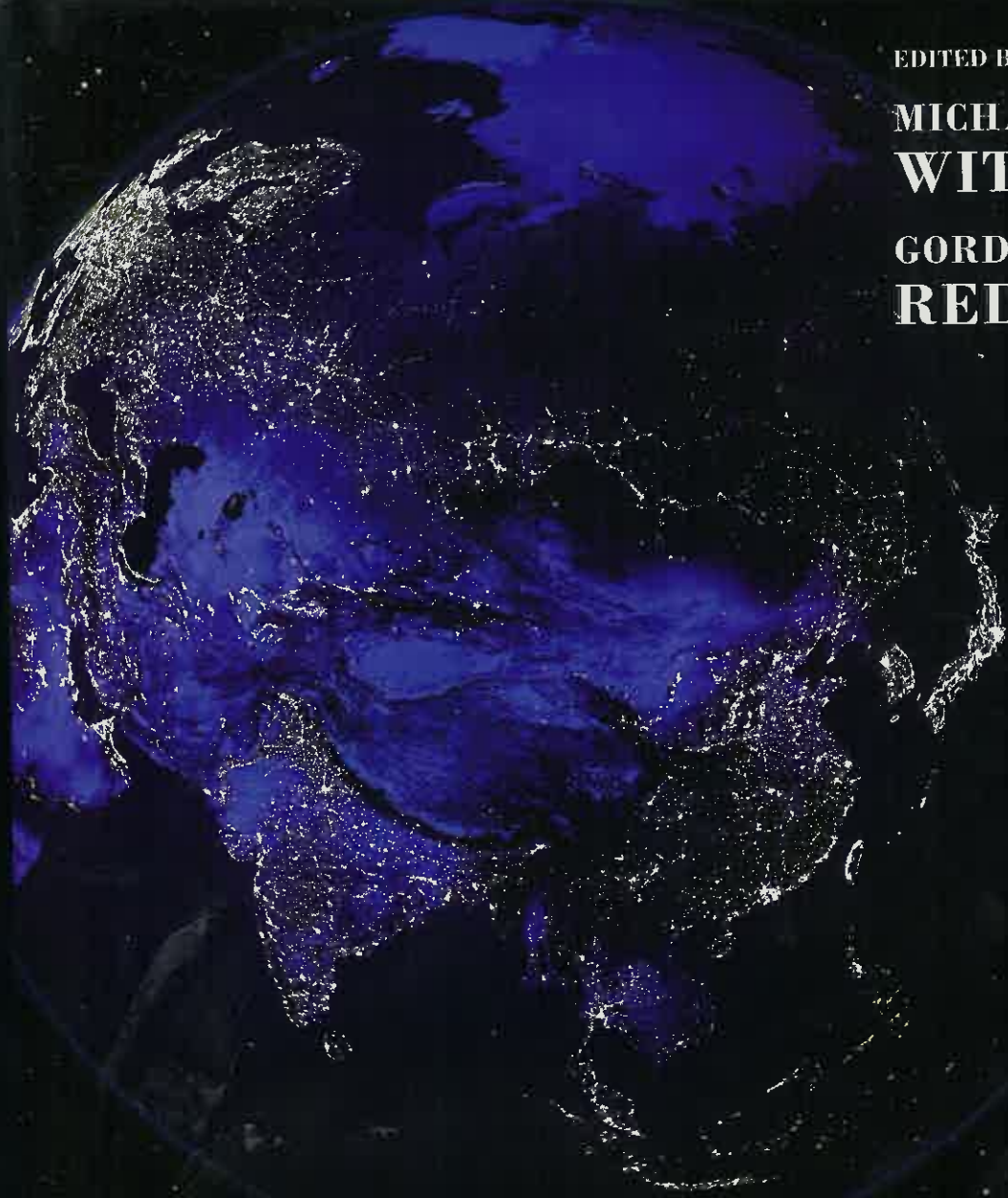


Witt &  
Redding

The Oxford Handbook of  
ASIAN BUSINESS SYSTEMS

EDITED BY  
**MICHAEL A.  
WITT**  
GORDON  
**REDDING**



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**ASIAN**  
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OXFORD

THE OXFORD HANDBOOK OF

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ASIAN BUSINESS  
SYSTEMS

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*Edited by*  
MICHAEL A. WITT  
*and*  
GORDON REDDING

OXFORD  
UNIVERSITY PRESS

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## CHAPTER 3

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# HONG KONG

## *Hybrid Capitalism as Catalyst*

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GORDON REDDING, GILBERT Y. Y. WONG, AND  
WILLIAM K. W. LEUNG

## INTRODUCTION

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IN a World Bank (2012) survey of the best places to conduct business, what is now termed 'Hong Kong, China' fared very well among 178 countries: second in ease of doing business, and trading across borders; third in protecting investors; fourth in getting credit and paying taxes; and tenth in enforcing contracts. The Heritage Foundation's (2012) annual rating of economic freedom placed Hong Kong first for eighteen years straight. This chapter provides background for this performance.

Hong Kong's character was set when it was first settled by international merchants in 1841. It was and remains a place to trade globally. In the eighteenth and nineteenth centuries, British foreign direct investment expanded hugely from state-licensed 'merchant-venturer' corporations dating from the early 1600s to the full Victorian free-trade imperial colossus. By 1914, Britain accounted for 45 per cent of world FDI (Jones and Wale 1998). Hong Kong, for most of its existence as a political entity, was a component of this vast colonial business system. Hong Kong today has developed in a post-colonial context, essentially as a gateway to mainland China, whose GDP is now five times greater than at the handover in 1997.

## HISTORICAL CONTEXT

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The coast of China was long a magnet for international traders, even though several dynasties severely restricted access to the China market. Under a gunboat-enforced agreement in which British merchants in Canton were able to evade restrictions on their

dealings, in 1841 they were permitted to occupy nearby Hong Kong island, then home only to fishing villages. Further treaties in 1858 and 1898 expanded the colonial territory onto the mainland, to a total of 1100 sq km. It is this total territory that was returned to China in 1997, under an agreement that defined it as a Special Administrative Region of China, using an agreed 'Basic Law' for the ensuing fifty years. Under this system, the HKSAR exercises executive, legislative, and judicial power, including that of final adjudication.

This far-sighted agreement enshrined the *realpolitik* of Britain's wish to move on from its colonial past, without abandoning the people of Hong Kong to a potentially threatening future, while for Mainland China, as dogma gave way to pragmatism, there were economic benefits from incorporating a controlled experiment in advanced modernization. The ending of a perceived historical outrage added deeper satisfaction to the process for the Chinese people. It also coincided with parallel trends inside China to encourage the decentralization of societal decision-making in the economy, a movement that has led to unusually high levels of local autonomy compared to OECD countries as a whole (OECD 2005). It should be noted that the nearby province of Guangzhou has a history of relative independence from control by Beijing, and of entrepreneurship. A study of attitudes to management in China concluded that the 'Hong Kong model' was clearly favoured by practitioners across much of the country (Ralston et al. 2006), although in policy circles the alternative 'Shanghai model' appeals to many in the Party for its emphasis on government control.

There is evidence that, in formulating the handover, China saw Hong Kong as a valuable conduit for knowledge, technology, and capital between the globalizing world and its own internal economy. PRC officials carefully studied Hong Kong's societal infrastructure, and adopted substantial portions, such as its stock market regulation (HK Stock Exchange 1992).

Hong Kong's recent economic history may be seen as a series of discernible but overlapping phases. With a population of only half a million in 1945, the flow of refugees from China became almost overpowering by the 1960s, but offered a large pool of labour, which meant that from around 1960 to 1980 Hong Kong grew as a major industrial city, making or assembling light-industrial and consumer goods for the world market. In the second phase, from around 1980, as China slowly opened up, Hong Kong's manufacturing industry was in effect sucked into the southern China provinces by their cost advantages, and its industrial reach grew significantly. This led to a third phase, from about 1990, as Hong Kong itself had to adjust, and it became a centre for the management (and ownership) of much of that industry, plus a centre for the professional servicing needed to link that industry with world markets. In effect, over the last two phases, Hong Kong's economic hinterland expanded greatly beyond its territory back into the mother country. Since then, carefully consolidating its position with the mainland, it has become one of the world's leading commercial cities in both volume and efficiency.

Since 1978, visible trade between Hong Kong and mainland China expanded 231-fold, at an annual average rate of 19 per cent in value terms, making the two respectively

now the eleventh and second largest trading entities in the world.<sup>1</sup> Half of Hong Kong's trade goes to the Mainland, and 90 per cent of its re-exports. By the end of 2011 the cumulative value of Hong Kong's realized direct investments in the mainland was US\$527bn, or 45 per cent of China's national FDI. The composition of this has shifted gradually from industrial processing to a wider spectrum, now including hotels, tourism, real estate, retail, construction of infrastructure, ports and terminals, business services, and communications. It is essential to acknowledge that for much of this, Hong Kong's role, like that of *entrepot* cities such as Venice, Constantinople, and London, is that of conduit.

A natural bias tends towards the neighbouring province of Guangdong in the pattern of Hong Kong's mainland investment, with US\$170bn of Hong Kong's accumulated FDI in that province. Many companies have their operations in the Mainland and management in Hong Kong. By 2011 local primary and secondary manufacturing had fallen, engaging only 3.2 per cent of Hong Kong employment, from 40 per cent in 1989. This change has been accompanied during the third stage by major societal shifts in Hong Kong, especially those orchestrated by the SAR and preceding government in such fields as education, research, and telecoms infrastructure, as Hong Kong re-skilled its workforce for the service and knowledge industries.

In that third stage, during the 1990s, integration began to take place on a much wider front, as the economies of Hong Kong and Guangzhou (and China more broadly) started knitting together (Enright, Scott, and Chang 2005; Yeung 2011). This shift was accompanied by growing trust, as the fear of interference by mainland China slowly subsided (though it has not disappeared).

The combination of the two economies is clearly visible in the patterns of enterprise listing and capital flows. Hong Kong had become a regional hub during the earlier Asian 'little dragons' phase. By 2011 it hosted 6948 overseas companies, with 3752 of those defined as regional headquarters or regional offices, an indication of confidence in its legal, professional, and regulatory systems. China-based firms followed and poured in money. At the end of 2010, cumulative Mainland FDI in Hong Kong was US\$402bn, or 37 per cent of Hong Kong's total received FDI. By mid-2011, 248 mainland companies had established regional headquarters there, and 557 had established local offices. By then 640 mainland companies were listed on the Hong Kong stock market. During 2011 mainland enterprises raised equity funding of US\$226bn in Hong Kong. Capital-sourcing for mainland China was also enhanced by the growth of *renminbi* trading, with sixty Hong Kong banks licensed, RMB590bn deposited, and RMB182bn in bonds issued. This role has now been expanded with official mainland support for Hong Kong and London as world centres for *renminbi* trading.

Two further features relate to this continuing integration. First, in 2009 the two governments agreed on a Closer Economic Partnership Arrangement (CEPA) in which further liberalization measures were agreed over forty-two service areas. The fence between Hong Kong and its hinterland continues to be lowered as the administrative systems of the two jurisdictions slowly converge, although this does not include the agreed political structures guarded by a vociferous Hong Kong minority.



Second, and at the level of practicality, the cross-boundary infrastructure grows daily. The new Hong Kong–Zhuhai–Macao Bridge, 50km in length, and scheduled to open in 2015, will facilitate flows of people and goods between Hong Kong and the Western Pearl River Delta region—into the still relatively undeveloped Zhuhai and beyond. In the north–south direction of the delta, an express rail link now connects Hong Kong with Shenzhen and Guangzhou, and is also stimulating similar expanded flows. The Pearl River Delta, a region of 120 million people distinct for its Cantonese dialect and sub-culture, may yet host the world’s largest mega-region, an agglomeration of conjoined cities reaching in this case a population of 100 million (UN Human Settlements Programme 2011).

To consider Hong Kong inside its geographical border alone is therefore to limit understanding. It is already ‘Hong Kong, China’, with interdependencies running across politics, economic and social issues, culture, and history. We propose here to describe Hong Kong in its interaction with China, while trying to capture the features that allow it to retain its own distinct character and independent trading traditions and power. Accidents of location and history make Hong Kong now the world’s largest container port. Along with its immediately adjacent neighbour, Shenzhen, over whose port systems it has much influence through Hong Kong-led joint ventures, it shipped 46 million TEUs<sup>2</sup> of containers in 2010 (24mn HK and 22mn Shenzhen), compared to 29 million for its nearest rival, Shanghai (World Shipping Council 2012). Since 1996, its airport has had the world’s highest export-freight volume, currently at over 4mn metric tonnes p.a. (Airports Council International 2011). This figure conceals the high value of goods shipped by air—30 per cent of domestic exports and 38 per cent of imports by value (Chen 2010). Hong Kong is also the world’s biggest issuer of IPOs, and home to the world’s third largest bank, as well as globally significant trading companies, a global airline, large property empires, and large telecoms companies, that is, it punches far above its population weight of seven million.

The process of hybridization with the mainland is fraught with challenges each way (Loh 2006; Wu 2008; Tang 1999). Put simply, Hong Kong has developed to a high point of modernity and individual prosperity, but mainland China, despite its recent explosive growth, remains essentially pre-modern, in the technical sense of not being able or willing to decentralize power to individual citizens without serious instability. Given the scale of China’s challenges, and the dramas of its recent history, this is perhaps unsurprising, but the end-result is that authority is exercised in very different ways each side of the border. Any meeting in the middle would risk China absorbing what some mainland observers see as a revolutionary cell. Hong Kong’s pluralism and free press, openness of information, and traditions of rational accountability, do not fit comfortably with a one-party structure dedicated to the preservation of order. Hong Kong’s defenders, on the other hand, see it as a transforming catalyst. Nonetheless, almost all the power lies with China, and that could undermine Hong Kong’s freedoms, and the civil structures of professional administration that it has come to rely on. As China becomes increasingly mercantilist, with government now moving strongly into the economy, the contrasts increase.

## THE ROLE OF THE STATE

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The policy of the Hong Kong government after 1970, when trading was joined by manufacturing, was officially termed 'positive non-intervention', meaning that the government would provide social order and infrastructure, while the economy was largely left to be managed by business itself. Thus, Hong Kong became a bastion of laissez-faire economic doctrine (Friedman 1998). At the same time, there being a long tradition of civic duty, business leaders were influential in key government committees (Carroll 2005).

As an aside to illustrate such civic-duty conventions, it is worth mentioning a remarkable Hong Kong phenomenon involving committed business leaders. The Hong Kong Jockey Club has a granted monopoly on gambling, and two of the world's greatest horse-racing venues. It also channels large volumes of local money into charitable use and into supporting key infrastructure such as hospitals and universities. With gambling revenue per race at fifty times the US average, 72 per cent of revenues go to the government, accounting for 7 per cent of the territory's tax revenue.

Positive non-intervention meant that if companies failed, they went bankrupt; if they succeeded, they remained taxed at low levels. This fostered prosperity, not just for owners, but for the population, who benefitted from the growth. Financial crises were handled largely by the banking sector's standing committee, in close touch with the Financial Secretary. Labour laws allowed employees only limited power, and entrepreneurship flourished. This regime gradually adopted more formal regulation as its scale increased, but the ideal of a capitalist paradise has not entirely disappeared, even with government intervention and regulation.

It was never true, however, that the Hong Kong government really stood back. Throughout the 'miracle' years from 1970, it always retained strong influence over several key sectors. Property prices are greatly influenced by a restricted property market in which the government owns all land and releases parcels at auction on long leases. The government continues to depend heavily on land as a source of revenue. Of 2011 revenue, 31 per cent came from the Land Fund, stamp duties, and the land premium. This ensures that the market price of land remains controlled at a high level and counterbalances the light taxes on salaries and profits of what is widely seen by outsiders as a low-tax regime. For those not in public housing, high property expenses are a displaced form of taxation.

Government intervention in the economy through schemes of control occurs in the pricing of fresh food supplies, in the control of transport prices, power costs, and the provision of extensive subsidized healthcare and education. Thirty per cent of people live in public housing, with a further 17 per cent in subsidized home-ownership flats. Private-sector housing follows government guidance. It is therefore deceptive to see Hong Kong as fully laissez-faire, but in the world of most day-to-day business practice, it is.

There is therefore considerable space in the business system for bottom-up institutional innovations. What regulations the government issues have normally flowed

from extensive consultation with the business world and are generally well-enforced, as indicated by the low corruption levels (Transparency International 2011) and the presence of the rule of law (Kaufmann, Kraay, and Mastruzzi 2012). Hong Kong is not a full democracy, but it has two features that leave it with a degree of political openness: one is grass-roots participation in local government, long encouraged and well supported, and the other is a lively legislature, albeit of limited enfranchisement, in which debate is often now furiously confrontational. However, the previously high level of press freedom cannot be reported as maintained (Cheung 2003).

## FINANCIAL SYSTEM

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Although business financing in Hong Kong is not directed or planned by the administration, the government has nonetheless been instrumental in building strong regulatory frameworks for the conduct of investment. With unrestricted flows of money in or out, it works rather like London in relation to Europe—a clearing-house for much continental and global financial action. It has thus become one of the world's top financial centres, seventh in terms of market capitalization, sixth in foreign exchange trading, recently third in raising equity funds, and first in IPOs. Of its 152 licensed banks, 142 are foreign-owned and 73 of the world's top 100 banks are present. For Tier-1 capital it is third in the world (*Economist* June 30 2011: <<http://www.economist.com/node/18895150>>). As far as capital availability is concerned, this environment is unusually favourable and highly liquid. As noted earlier, in the World Bank 'Ease of Doing Business' scores, it ranks fourth in the world for getting credit. In the field of finance, it scores ten out of ten for legal rights and disclosure, and nine out of ten for investor protection (World Bank 2012), even though such protection mostly serves dominant owner interests.

For firms relying on sourcing finance in Hong Kong, two main patterns may be discerned. At the base of the pyramid are large numbers of small and medium-sized enterprises (SMEs). These are usually closely held and owned in tight social networks such as families, drawing their funding mainly from retained earnings. Many, however, have also cultivated strong and longstanding relations with local banks to obtain working and investment capital for expansion, local banks being permitted to take equity. This process has often brought with it a great deal of managerial standard-setting, control, and advice as conditions of such funding. The banks have then played an important part in raising local standards of organizing and managing business (Jao 1983). In such a highly liquid market for finance, apart from retained earnings, the main source of funding is banks, and the main basis of such funding is relationships; because of this, capital is normally patient.

At larger organizational scales, a number of local enterprises have attained significant size and global reach, such as the Cheung Kong group. Such conglomerates, as they grew, usually incorporated highly professional finance functions able to interact

fruitfully, not just with local, but with global sources of capital. Many incorporated banks into their structures, or cooperated closely with global banks. For instance, Li Ka Shing was for a period Deputy Chairman of HSBC; his conglomerate included the merchant bank Peregrine and the Royal Bank of Canada. The consequent exposure to full international scrutiny required conformity to global standards of accounting and conduct, all of which could be provided in Hong Kong itself. This ability to live in the two worlds of (a) local entrepreneurship and networks and (b) global capital-sourcing has been a powerful formula, giving rise to a number of globally significant business empires. Into this mixture can be added an instinct for alliance-building, and cultural compatibility with the mainland (Mathews 2006).

What is not found here, compared to many other Asian environments like Singapore, South Korea, Japan, and Taiwan, is a strong government-controlled central source of investment capital, or a central bank used by the government to manage the economy, although there does now exist a fund of approximately US\$50bn stemming from a mandatory provident fund set up in 2000. Instead, a series of autonomous commissions regulate the operation of finance laws. The success of Hong Kong and its differences from Singapore show that there are several ways for a city-state to build prosperity, and that such options are shaped by heritage. In this case, strong private banking has taken over the role of a central bank. This would not have worked for so long without close collaboration between the highest levels of government and business.

## Ownership and Corporate Governance

There are four main categories of enterprise in Hong Kong. First are the large, long-established organizations that were originally colonial and have evolved into global players, still with a Western flavour, though several have been acquired by Chinese capitalists. They are known locally as the *hongs*. Examples of the originally colonial are the Jardine and Swire groups, and HSBC, while Cheung Kong/Hutchison and the Worldwide group are among the acquired entities. The second category is that of global arrivals establishing branches of large companies based elsewhere, such as Citibank, whose Hong Kong branch was established in 1908. The third and numerically largest group is that of local SMEs, usually displaying the flexibility needed to adapt to the shifting industrial structure, but with many members retaining their industrial roots by managing operations transferred to China or acquired. Fourth are the organizations arriving from China, usually with a view to engaging directly in global business, an early example being CITIC.

Mainland enterprises in Hong Kong come in three categories: H-share companies, incorporated in China and controlled by either government entities or individuals; Red Chip companies, incorporated outside China, but controlled by Chinese government entities; and Non-H Share mainland private enterprises, incorporated outside China, but controlled by Chinese individuals (although listed in Hong Kong, they normally register elsewhere, popular bases being Bermuda, the Cayman Islands, and more recently British Virgin Islands). China-related companies at the end of 2010 numbered

163 H-Share, 102 Red Chips, and 327 Non-H. This total of 592 grew to 640 during 2011 and accounted for 57 per cent of Hong Kong's market capitalization.

Hong Kong is attractive for regional headquarters; in 2010 it had 288 American, 224 Japanese, 113 British, 99 PRC, and 72 German bases. The focus of their work tends to be principally China, but sometimes extends further.

It cannot be said that full transparency is the norm for most companies, and the protection of minority-shareholder rights has long been contentious. Tracking ownership patterns in the largest 200 publicly-traded firms in Hong Kong, Carney and Child (2012) found that 60 per cent remained under family control in 2008, compared to 65 per cent in 1996. The new feature in the Hong Kong pattern was the growth of state ownership from 4 to 28 per cent over that period. Two forces have had opposing impacts on the possible bias stemming from family control. One is the flow of international influence reforming governance behaviour, but countering this has been an increasing tendency for financial manipulation to be conducted across the mainland border, and for miscreants to be unreachable (Cheung, Rau, and Stouraitis 2004).

Therefore, compared with Western systems of administration, the governance of most companies in Hong Kong remains relatively closed. Shares tend to be closely held, in family groupings or through nominees. There is also a strong tendency for owners in their governance behaviours to co-opt political support, especially in larger enterprises (Wong 2010). This has long been a standard feature of companies throughout the region and is a rational response to the regional environment of high volatility, opaque information, and strong government influence (Redding 1990). In Hong Kong, government committees tend to be quite heavily occupied by business representatives, perhaps not unlike old Venice's business-dominated oligarchy, in which public duty was an honour as well as a convenience. Despite the implied honour, this leads to sporadic charges of collusion in industries such as property development, where government land policies are clearly of strategic relevance (Goodstadt 2005). During the handover transition, Scott (2000) reported a wave of defections from the British political camp to that of Beijing, and a breakdown of the earlier informal coordination and balancing between interest groups that had underpinned much of the society's political functioning. In practice, recent co-option of this sort involves executives sitting on key committees such as the Election Committee, which chooses the Hong Kong contenders for senior government positions, or in more favoured cases joining one of China's People's Political Consultative Committees.

An outcome of patrimonial domination by ownership is a downplaying of the role of shareholders in financial markets and firm strategy-making, and the retention of the connection between ownership and control. At small scale, this is quite normal, but at large scale it reaches levels that make Hong Kong symbolize what some see as a pre-industrial form of mercantile capitalism (Whitley 1992). It may equally be seen as a very well-judged response to potential hybridization, whereby Chinese and Western skills and attributes combine. Typical contributions to this mixture from the Chinese side would be political connections co-opted across the region by major players, and especially in China and Hong Kong; extensive private networks of information-sharing and deal-making; and the ability to pull together at low transaction cost syndicates of investors tied by

bonds of trust, risk-sharing, and rapid response to opportunities (Redding 1995). From the Western side, the contributions have tended to be capital itself, from banks tapping global capital markets; managerial and professional skills in the handling of complex, technical, or large-scale organization; and means of access to global markets.

Hong Kong's largest indigenous companies have tended to be built on certain distinct foundations: a patrimonial leadership based on original ownership; reliance on property investment; heavy early investment in cash-cow industries related to development (e.g. trading, construction materials, retailing, food refining, and distribution); and high entry-barrier industries yielding steady cash-flow (e.g. container ports and terminals, airlines, power generation and distribution, telecommunications) (Ko 1998; Elvis 1999; Yeung 2006). Absent from this list are complex manufacturing industry; the creation of global consumer-goods brands; and direct dependence on high-technology specialists. Reasons for this mainly reflect how managerial authority is exercised.

## Internal Structure of the Firm

The Chinese family firm, large or small, has a management structure reflecting its origins in Chinese social history (Redding 1990; Faure 2006). Until 1949, entrepreneurs in China had to survive revolution, invasion, civil wars, and two world wars; after that, family business was banned under Maoism for thirty years, and then re-emerged slowly. Hong Kong thus became a twentieth-century refuge for this family business formula, a role it shared with Singapore and countries around the South China Sea, where ethnic Chinese have been trading for over a thousand years.

The resulting organizations tend to be run by dominant owners who take all key decisions. They are likely to be assisted by family members and trusted subordinates or specialists. A spirit of paternalism is common and conveys the Confucian ideals of responsibility downwards in exchange for disciplined obedience upwards (Westwood, Sparrow, and Leung 2001). When well used, it can release 'the efficiency of benevolence' (Pye 1985). Control is usually tight. External relations are usually managed personalistically if strategic, on networks of reciprocal obligation from the owner outwards. Such networks may also be used to carry information and share investment risks. At larger scales, networks may entail co-opting political support.

Social respect is accorded to owners, not employees. Owners strive to fulfil the duty of building or enhancing the family 'name'. In most environments, officialdom is seen as potentially threatening, with unpredictable demands. A norm of secrecy thus builds and typifies action, as do norms of hard work, discipline, and control (Man and Lau 2005; Cheung and Chan 2008; Anderson and Lee 2008).

In structures of this nature, trust, though perhaps intense, is limited, so delegation and organizational growth have limits. The depersonalization of power is difficult, and organizations only attain large scale if they evolve out of the basic patrimonial formula. This can be done by professionalizing management, but tends to be rare. The risks of not evolving away from personalism are high. A study of 127 such large organizations

in Hong Kong, Singapore, and Taiwan (Fan, Jian, and Yeh 2008; Fan, Wong, and Zhang 2012) examined market-adjusted stock returns over the five-year period during which owners pass control to successors. They reported an average loss in value of 56 per cent, attributed to the specialized assets of the owner being in the form of non-transferable connections, and to slow responses to declining values.

Even so, some firms adjust and incorporate professionalism, producing hybrid large firms able to deploy networking and alliance skills to counter the uncertainties of foreign markets and industries (Mathews 2006). Hong Kong is a natural centre for such new forms. Of the top 50 MNEs from developing countries classified by UNCTAD, 26 derive from Pacific Asia. Of these, 15 are unequivocally from the private sector, rather than being extensions of government funding. Of these, half come from Hong Kong.

Few societies display more clearly the constant work of creative destruction that typifies successful entrepreneurial economies (Yu 1997). There is a tendency for these organizations to stay focussed in one main business field. The sense of hierarchy also limits manager-worker interdependence, except for bonds where key loyal employees hold technical competence—that is, an accountant or production manager might over time be treated like an honorary family member. Social distancing between management and workers would have emerged in earlier periods in conditions of relatively straightforward work, where control was not complex. It will predictably give way to greater interdependence—and some change towards more participative style—as industry is redesigned around the more technical skills of workers in the new service industries. Influencing this also is the influx of Western and Japanese employers using more open styles of control and motivation, usually preferred by workers (Ngo et al 1998; Fields, Chau and Akhtar 2000).

Change towards less personalistic structures is clearly affected by the absence (or at least weakness) of a market for corporate control in the larger system of share ownership and finance (Cheung 2008). The inroads of new corporate-governance regulations and practices have had little effect so far, possibly because of their embeddedness in Western assumptions (Redding 2004; Tan 2010). It is as if Hong Kong's business owners are responding to their social history, and perhaps to an anticipated destination, and so maintain their trusted beliefs and institutions.

The ex-colonial companies have remained prosperous and still reflect their trading origins in such industries as air transport and services, shipping, sugar-refining, drinks-bottling and distribution, insurance, and engineering services, with solid reserves of property investment in the background. So too have the once-colonial banks flourished on the global stage as the world's centre of business gravity moved in their favour and they were flexible enough to take advantage.

## EMPLOYMENT RELATIONS

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Hong Kong has one of the world's lowest average loss of working days per 1000 employees (Hong Kong Yearbook 2011:135). Labour relations are comparatively quiescent,

maintaining a longstanding feature of a society unused to active labour defence of its status. Too much overt democracy would have disturbed the peace with China, where unions are essentially instruments of the Party, involved only in communication and limited welfare. In any case, most Hong Kong workers were never exposed to the ideals of socialism in its Western forms. The majority were from refugee families escaping the ravages of the Great Leap Forward (Dikotter 2010), the hounding of landlords and 'capitalist-roaders', and the extreme cruelties of the Cultural Revolution (Chang and Halliday 2005; MacFarquhar and Schoenhals 2008). Their tolerance of left-wing ideology is unlikely to have been enhanced.

Confucian paternalism is an alternative, with its own moral force, and lies deeper in the Chinese psyche (Bond 1986; Tu 1996). The metaphor of the iron rice bowl has real meaning. One might also note that the market itself, when as fluid as Hong Kong's, and all in one city, affects employment conditions directly. When growth is good, employees can leave, and this protects them from abuse.

The government has shaped most labour legislation along ILO guidelines, mainly following British institutional practices, without granting the kind of collective bargaining rights usual in Europe (Ng 2010; Chiu 2002). Unionization has risen slowly in the early 2000s from about 20 per cent to about 23 per cent, partly through a rise in China-supported left-wing activism. Within that proportion, membership of the pro-Beijing HK Federation of Trade Unions now accounts for 48 per cent. However, union membership tends to cluster around the large public institutions and big firms that depend on labour, such as airlines and major utilities. Ninety-eight per cent of union membership is defined by craft or occupation (Labour Dept. 2012).

In most of the 303,000 SMEs, labour relations are personalistic rather than formally institutionalized, and strikes are rare. In most firms, matters such as pay and conditions are dealt with by owners against a backdrop of a highly fluid labour market. Union representatives are only involved in negotiations with the few large and relatively visible organizations where employer negotiations are conducted by professionals, not owners. Even in those cases, strikes are very rare. Significant here have been government actions such as (a) a statutory minimum wage of HK\$28 p.h., introduced in May 2011, and (b) a mandatory provident fund brought in ten years earlier.

For the vast majority of employees not connected personally with employers, there is a tendency to move jobs readily and easily, often for quite small advantage in pay. Voluntary turnover runs at 14.5 per cent (Hong Kong Institute of Human Resource Management 2012). What does hold employees is the availability of training, and the fact that many foreign companies offer this makes them preferred employers for a workforce driven by ideals of self-improvement.

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## EDUCATION AND SKILLS FORMATION

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We have noted earlier how the radical transition of the Hong Kong economy from manufacturing towards services, including the addition of extensive managerial



intervention in the mainland, has caused a shift in the nature of work. The government had planned for this by giving early priority to expanding education and skills training. Consequently, Hong Kong now competes with Singapore as a regional hub in education, invests heavily in it, and responds to global education trends such as e-learning, advanced scientific research, and the self-financing of higher education. Its oldest university, the University of Hong Kong, was ranked top among Asian universities in both the recent Quacquarelli Symonds (QS) and 2012 *Economist* rankings [QS 2012; *Economist* 2012]. QS placed six of the twelve local universities in the world's top 100.

The educational structure consists of competent and accessible primary and secondary education over a wide spectrum of types, subsidized extensively by government; standards are above average, ranking third among seventy-four countries in maths, third in science, and fourth in reading (OECD 2009). Higher levels comprise two sets of institutions, universities and vocational training institutions, also supported by government funding, as well as local philanthropy. Under mainland influence, its universities are now changing from three to four-year degrees.

Holders of tertiary-level degrees in Hong Kong have increased from 3 per cent of the population in 1986 to 16 per cent in 2010; numerically, from 164,000 to 1,107,000, with an equal gender balance. In management education, Hong Kong has Asia's top-ranked MBA programme and a cluster of close followers; its business schools receive 17 per cent of the region's GMAT applications, despite Hong Kong having 0.2 per cent of the population (GMAC 2011), a statistic that illustrates Hong Kong's business character.

In addition to formal full-time education, workforce skilling is boosted by high popular interest in self-improvement, supported by an array of institutions offering part-time education. Much technical training is coordinated by the Vocational Training Council, itself with ten campuses and strong links with industry, although on-the-job training is uncommon. Professional education runs parallel with degree teaching, often sponsored by the professions themselves. There is also a wide choice of foreign qualifications available, either online or locally; quality is monitored where possible by the Hong Kong Council for Academic Accreditation.

## INTER-COMPANY RELATIONS

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There are two scales at which networking operates in the Hong Kong economy. The first is small-business networking, often to construct a flexible value or supply chain, the components of which are separately owned, but whose effectiveness depends on maintaining and operating connections personally, and thus at low transaction cost. This partly explains the large number of small companies, as the coordination of scale is generally handled by networking across still-autonomous units rather than by managerial integration under one firm. It results in the retention of owner-inspired responsibility in each sub-unit—the source of the 'strength of weak ties' that gives flexibility to the business system as a whole.

The second applies on a larger scale, where collaboration lies mainly in capital investment, and where necessary political lobbying. This often entails sharing opportunity and risk. Personal ties are also active here, strongest where they link people originating from the same region, and so speaking the same dialect and having similar trust networks. The main dialect subgroups of this nature in Hong Kong are the majority Cantonese from the Pearl River Delta, Hokkienese from southern Fujian, and Teochew from eastern Guangdong. To these may be added smaller groups from Fujian, Shanghai, and the Hakka, from a wide area of south China (McKeown 2005).

Like the other *entrepot* cities noted earlier, Hong Kong has the virtue of smallness, or at least human scale, when it comes to inter-company relations. People tend to know each other, or are able to find out about someone, especially within an industry or profession. Sometimes like a large village, connections run through the fabric of business dealings, meetings, and boards, as well as the social institutions that maintain networks: the dining clubs and restaurant hospitality, interlocking directorships, hospital charities, the Jockey Club (where stewardship status is especially coveted), and the government advisory committees that knit together the worlds of business and administration. As in the City of London, or Wall Street, most senior business meetings can be reached on foot, and on the way you are likely to bump into a number of your network of several hundred.

At the scale of small-firm networking, efficient and flexible supply chains grow naturally, and Hong Kong companies regularly find themselves intermediating between, or occupying parts of, supply webs in China and distribution webs in global markets. The 'workshop of the world' with its price competitiveness owes much to these network structures and the psychological cement that holds them stable but not rigid.

The fierceness of competition in most markets has kept Hong Kong mainly free of cartels. In industries with high entry barriers, such as power generation, or cross-harbour tunnels, the government has prevented the possible abuse of monopoly by imposing licensing, and collusion with government over such matters was more or less eliminated by the work of the Independent Commission Against Corruption, launched in 1974. There is nonetheless always a sense of uncertainty over the property industry, and abuses were regularly reported into the 1990s (Lo 1993). More recent studies of corruption suggest that this issue is also now under control (Manion 2004), and in 2011 Hong Kong scored twelfth of 182 countries on Transparency International's Corruption Perceptions Index (with China at 75th).

## INSTITUTIONAL COMPLEMENTARITIES

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In the literature on comparative capitalism, the commonly accepted unit of analysis so far has tended to be the nation-state with its own cultural heritage, or clusters of countries with similar heritages, such as liberal market economies. In Asia we find a set of countries with similar distinctions, such as China or Japan, but many are hybrids, tending to

emerge from colonial histories. They vary in economic success from struggling, such as the Philippines (Kondo 2014), to successful, such as Taiwan (Lee and Hsiao 2014). It may be that success stories coincide with the coming together of two strong cultures robust enough to interact fruitfully without loss to one side. In weak outcomes it is often a local culture that is not yet fully formed at a level of national identity at the onset of colonialism that is subsumed and can only play a weak part. Hong Kong and Singapore are hybrids of Chinese and British culture, both strong, and their different routes to similar results illustrates how complex adaptive systems evolve on different trajectories. We now briefly note complementarities in Hong Kong, visible in the connections between forms of enterprise and economic coordination, and the institutions that emerged from the hybridizing of cultures.

## Forms of Enterprise Management

The confluence of British and Chinese institutions is perhaps best seen in company ownership and management, especially in the vibrant SME base, from which larger structures are constantly emerging. The institutions that interact here largely stem from *laissez-faire* political philosophy. There are simple, clear, and well-organized administrative regulations of commercial law and accounting based on Western company law and strong professions, efficient and business-friendly commercial banking, a fluid labour market capable of skilling itself, agencies to connect with world markets, available business services, and local traditions of private family ownership and partnership that have their own long history. To exercise the last with the support of the former makes for a fruitful combination and self-reinforcement of elements.

## Acquiring Organizational Scale

An important follow-on from Hong Kong's entrepreneurship appears in the evolution of large conglomerates moving onto the world stage (Peng and Delios 2006). These new players exhibit two features: the habits of entrepreneurship and alliance networking at large scale that were culturally instinctive at small scale, and the ability to absorb into the same structures the most modern professional standards in the managing and financing of operations. It is arguable that the institutional environment of Hong Kong acted as a test bed and facilitator for much of this new organization skill, as it did historically to foster fruitful interaction between the two cultures as the industrial terrain came to be shared. An early form of this was the incorporation of Chinese (or Eurasian) interface specialists, or *compradors*, often of very high status, into the managing of complex Western organizations such as banks or trading houses, to handle key issues in the local environment. In the other direction was the employment of Western technical specialists such as engineers into local organizations.

The Hong Kong institutions in this configuration for large international firms might be summarized as (1) systems of bureaucratic government administration, (2) autonomous commissions regulating financial markets, (3) training and education systems that input appropriate talent (e.g. access to employment in the administrative grade of the civil service is seen as entry to an elite by an intellectual subset), (4) autonomous professions regulating much of the behaviour of lawyers, accountants, engineers, doctors, etc., (5) a legal system based on common law and an independent judiciary, backed by an effective corruption-prevention force. All these institutions can be traced back to colonial and post-colonial flows of influence and example, connections that have not yet disappeared. They are also in accord with Chinese traditions of bureaucracy and order.

## **A Business-Friendly Infrastructure**

Hong Kong has been a world leader in public transport, telecoms connectivity, corruption prevention, tax administration, free and sophisticated advisory systems to encourage the finding of suppliers or customers, and keeping systems simple and accessible. Such determined pursuit of an ideal business context would not have arisen without a special feature of public administration in Hong Kong—politically disinterested rationality, visible in the institutions of long-range planning for infrastructure, in the clearly visible public management of societal finances, and in an elite civil-service cadre selected for educational quality, reminiscent of the traditional mandarin of China and the Whitehall ‘mandarins’ of London. A contribution has also been made to the workings of this configuration by the tradition of direct accountability to the public of all departments of government, and openness to criticism and suggestion.

The main outcome of such a business-friendly environment is the high level of entrepreneurship. Start-up is simple, and expansion is facilitated by the availability from banks, not just of loans, but of managerial guidance. Also, the sheer size of the opportunity space provided by the China access and global connections adds much to the mixture. On top of this is a skilled and mobile labour force.

## **Strong Human Capital**

Human capital is essentially the availability of skills and knowledge. In Hong Kong, its development has been zealous at several levels. With many families fleeing China as refugees, survival through to prosperity was mostly achieved through hard work, self-denial, and discipline, as well as through family support for individuals. For individual members, in response, familial duty is dominant and powerfully moral. This bestows a strong sense of responsibility to enhance the ‘family name’. The dedication to education and level of attainment attest to this. These aspects of traditional Chinese familism have stabilized as institutions, rendering a predictability to behaviour patterns.

Familism alone, however, is insufficient to explain the development of such high levels of human capital. Other contributions in that configuration have been the accessible and subsidized educational system, the breadth of education, vocational as well as basic, the quality attained through inspection and regulation, the fluidity of the labour market and career opportunities, the wealth that permits access to foreign education for many, and lastly the institutionalized respect for education as a basis for status, so central to Chinese society.

## Preserving Freedoms

The commonly agreed keys to economic progress include property rights, freedom from government interference, a context of high and reliable information flow, and the liberty to express individual initiative and creativity. These do not accord with autocracy. Although Hong Kong has never been a full democracy, much had been done to encourage political participation at local levels. There was and remains a high degree of civil rights, rule of law, an independent judiciary, and a well-developed civil society that included until recently a vigorous free press.

Appearing now are fears of 'growing authoritarian Chinese clouds above Hong Kong' (Wu 2008:279), as local politicians are either co-opted or go quiet. As Ghai (1999) concludes, it is in the nature of state-dominated capitalism to use official patronage as a lever of control over business behaviour. As So (2000:379) puts it, an 'unholy alliance developed between Beijing and big business in Hong Kong' and 'integration with the mainland generated both conservative forces to obstruct democratization and popular forces to promote it'. This tension continues, but has been greatly eased by China's promise that elections to the Legislative Council will be on the basis of universal suffrage by 2020. Questions remain as to whether and how the large firms and professions will respond to this promised easing, and whether the political system will remain sufficiently sophisticated and robust to handle the extra demands of a much more complex set of interests.

In all this, it must be remembered that Hong Kong is also exerting countervailing pressures on China by virtue of its capacity to perform at global standards of efficiency. The per capita income gap—US\$46,000 in Hong Kong, against US\$7500 in China—suggests that the game will be played out over a long period, and will be full of twists and turns.

## Evolutionary Dynamics

Hong Kong's business system is evolving in quite dramatic circumstances due to the scale of the issues affecting it. As one of the world's most successful interpreters of laissez-faire capitalism, dedicated to the dominance of market logics, it is being absorbed into a society whose own future direction is a matter of experiment, but whose tradition of controlling government is deeply entrenched. Hong Kong has demonstrated how a society

of Chinese people can grow prosperous and acquire most of the trappings of modernity with which to continue stable progress. But Hong Kong is a hybrid and China is not; and China's gigantic scale, together with its own political legacy, mean that what is possible in a city of seven million is unlikely to be possible in a continent-sized country with a fifth of the world's population. The stage is therefore set for some decades of finding a workable balance between alternatives.

A related feature of importance to Hong Kong is the unpredictability of socio-economic policy in China. Only two aspects may be proposed with any confidence as likely: (1) the priority given by the mainland government to maintaining social order, and (2) the concern of that government to legitimize its retention of power by delivering continued prosperity. For Hong Kong, the spectrum of judgement as to what will happen is wide. In lay terms, at one end there were people describing 1997 as 'the great Chinese take-away'; at the other end were Hong Kong business leaders who, when asked 'What happens when China takes over Hong Kong?', would say 'Hong Kong takes over China.'

Against this uncertain background, Hong Kong's business system has evolved in two main ways: it has become much more closely intertwined with China, and at the same time has strengthened its global reputation as a city for business. The latter feeds off the former. Hong Kong is now a global city to the extent that China is a global economy, but it would be hard to demonstrate that China is a global economy to the extent that Hong Kong is a global city, as China has alternatives.

The success of the first stage of transition, visible in economic growth, may well owe much to the high level of cooperation with Chinese provincial governments. Examples of the transfer of crucial 'soft skills' from Hong Kong to China are the work of the Hutchison Whampoa group in establishing the container ports of Yantian and Shanghai, the hundred plus China joint-ventures of Hong Kong Towngas, and the role of Hong Kong's Mass Transit Railway engineers in the new city rail systems of Shenzhen and Beijing.

The second evolutionary dynamic has been Hong Kong's dramatic progress as a world business city, an evolution that continues a long trajectory, but has perhaps speeded up greatly with the weight of the mainland economy. Between 1997 and 2010, China's GNP, in PPP terms, grew from US\$2.23tr. to US\$10.13 trillion. Symbolic of the impact of this was the return of the HSBC headquarters from London to Hong Kong in 2010. Equally emblematic was Beijing's preferment of Hong Kong over Shanghai as its base for global *renminbi* trading. Much of this evolution has been due to the deliberate incorporation of global standards into higher definitions of best practice among Hong Kong professionals, regulators, and administrators; also contributory has been bottom-up institutional innovation, facilitated by light regulation.

## CONCLUSION

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Hong Kong is often compared to Singapore. They are roughly the same size, with a similar colonial heritage, and they now enjoy similar levels of economic success per capita.

They are both modern societies. Even though neither is a fully functioning democracy, they have tried in their own ways to establish government legitimacy by the delivery of wealth, opportunity, and stability, and could not be called autocracies. But, apart from having different industrial bases, their trajectories have diverged in one major respect. Singapore is a developmental state, with direct strong government intervention in the economy, including complex planning. Hong Kong remains a bastion of laissez-faire capitalism. One outcome of this divergence is that Singapore is heavily dependent on multinationals and has a relatively weak indigenous business sector, whereas Hong Kong has ethnic-Chinese control of the economy and a relatively weak foreign sector. Its government is light and positively non-interventionist. We have noted certain imperfections in some markets in Hong Kong, but this does not prevent the overall balance being strongly towards competitive discipline, as opposed to government policy, as the decider of events.

Such contrasts bring out the way in which business systems vary and reflect their geographical context, histories, and cultures; and so too the consequent evolutions of their forms of order are distinct. The level of measured success in Hong Kong and Singapore may be similar, but the subtle differences that are not always visible will continue to work in shaping and adjusting them. The impact of this on both policy-makers and practitioners can be significant.

Almost all Asian state governments are 'stronger' in the political economy sense than Hong Kong (Wade 1990). The explanation for this may lie in two factors. In many other Asian states, their histories have brought into the modern age the vested interests of dominant elites which have either been traditional or historical, as occurs with land-owners, or opportunistic, as with military power groups. Partly as a result, many other states in the region have been hampered by corruption and cronyism, unable to release the positive power of advanced social capital, and have only managed to stage 'ersatz' (Yoshihara 1985) or mercantile capitalism (Whitley 1992), instead of the free-market liberal form that has underpinned Hong Kong. This is arguably historical accident: British Victorian zeal met equally zealous, different but complementary Chinese partners, and once set in motion, the combined system became self-perpetuating.

How far Hong Kong can continue, and in what way, has arguably the largest potential import for the world's economies. China's dominance in solving the equation is balanced by its dependence on the managerial and societal technology that Hong Kong expresses at such a high level. At one time that would have been a challenge to national face. It no longer is, as learning, adaptiveness, and progress are slowly becoming entirely internal.

## ACKNOWLEDGEMENTS

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The authors are most grateful for comments and suggestions made by Dr Philip Chen, Dr Kenneth Tse, David O'Rear, Simon Tam, and Prof. Ng Sek Hong

## NOTES

1. Unless otherwise stated, all figures in this chapter derive from the Hong Kong Yearbook 2011 published by the Hong Kong Government, Information Services Department.
2. TEU = Twenty-foot equivalent units, the standard measurement in the container industry.

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