions for the company's future development.

The Investigation Method. The research subject of this paper, D Enterprise Group, is a multifaceted organization with numerous branches. In order to comprehensively address the corporate governance challenges faced by the group and gain insights into the concerns and demands of its employees, we have opted to utilize a survey method. This approach involves visiting the various subsidiaries in accordance with principles of representativeness and thoroughness. Through interviews with 58 individuals from diverse hierarchical levels within the company, our aim is to delve into specific issues related to corporate governance and seek suggestions for improvement. By doing so, we hope to establish a robust practical foundation for our research in organizational behavior.

3. D Enterprise Group's Current Situation Analysis

The D Enterprise Group Limited, established in 1993 and headquartered in Hong Kong, has experienced significant growth over the past three decades, expanding into a comprehensive group with subsidiaries across the Guangdong-Hong Kong-Macao Greater Bay Area. With a registered capital of 100 million Hong Kong dollars, a workforce of over 100 employees, and total assets amounting to approximately 3 billion, D Enterprise Group Limited holds a prominent position in the market. The founder, chairman, and general manager of the company wield full authority in shaping the company's governance structure, guiding the board of directors' operations, and influencing the decision-making process.

Scholars have differing perspectives on the definition of ownership in family businesses, ranging from full ownership [5] to families holding over 60% of the shares and encompassing models such as the three-circle overlap model [6], the measurement model of family influence [7], and the target model [8]. Research on family business definitions demonstrates widespread recognition of family or household ownership. In 2019, the global family business index (top 500) defined a family business as one where the founding family holds over 50% of shares in non-listed companies and over 32% in listed companies, emphasizing the typical characteristics of a family business in the corporate governance of D Enterprise Group Limited [9].

In the initial stages of establishing Enterprise Group D, this model exhibited a strong advantage due to the entrepreneur's high decision-making authority. Thanks to the entrepreneur's rapid, adaptable, and precise decision-making abilities and risk awareness, D Enterprise Group transitioned from being trade agents to operating in taxi services, real estate, and other industries within just a few years. However, as the enterprise expanded into diversified fields, the entrepreneur continued to maintain sole decision-making power due to its single ownership structure. As the entrepreneurial management scope widened and the number of enterprises increased, management efficiency inevitably declined. This resulted in low employee morale and difficulty retaining high-quality managers—especially professional ones—due to their lack of involvement in decision-making processes. Consequently, company performance experienced sluggish growth. D Enterprise Group relies solely on a single funding source, with investment funds primarily provided by the founders due to the single ownership structure. This has led to short-term decisions being made at times to alleviate financial pressure, which may not align with long-term enterprise development goals and consequently increases the likelihood of risks, making it more challenging for the enterprise to secure development funds. Furthermore, the arbitrary nature of financial systems within family businesses, coupled with unclear accounting practices and a lack of designated oversight bodies such as cashiers and custodians, results in ineffective internal review processes. The intricate intertwining of family and business matters further complicates matters. These factors contribute to an imperfect and opaque financial management system that lacks sufficient social audit oversight, thereby hindering access to financial support from banks. Currently, D Enterprise Group's annual loan fund is less than 200 million yuan without a well-established open cooperation system in place. Consequently, the enterprise finds itself facing "capital constraint" in its development trajectory. Additionally, Li Bin's limited personal capacity along with his conservative approach towards property rights have prevented him from utilizing idle external funds for expanding and enhancing operational capabilities beyond the confines of the enterprise.

The influence of family members on the business is a crucial aspect that significantly impacts corporate governance [10]. The extent of family members' involvement in equity ownership, operational engagement, and middle to senior management roles is a key factor to consider [11]. To begin with, the CEO's wife, children, and close relatives neither hold shares nor occupy positions within the group, and are not involved in company operations. Board members are solely focused on operational management and lack decision-making authority. Additionally, a minority of individuals from the same village hold managerial positions within the company, but they do not have decision-making authority, while the majority are employed at the grassroots level. This situation may be attributed to the company controller's good health and prime age, which has not prompted consideration for generational succession within the company. Furthermore, owing to the high concentration of corporate ownership, decision-making authority is highly centralized. The company controller diligently safeguards trade secrets, reflecting low levels of family trust.

In conclusion, establishing a modern corporate system, strengthening financial controls, implementing standardized accounting procedures, regulating investment processes, setting up project evaluation systems, increasing asset return rates, and actively exploring financing channels to enhance the reputation of the family business are urgent issues for D Enterprise Group. Simultaneously, mitigating the problem of a single source of funding can be effectively addressed through the introduction of external investors and the diversification of the company's shareholder structure to achieve corporate governance diversification. Additionally, establishing a modern corporate governance structure, clarifying rights and responsibilities, improving management efficiency, and attracting and retaining high-quality managers are also crucial for the long-term development of family businesses [12] [13]. Therefore, D Enterprise Group needs to comprehensively adjust its corporate governance structure, establish standardized decision-making processes, improve internal management mechanisms, and enhance the transparency and fairness of the company, laying a solid foundation for the long-term stability and development of the enterprise.

4. Corporate Governance Recommendations of D Enterprise Group

Based on the developmental characteristics and current situation of D Enterprise Group, along with the issues existing in its governance structure, this paper presents several suggestions to enhance the development of D Enterprise Group from different perspectives. Over the past 30 years, the equity of D Enterprise Group has been highly concentrated in the hands of Li Bin. In the initial stages of entrepreneurship, he successfully consolidated resources, seized market opportunities, and swiftly adapted to market changes, showcasing significant advantages. However, as the business expanded, diversified, and the workforce increased, this highly centralized single ownership structure has revealed its negative effects: limited ability to raise funds, failure to effectively integrate capital and talent resources, neglect of organizational climate, salary system, and performance management system establishment, resulting in unguaranteed fulfillment of corporate strategy development needs such as corporate organizational restructuring or talent team building.

Firstly, in the face of market competition, family enterprises must transcend their own limitations by effectively integrating social financial capital and family capital, and by sharing asset ownership, surplus, and management control with non-family members [14]. Compared with a single ownership structure, a diversified ownership structure takes into account the role of stakeholders. By appropriately transferring part of ownership and mobilizing factors and resources inside and outside the enterprise, it is conducive to stimulating the enthusiasm of relevant stakeholders such as enterprise owners, employees, and external investors to participate in enterprise management, and promotes the improvement of enterprise innovation capability [15]. It can be seen that the adjustment of ownership structure is the key factor in improving the internal governance structure of family enterprises. In response to the extensive business scope and weak correlation within Company D Group, optimizing the ownership structure can be achieved through a reassessment of the current ownership framework. This may involve seeking potential equity partners or implementing equity incentive measures to enhance employees' equity incentives, thereby strengthening the relevance to the business scope and improving overall operational efficiency [16]. Additionally, the company may consider introducing strategic investors to promote specialized development in the business field and expand the business scope through joint ventures and collaborations, ultimately increasing relevance and optimizing the ownership structure. Furthermore, beyond the optimization of the equity structure, companies can establish effective corporate governance mechanisms to ensure alignment with the company's goals and strategies. This involves creating transparent decision-making, incentive, and risk control mechanisms to facilitate coordination of interests among shareholders, management, and employees, thereby enhancing operational efficiency and risk management levels. Moreover, companies can consider optimizing business structures through mergers and acquisitions to integrate resources and improve business relevance, thus optimizing the overall ownership structure and effectively achieving diversification of ownership in family businesses [17].

Secondly, Enterprise Group D can establish family investment companies as a strategic initiative. Family investment companies are established by family members to invest in both the family's existing business and ventures outside of the current business scope. The ownership structure allows full control by family members, ensuring that both male and female family members have equity entitlement based on blood ties. The board members of the family investment company are selected from family elites based on their management capabilities, entrepreneurial spirit, and interest, and are tasked with making strategic decisions related to business operations. Moreover, external non-executive directors can be appointed to ensure the adoption of sound decision-making processes. The CEO of the company can also recruit external professional managers. Furthermore, the family investment company is entrusted with the responsibility of providing learning and training opportunities for all family members, with a focus on the inheritance of family values and the fortification of the family's ethos. This includes the development and implementation of intergenerational family succession plans. Additionally, 30% of the equity originally held in the founder's name can be allocated to the family investment company, delineating the rights and obligations of family members in the management of the business. This strategic move enables the company to effectively harness internal resources, distinctly segregate corporate assets from personal assets through formal agreements, and clearly demarcate the company's investment activities from the family's independent investments. Ultimately, this approach empowers family businesses to expand their horizons and attract external investors more effectively.

Finally, enterprises should be adept at identifying the associated benefits and risks based on the type of participation. Chinese family enterprises have undergone a generational shift and are now grappling with intergenerational inheritance issues [18]. To break the cycle of "three generations of wealth" and ensure successful succession, it is imperative to focus on intergenerational inheritance. According to the 2018 White Paper on Family Succession of Chinese Entrepreneurs [19], a survey revealed that 32.9% of first-generation entrepreneurs favored deinstitutionalization (*i.e.*, establishing and nurturing professional team management), while 37.1% of second-generation entrepreneurs leaned towards the law firm model as their preferred family succession method. Currently, D Enterprise Group lacks a clear intergenerational inheritance development and training plan for the second generation of entrepreneurs. Despite the 60-year-old founder being in good health, their inclination towards a "natural" handover aligns with Chinese cultural traditions but may pose challenges to the succession process. Moreover, the enterprise lacks a clear successor, which can lead to employee concerns about the long-term development and create uncertainty about the future. Succession planning is essential for the sustainable development of enterprises, and strategic intergenerational succession planning must be prioritized [20]. This includes promptly determining the succession model, developing a corresponding succession plan, and supporting strategic planning. This encompasses the transfer of ownership and management, industry inheritance, the preservation of family values, and the implementation plan for engaging with government, social organizations, and business partners. The successful passing down of the Lee KumKee Group to the fifth generation can be attributed to the cultivation of heirs and the emphasis on core family values. The group has a comprehensive plan and has developed a corporate strategic plan to align with the succession plan.

In the context of intergenerational succession, this paper asserts that the D Enterprise Group should proactively initiate the grooming of their family successors from the time they enter university. It is imperative to guide them in selecting majors that align with the needs of the enterprise and equip them with comprehensive and systematic management knowledge. Upon completion of their education, the successors should be strategically placed in specific roles within the enterprise, enabling them to amass practical business management experience and gain a thorough understanding of the operations. This approach will facilitate the genuine assimilation of the founder's ethos of "people-oriented" leadership and astute human resource management into the successor's mindset.

By embodying these principles and integrating them into their actions, the successors will effectively perpetuate the founder's legacy and propel the enterprise's growth. To this end, the D Enterprise Group should consider engaging professional consulting agencies to meticulously devise succession plans tailored to the founder's aspirations and the current business landscape. These plans should encompass the systematic identification and cultivation of heirs, ultimately ensuring the seamless intergenerational transfer of leadership and the enduring prosperity of the family business. Furthermore, given the diverse portfolio of businesses under the purview of the D Enterprise Group, it is essential to deliberate on the allocation of ownership, administrative authority, and managerial responsibilities within the family business. One approach could involve the selective inheritance of a portion of the ownership and management rights in accordance with the heir's inclinations. Alternatively, the family business could retain ownership of assets and decision-making authority while appointing professional managers to oversee day-to-day operations. Alternatively, a hybrid model combining elements of both approaches could also be considered. This strategic flexibility would afford the heirs the opportunity to pursue their individual interests while also leveraging the expertise of professional managers to steer the business forward, thereby ensuring sustainable growth. Ultimately, these proactive measures will empower the D Enterprise Group to forge a seamless intergenerational succession plan that harmonizes the founder's vision with contemporary business imperatives, ushering in a new era of sustained prosperity and growth.

5. Conclusion

Family businesses are a significant component of the private enterprise sector, drawing considerable attention from society due to their impact on economic development and their role in fostering social harmony. As family enterprises transition towards modern management practices, the central focus lies in implementing standardized corporate system reforms and fostering continuous innovation to drive standardization and innovation within the sector. Central to this endeavor is the enhancement of corporate governance, with a specific emphasis on refining governance systems. The D Enterprise Group stands as a family enterprise characterized by a high level of equity concentration and centralized management and control rights. Presently, the company grapples with various corporate governance challenges. This study examines the current governance landscape of the D Enterprise Group, meticulously analyzing existing issues, delineating the root causes, and presenting a comprehensive plan for optimizing governance. Furthermore, robust measures are proposed to ensure the seamless execution of the optimization plan. In conclusion, this research on the corporate governance of the D Enterprise Group yields valuable insights, culminating in the following key findings: (1) Based on the analysis of D Enterprise Group's ownership structure, this paper contends that the excessive concentration of ownership and management rights within the group has significantly hampered the enterprise's development. It is imperative to address this issue by effectively reducing the overconcentration of equity and fostering a more diversified equity structure. One potential approach is to segregate family investments from business investments. Additionally, in line with the enterprise's development strategy, the introduction of external investors and the provision of equity incentives for employees can be considered as viable measures. (2) Based on the analysis of the current governance structure of D Enterprise Group, this paper contends that while the group has established a governance structure comprising the general meeting of shareholders, the board of directors, and the board of supervisors, its effective implementation in daily operations has been limited. Thus, there is a pressing need to optimize the governance structure. Simultaneously, it is essential to develop protective measures to ensure the seamless implementation of the regulations governing the general meeting of shareholders, the board of directors, and the board of supervisors. This will enable the effective implementation of various management systems and foster the advancement of the corporate governance model. (3) The primary objective of corporate governance is to enhance the governance framework. This paper asserts that the establishment of effective incentive and restraint mechanisms is equally crucial for improving the governance system. By implementing a comprehensive incentive mechanism, a practical evaluation system, and constraint mechanisms, an effective balance between incentives and constraints can be achieved. (4) In the current era of intense competition, securing the long-term development of family enterprises requires not only a focus on the tangible performance indicators but also an emphasis on cultivating the soft power of enterprises. This can be achieved through the construction of corporate culture, which serves to energize and unify the collective mindset of all employees, facilitating collaborative efforts to achieve the strategic objectives of the enterprise. (5) Elevating the priority of intergenerational succession planning is imperative. This paper asserts that the succession of a family business is intricately linked to the enterprise's survival and growth, demanding the founder's utmost attention. Firstly, a succession plan should be devised, serving as the foundation for developing corporate strategic planning. Subsequently, heirs should be selected and nurtured in accordance with this plan over a specific timeframe. A range of preparatory measures, including heir selection and training, family charter design, enhanced family governance, enterprise basic law design, and improved corporate governance, should be undertaken in alignment with the succession plan.

Conflicts of Interest

The authors declare no conflicts of interest.

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