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THE HISTORY OF CORPORATE OWNERSHIP IN CHINA: STATE PATRONAGE, COMPANY LEGISLATION, AND THE ISSUE OF CONTROL

William N. Goetzmann
Yale School of Management
Elisabeth Köll
Case Western Reserve University

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William N. Goetzmann, Yale University

Elisabeth Köll, Case Western Reserve University

Abstract:
This paper examines the emergence of corporate ownership in China from the final decades of the Qing empire in the late 19th century to the early Republican period in the 1910s and 1920s. By analyzing the actual process of incorporation, the development of the legal and financial environment, in particular the role of the state, we ask whether the "top-down" approach, in which the central government established a legal framework for corporate enterprise based on Western models and the assumption that it would work as it did for Western firms and markets, was a viable approach to the modernization of a financial system traditionally dominated by family businesses and economic state patronage. Using business records from turn-of-the-century Chinese corporate companies, this paper argues that the government's "top-down" approach, while clearly well-intentioned, created a framework which only insufficiently promoted the system of corporate capitalism in pre-war China.

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Introduction

In the last fifteen years, China's market liberalization and enterprise reforms have triggered stunning economic growth and privatization initiatives in all areas of Chinese society. After decades of socialist economic policies controlling the market through state-owned enterprises, China has begun to experiment with corporate enterprise — first through the issuance of minority ownership shares in state-owned enterprises and the creation of share markets — and more recently with the development of legal and regulatory frameworks that seek to protect shareholder rights and insure managerial responsibility. One feature that continues to distinguish modern Chinese corporations it that they typically preserve a joint public\private ownership structure that, in fact, also characterized some of China's first large-scale domestic companies. As Chinese enterprise moves towards more complete privatization, using and adapting foreign models to its purposes and taking what is generally characterized as a gradualist approach to nurturing a private business sector, there are few contemporaneous models it can turn to for study. Certainly the Russian experience with privatization and the adoption of corporate capitalism before the development of a legal system to maintain it must be taken as a cautionary tale in the problems of abrupt transition.

One potentially useful model for capitalism with Chinese characteristics is China's creation and adoption of its own code of corporate governance a century ago. Then, as today, some of China's most important enterprises were structured as public\private enterprises — financed in part by equity capital, but effectively governed under the auspices of official oversight. In this setting, China adopted a Western-style corporate code which had limited but instructive effects. The analysis of this salient episode in the history of corporate ownership in China can help modern policy-makers and market analysts understand not only the economic and

political conditions in which the first models of the Chinese corporate firm originated, but how corporate governance and markets responded to regulatory innovation in a Chinese setting. This, in turn may help us to understand whether China's corporate sector is likely to converge to Western models, or instead whether the public\private structure of enterprise will remain dominant.

Exactly a century ago, in 1904, China's imperial government promulgated a set of laws that created a framework for modern, Western-style limited liability corporations in China. Until the late 19th century, the private firm run as family business was the predominant form of business institution aside from a few state-controlled monopolies like salt production and imperial silk and porcelain manufactures. Many of the family business institutions were substantial in scale and financially successful, operating throughout the local, regional and interregional markets. In its effort to maintain the agrarian base of the state and to control the production and distribution of commercial goods, the imperial government did not allow private business enterprises to engage in large-scale industrial production. This attitude began to change at the turn of the century, and the introduction of the company law in 1904 should be interpreted as the government's belated response to the ever-increasing competition and stimulus from foreign business enterprises in China.

As one might expect, the newly introduced corporate structures based on Western business models contrasted with existing managerial and financial structures in the Chinese business environment influenced by kinship networks and state patronage. As our analysis shows, Chinese business institutions essentially imitated the form of Western corporate institutions without fully installing essential structures and features of the corporate system according to our Western interpretation. Although China's first corporate code contained many

elements of the modern formula for privatization — including some requirements for transparency, separation of ownership and control, plus annual auditing and reporting requirements — it ultimately failed to effectively transform Chinese business enterprises into full-blown corporate institutions. Why?

We argue that the code fell short on two counts. First, it did not sufficiently shift ownership and control from managers, previously empowered by government patronage, to shareholders – despite vigorous attempts by shareholders to assert their rights. Second, the company code was not effective in stimulating the emergence of an active share market that would induce family-owned firms and entrepreneurial managers to exchange control for access to shareholder capital and the liquidity of an active exchange. While a market for domestic Chinese companies began in Shanghai as early as the 1870s, it was subject to a series of booms and busts preventing it from being an effective means to tap investor savings. In contrast, during this same period the Shanghai Stock Exchange for foreign-domiciled companies became one of the world's most active equity markets.

Without any doubt, the evolution of corporate structures in Western nations was slow, incomplete, and difficult. However, what we argue in this paper is that the historical development of the corporation in early 20th century China sets an immediate precedent for the revival of the corporate economy in contemporary China. Characteristics of the Chinese corporate company in 1904 with regard to ownership and control are useful to understand corporate enterprises in 2004, from the different modes of capital access for Chinese and foreign investors to the influence local governments and their officials then and now.

This paper is structured as follows. In the first part we discuss the general historical trajectory of business institutions in China and the changing role of government participation in

companies in the 19th century in order to create a framework for our discussion of the 1904 Company Law. In the second part we explore the law's impact on the development of corporate business structures and use the Dasheng spinning mills, a major industrial conglomerate founded in 1895 in Shanghai's hinterland, as a case study to examine in detail the process of incorporation in terms of legal, managerial, and financial changes. Although our analysis of ownership structures is limited by the extremely complex nature of Chinese accounting material available in the archives and the absence of a strict regulatory institutional framework, in the third section we focus on the issue of control and ownership by exploring the role of shareholders, their rights and representation, investment patterns and the development of capital markets. One of our major findings is that control in corporate enterprises in China, even if the founder and his family continued to play a major role, did not depend on establishing ownership through majority shareholding. The conclusion discusses the lessons that modern market reformers can learn from the historical Chinese experience. Considering the "top-down" approach of the current Chinese government and the hope of other nations around the world to create effective capital markets, this paper has implications for the modern challenges of privatization and introduction of corporate capitalist structures in the 21st century.

Business Institutions in 19th Century China: State Governance through Patronage and Sponsorship

Before the introduction of the first Company Law in 1904 and the founding of the Republic in 1911, private household businesses, many of them of substantial size and scope, were the central institutions for domestic private economic activities in imperial China during the Ming (1368-1644) and Qing (1644-1911) dynasties. Family businesses have a long tradition in China and have been

highly successful in the production and/or distribution of commercial goods, including long distance trade.[1] The largest and most successful of these enterprises also relied upon some form of state sponsorship. For example, in the late 17th and 18th century famous family firms such as those of the Tianjin salt merchants benefited from nurturing policies of the Qing government such as deferment and extensions of tax payments, salt price adjustments responding to fluctuations in the exchange rate between copper cash and silver, deposits and loans with the Imperial Household Department, and administrative measures to deter salt smuggling. However, as these merchant businesses were dependent upon government patronage, they were forced to stay in good favor by contributing large sums to the state's military campaigns and making huge donations to various public and imperial projects.[2]

Large private enterprises for industrial production like the gas and brine wells for salt production, operated by the merchants in Zigong, Sichuan province, remained an exception among business institutions in 19th century China. The state interacted with these contract-based unlimited liability shareholding companies only through taxation and market regulation but did not interfere in their business organization and management structures.[3] However, the absence of the law of limited liability and the law of bankruptcy had an increasingly negative impact on the expansion of those businesses at the turn of the century. Thus only changes in business law, which came about first in the treaty ports and then by 1904 in the rest of China, were conducive to the incorporation of those private business institutions.

By contrast, foreign corporate enterprise developed vigorously in Chinese treaty ports during the late 19th Century. Shares of foreign-registered corporations doing business in China

[1] See, for example, Chi-cheung Choi, "Competition among Brothers: The Kin Tye Lung Company and its Associate Companies", and Wellington K. K. Chan, "The Origins and Early Years of the Wing On Company Group in Australia, Fiji, Hong Kong and Shanghai: Organisation and Strategy of a New Enterprise".
[2] Kwan Man Bun, *The Salt Merchants of Tianjin*, pp. 37-45.

began trading in Shanghai in the 1860's, and the Shanghai Stock Exchange served as a conduit for domestic and foreign investment in China for the next 70 years. While Chinese domestic corporations did not trade on this colonial stock exchange, the evolution of a domestic Chinese corporate code and domestic capital markets must be studied against a backdrop of a colonial business that was regarded by the Chinese government both as a foreign competitor to domestic business and, eventually, a useful structure for adaptation to China's own purposes.

The issue of Chinese "imitation" of Western practice in this period has been much discussed, and numerous authors have pointed out legitimate domestic precursors to nearly every kind of large-scale business enterprise in China before the appearance of foreign capitalism in the treaty ports. There is no doubt that China before Western influence possessed the seeds of a long-distance/interregional banking system, experience with large-scale business institutions, the capacity to plan and execute large-sale infrastructure improvements, and countless manufacturing and mercantile entrepreneurs whose firms employed numerous workers and whose business ventures extended great distances. Given the existence of large-scale domestic business ventures in China prior to the presence of Western enterprises, we suggest that the utilization of a Western-style corporate code in 1904 should be thought of as an adaptation of an international financial and managerial "technology" to Chinese business needs. The term technology is appropriate here because the early champions of Western-style finance in China regarded it as a tool to advance the goal of improvement to China's social, military, and economic well-being, rather than as a means to "Westernization" or acquiescence to foreign influence.

Indeed, the processes of adaptation began well before the formal introduction of the corporate code in 1904. These processes were largely motivated by a sense of competition with the West, rather than a sense of imitation. The first attempts to build large-scale industrial enterprises on

[3] Madeleine Zelin, *The Merchants of Zigong*, introduction.

the Western model were undertaken by concerned Chinese government officials after the end of the Taiping Rebellion in 1864. In the wake of this major political crisis, a 14-year long civil war in southern China with catastrophic economic consequences, the Qing government experienced a substantial weakening of its central political authority and fiscal stability: political power shifted from court officials to governor-generals with strong regional military bases, who became instrumental in defeating the Taiping rebels and profited from the newly introduced commercial transit tax (*likin*) for the support of their troops.[4]

The next decade was characterized by political debates about the weak state of the national economy and sovereignty in the face of foreign economic and political aggression which eventually led to moderate and rather haphazard attempts for reform. In the so-called Self-Strengthening Movement during the Tongzhi Restoration period between 1862 and 1874, reform-minded government officials — mostly politically powerful provincial governor-generals — attempted to revive the national economy and military after the devastating Taiping Rebellion. Therefore, whatever little industrialization resulted from China's Self-Strengthening movement, was characterized by a focus on heavy industries serving the government's military and defense purposes.[5]

When Li Hongzhang (1823-1901) was appointed governor-general of Zhili and imperial commissioner of the northern ports in 1870, he became the most ardent proponent of the Self-Strengthening Movement. One significant part of his plan was to acquire knowledge from the West — including knowledge of Western industrial and financial practices. He secured permission from the imperial government to send Chinese students to study in France in the 1870s. One of them, his

[4] Albert Feuerwerker, "Economic Trends in the Late Ch'ing Empire"; Lloyd E. Eastman, *Family, Fields and* pp. 1158-70; Mary Clabaugh Wright, *The Last Stand of Chinese Conservatism*, pp. 167-74.
[5] Mary Clabaugh Wright, *The Last Stand of Chinese Conservatism;* Albert Feuerwerker, "Economic Trends in the Late Ch'ing Empire".

protégé, reformer Ma Jianzhong, conducted a careful study of Western railroad finance in 1879, and proposed the adoption of public bond issues for infrastructure development in China.[6]

Together with moderately reform-minded officials and political authorities such as Zeng Guofan (1811-1872) and Zuo Zongtang (1812-1885), Li Hongzhang demanded that the Chinese government strive to improve its military equipment and technology in order to defend against the Western powers who had displayed their military superiority so forcefully at China's expense. However, these government officials were not proponents of launching an industrial revolution or a modern economy in China. On the contrary, they wanted to restore the traditional economy, including agriculture and commerce, and were not planning on "enhancing the strength and wealth of the country at the cost of its traditional institutions."[7]

Thus the initial establishment of industrial enterprises has to be interpreted as a step towards regaining military strength and national pride without contesting the status quo of government and society, rather than as a step towards planned economic development. In order to secure control over this policy, any industrial enterprise founded before 1895 required not only sanction or permission, but even active supervision and sponsorship from the government and its agents, the official bureaucrats. Notable examples of this promotion of industrial enterprises under government sponsorship in the 1860s and 1870s included the Jiangnan Arsenal (Jiangnan zhizao ju) and the China Merchants' Steamship Navigation Company (Lunchuan zhaoshang ju), both in Shanghai, as well as the Kaiping Coal Mines (Kaiping meikuang) near Tianjin.

Curiously, the China Merchants' Steamship Navigation Company evolved from a business proposal by Yung Wing, an 1857 Yale College graduate, who like Ma Jianzhong drew upon his experience overseas to propose innovations in Chinese enterprises. Albert Feuerwerker notes that

[6] Paul Bailey, *Strengthen the Country and Enrich the People*, p. 14.

the idea of beating the West at its own game, that is, adopting Western-style corporate business practices to government-controlled enterprise was present in Wing's initial conception. Quoting Yung Wing's autobiography, "No foreigner was to be allowed to be a stockholder in the company. It was to be a purely Chinese Company, managed and worked by Chinese exclusively."[8] Once formed, the China Merchants' Steamship Navigation Company competed vigorously and effectively against Western shipping firms in Shanghai, fulfilling the original dreams of its founders, for whom the joint-stock enterprise form was simply a means to the end of reducing China's dependence upon foreigners.

In fact, all three enterprises self-evidently demonstrate the immediate goals of the Self-Strengthening Movement: the Jiangnan Arsenal was to improve China's military strength by manufacturing modern arms, the steamship company was to facilitate the grain transport for the government as well as make China less dependent upon foreign-owned transportation companies, whereas the mines were supposed to provide the power for national transportation facilities and limited private consumption.[9] This strategy was certainly not an ambitious program aimed at nation-wide industrialization through private initiatives. In order to stress their close relationship with the government's agenda, these new industrial enterprises carried the character *ju* for governmental bureau in their names instead of the characters for factory (*chang*) or industrial company (*gongsi*) which would have indicated a private business concern. While each of these firms was funded in part by the issuance of shares to Chinese merchants, they were not floated on a public capital market in the manner we understand today, nor indeed were they funded through a public issue in the manner used by foreign-registered companies in Shanghai at the time.

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[7] Mary Clabaugh Wright, *The Last Stand of Chinese Conservatism: The T'ung-chih Restoration, 1862-1874*. Stanford: Stanford University Press, 1957, p. 153.
[8] Quoted in Albert Feuerwerker, *China's Early Industrialization*, p. 97.

However, despite their public/private genesis, the shares of these first Chinese joint-stock companies did trade publicly in the first decade after their founding, and they seem to have been part of China's first stock market "bubble." In fact, whereas Chinese merchants invested heavily in Western enterprises in the treaty ports during the 1870s, as speculators they evidently took also a strong interest in the shares of these first domestic firms.[10] Trading in the 1880s was handled by at least one broker (the Pingzhun Stock Company) registered to trade and publish prices, and the prices appeared in local Chinese language newspapers.[11] A chart of these prices shows that they were trading at a 20% premium to par by 1882 only to drop to half of that by the middle of the 1880s. (See Figure 1: Equal-Weighted Index of Chinese Stocks in Shanghai, 1882-1887) Speculations and price manipulations of some of the companies' major shareholders who often were also the managers of the companies, contributed to the crisis.[12] Thus it is curious that, at about the time that the robber-barons Gould and Fisk were manipulating prices of railroad securities on the New York Stock Exchange, the Shanghai market suffered from the same problems of insider trading.

This was thus not a failure of corporate law *per se* but rather a regulatory failure. While the NYSE eventually managed to recover the trust of investors and serve as a conduit for investor capital, the domestic Shanghai market was not so lucky. After the crash of 1883, the Shanghai market for domestic shares did not recover for decades. Except for a flurry of speculative trading in domestic railroad companies' IPOs in the first decade of the 20th century, public quotes for shares were few and far between. As David Faure notes, "tradition-bound attitudes were not replaced by share-holding in the modern companies. Rather, it was share-holding that was being absorbed into

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[9] See Feuerwerker, *China's Early Industrialization*; Chi-kong Lai, "The Qing State and Merchant Enterprise", pp. 139-55; Ellsworth C. Carlson, *The Kaiping Mines (1877-1912)*.
[10] David Faure, *China and Capitalism*, pp. 35-36.
[11] Andrea McElderry, "Shanghai Securities Exchanges", pp. 5-6.

the Chinese business tradition".[13] Indeed, from 1887 to the 1920s, when a formal exchange was finally created for Chinese firms in Shanghai, the public market for shares was moribund.

This market failure was particularly unfortunate, for, as we will show later in the paper, it removed one of the major motivations for entrepreneurs and managers to accede control to outside shareholders. If the public would not willingly commit new capital to the enterprise, and if privately held shares were worth relatively little in the public market, why should owner-managers give up the private value of ownership and control?[14]

One way to overcome the predicament of the lack of public markets would have been to establish the new enterprises as government monopolies similar to the economic strategy employed by the Meiji government in Japan during the 1870s and 1880s. However, given its strained financial situation, the Qing government did not have sufficient funds available for such investment. In addition, the machinery, the technological and managerial procedures of the new enterprises required expertise which Chinese government officials with their administrative background could not provide.[15]

It is important to point out that the financial problems China faced in the 1870s and 1880s were not unique. This was the era of a worldwide transportation revolution, and the challenge of financing the construction of large-scale transportation networks confronted virtually every sovereign nation in some form. Major infrastructure projects like rail, gas, and electrification required a quantum leap in financial technology. It was the fundamental nature of these projects

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[12] David Faure, *China and Capitalism,* pp. 38-40; McElderry, "Shanghai Securities Exchanges", p. 5.
[13] Faure, *China and Capitalism*, p.39.
[14] See Yingui Zhu, "Three Market Crashes and Shanghai Securities Market in Late 1880s and Early 1900s" and Andrea McElderry, "Shanghai Securities Exchanges". A time-series comparison of prices of domestic and foreign shares can be found in William N. Goetzmann, Andrey Ukhov, and Ning Zhu, "China and the World Financial Markets 1870-1930: Modern Lessons from Historical Globalization".
[15] For a general introduction see Wellington K. K. Chan, "Government, Merchants and Industry to 1911". On Japan's industrial development see Johannes Hirschmeier, *The Origins of Entrepreneurship in Meiji Japan* and Thomas C. Smith, *Political Change and Industrial Development in Japan*.

that their benefits were only experienced after large up-front costs were incurred. Most nations, including China, turned to the foreign capital markets in London, Paris, and Brussels to fund construction through railroad bonds and deals with foreign railroad companies. However, these deals were conceptually at odds with the initial motivation for establishing domestic firms to compete against foreign businesses. China possessed considerable economic potential at the turn of the century; however, without a functioning domestic capital market, it was unable to tap these resources to retain control of its own technological development.

In order to address some of the failures of the domestic capital marketplace, new industrial enterprises established in the 1870s and 1880s took the form of government-sponsored enterprises, known as *guandu shangban* (government supervision and merchant management) enterprises. The bureaucratic term for this type of enterprise had its origin in the traditional set-up of the government's salt monopoly where merchants had provided capital and management while government officials maintained control of production and trade quotas.[16] Under the new scheme for large-scale industrial enterprises, private investors, mostly merchants, were expected to put up the capital and to manage their investment under the supervision of government officials. This arrangement meant that apart from some financial sponsorship through government loans, the merchants bore all the financial risks of the enterprises which often became joint-stock operations. In addition, they were required to work under the thumb of supervising government officials who often followed their own, not necessarily government-directed business agendas and who introduced bribes, corruption, and inflexible management into these enterprises. Albert Feuerwerker and Guohui Zhang have shown in detail the manifold problems these industrial government

[16] On the salt monopoly in the 18th and early 19th century see Thomas A. Metzger, "The Organizational Capabilities of the Ch'ing State in the Field of Commerce".

enterprises encountered due to the peculiar financial and managerial arrangements.[17] Not surprisingly, the financial profit for the private investors in these *guandu shangban* enterprises in the 1870s and 1880s was rather limited.

For example, the China Merchants' Steamship Navigation Company attempted for a short while to consolidate the government-business cooperation with its new joint-stock structure between 1872 and 1884, but continued under dominant government influence in the following years.[18] In the privatization process after 1895, the supervising director of the company appointed by the government, Sheng Xuanhuai (1844-1916), became an appointee of the board of directors, which was more a change in name than in fact, as Sheng, while supervising director, had already acquired substantial shares in the company.[19]

During this period of initial state-directed industrial efforts, Li Hongzhang, in his position as government official and personal supervisor/sponsor, became the most powerful patron of *guandu shangban* enterprises. The China Merchants' Steamship Navigation Company, the Kaiping Mines, and the Shanghai Cotton Cloth Mill were all under his official sponsorship which actually translated his political power in the government into the opportunity to establish his own sphere of economic influence and to control these enterprises in a quasi-monopoly situation. This is not to say that Li Hongzhang's patronage had a completely negative impact on these enterprises. As Chi-kong Lai has shown for the China Merchants' Steamship Navigation Company, in the beginning Li's sponsorship in fact secured sufficient financial support and autonomy for the merchant managers.[20] Only when Li Hongzhang was eventually unable to prevent the government from assuming more direct control

[17] Albert Feuerwerker, *China's Early Industrialization*; Guohui Zhang, "The Emergence and Development of China's Modern Capitalist Enterprises".
[18] Chi-kong Lai, "The Qing State and Merchant Enterprise."
[19] See Albert Feuerwerker, *China's Early Industrialization*, especially pp. 161-64; Chi-kong Lai, "The Qing State and Merchant Enterprise".
[20] Chi-kong Lai, "Li Hung-Chang and Modern Enterprise", especially p. 238.

of the management, did the company encounter problems. Extraction, mismanagement, and misuse of funds accompanied the government's growing intervention in the enterprise, leading to decreasing merchant investment. In general, lack of auditing procedures and absence of distinction between private and company funds characterized these government-sponsored enterprises as much as any family business at the time.

In order to attract private investment from merchants who had become less and less willing to risk their money in government-sponsored enterprises in the 1880s, the government devised a compromise and promoted a more attractive kind of cooperation with merchants in the form of *guanshang heban* (joint government-merchant management) enterprises. According to this new arrangement, merchants were to be more in control of the management and the allocation of the capital invested. However, this move by the government towards more flexibility and private financial as well as managerial involvement never really materialized and did not trigger the desired outpouring of investment funds. In fact, the dissatisfaction of the merchants grew during the early 1890s and was even acknowledged by government officials.[21]

Certainly, the now more restrained presence of the government in the *guanshang heban* enterprises still offered private investors some advantages with regard to official protection against inconvenient national and foreign competition. Nevertheless, creating a positive investment climate for private activity in the industrial sector would first require the more drastic step of abolishing the general protectionist mechanism against private enterprises in China, namely, the government policy which did not allow Chinese nationals to open private industrial enterprises independently anywhere in the empire. The turning point came in 1895 with a new phase of industrial entrepreneurship in China, initiated by a major political event.[22] Indeed, the incentives for increased

[21] Wellington K. K. Chan, "Government, Merchants and Industry to 1911", pp. 434-35.
[22] Quan, Hansheng, *Zhongguo jingjishi yanjiu* (Research in Chinese economic history), vol. 2, p. 715.

industrial activity and the changing ownership conditions did not originate in deliberate government reforms out of concern for a weak national economy; rather, they resulted from events in connection with China's foreign policy.

Having lost the first Sino-Japanese war of 1894/95, China was required by the Treaty of Shimonoseki to pay huge financial reparations to Japan and, most significantly, for the first time grant foreigners permission to engage in manufacturing operations in Chinese treaty ports. Since permission had been given to foreigners for building factories in China, it was impossible for the government to prevent its own nationals from engaging in industry any longer. However, the fall of Li Hongzhang from power in 1895 was also a vital factor.[23] Li Hongzhang's personal patronage of such enterprises as the Kaiping Mines, the Shanghai Arsenal, and the China Merchants' Steamship Navigation Company had been a crucial reason for their success. Li Hongzhang was powerful not only in Beijing near his power base in Zhili province, but also in Shanghai. There he exerted his influence in the appointment of the Shanghai circuit intendant, the most senior official in Shanghai's administration, and worked successfully for his operations by networking through fellow provincials, colleagues, and fellow examination graduates.[24] Through these formal and informal relationships Li Hongzhang was able to gain support from Shanghai and Jiangsu officials as well as from merchants and gentry members who either were attracted by Li's financial awards or by their own vested interests in the enterprises. As long as Li Hongzhang was in power, the operations under his supervision were protected through his patronage and thus also through their exceptional monopoly status. In short, the fall of Li Hongzhang and his monopolistic restrictions opened the industrial realm to private initiatives.

[23] Shao, Xunzheng, "Guanyu Yangwupai minyong qiye de xingzhi he daolu ", especially p. 369.
[24] Yuen-sang Leung, "The Shanghai-Tientsin Connection".

From 1895 on, enterprises in light industry and in the consumer goods industry were founded in greater numbers with a significant shift from government sponsored enterprises to enterprises with private involvement in ownership and management. For example, a boom in establishing cotton mills with full Chinese ownership took place after 1895. Between 1890 and 1894 only a total of five cotton spinning mills had been successfully established (all but one with government involvement), while by 1916 thirty new mills were in operation, all of them under private merchant management.[25] The statistics of weaving mills is even more impressive. Whereas only one factory in private management was operating in 1897, by 1916, 81 private weaving mills were in business.[26]

In another important sector, 35 mining enterprises were founded between 1895 and 1911 as private enterprises in contrast to nine mining enterprises in total government ownership, ten other enterprises under joint government-merchant management, and only two as government supervision-merchant management operations.[27] As the government withdrew from direct involvement in the enterprises remaining under joint management, new forms of private business operations developed, now supported by structural aspects of incorporation, limited liability, and legal accreditation.

However, it needs to be said that it took more than a decade before China was to experience substantial industrialization in regard to the number of factories and their output, and it was not until the post-1900 Qing reforms that the imperial court openly encouraged private business and industrial enterprise.[28] Establishing factories for light industry production, transportation or banking

[25] Du, Xuncheng, *Minzu zibenzhuyi yu jiu Zhongguo zhengfu*, pp. 286-292. All the mills included in this statistic have a starting capital of at least 10,000 yuan.
[26] Ibid., pp. 293-304. Only five of the 86 new weaving operations established between 1902 and 1916 were under government management (*guanban*).
[27] Du, Xuncheng, *Minzu zibenzhuyi yu jiu Zhongguo zhengfu*, pp. 460-70.
[28] See also David Faure, *China and Capitalism*, pp. 46-48.

businesses required considerable private capital investment from merchants or businessmen. Even without interference from the government and influential officials, the risk of investing private capital in major industrial operations such as cotton spinning mills or silk filatures was still considerable in the early 20th century. Without an open and accessible capital market for domestic shares, the raising of capital was still one of the major problems in founding private enterprises, with the exception of family businesses which continued to recruit their capital from kinship and native-place networks.

There were, however, instances during this post-1900 period when the potential for full development of a Chinese share market appeared. Lee En-han documents the evolution of the Chinese Railway Rights Recovery Movement from 1904 to 1911, a period in which a number of domestic Chinese railroad companies were chartered and capitalized in the wake of nationalistic efforts to recover the railroad concessions made to foreign development firms.[29] Nineteen major provincial railway companies were formed with Chinese capital raised through a combination of public share issuance, domestic and overseas Chinese merchant investment and provincial government sponsorship. In some cases, these firms were given development rights that were stripped from foreign entities. However, virtually all of these ventures foundered in the late Qing or early Republican period; some for political reasons associated with the suspension of their charters by the imperial government, others from lack of capital and mismanagement.

So far we have addressed in our discussion some of the restrictive features of state interference in China's economic development in regard to corporate business and capital markets. However, the imperial bureaucracy's priority to maintain control over commercial production and distribution, prices, and markets was arguably based on a well-intentioned political philosophy

and should not be simply interpreted as a governmental "grabbing hand." We also should not overestimate the state's impact on the formation of Chinese business structures. Religious trusts run by lineages managing land and other assets have operated for generations according to the most basic principle of a corporation in terms of property division and management based on the ownership of shares.[30] The introduction of the 1904 Company Law thus would not mean the introduction of the already familiar concept of shareholding to Chinese business institutions but rather the establishment of limited liability in legal terms with the goal to make companies more attractive to Chinese investors. Whereas the legal reforms initiated by the state were a step in the right direction, the following section will point out the serious caveats of the legislation which encouraged a hybrid development of the corporation in the Chinese context. Success and failure of newly founded corporate enterprises in early 20th century China, in particular the role of the shareholders, reflect this development. In the case of the reorganized railway companies mentioned above, aggressive proxy contests challenged managerial expropriation, some of which emerged in the evolution of one major Chinese industrial company, the Dasheng cotton mills, that we will examine in some detail in the following section.

The Power of the Law? Chinese Company Legislation in 1904

The late Qing reforms were a moderate attempt by the government to introduce legal, institutional, and educational reforms in order to satisfy popular demands for change and modernization while maintaining the political status quo of a conservative imperial monarchy. China's first Company Law (*gongsi lü*) was issued by the newly created Ministry of Commerce on January 21, 1904, based on Japanese and English company laws, but in much abbreviated form. The document was

[29] En-han Lee, *China's Quest for Railway Autonomy: 1904-1911.* Singapore: Singapore University Press, 1977.
[30] David Faure, *China and Capitalism*, pp. 14-16.

intended to define the terms of Chinese corporate enterprise and to create a better legal environment encouraging private investment which would ultimately lead to greater national prosperity.

In the debate about the nature of business institutions and economic growth in China, the late appearance of business legislation has often been misinterpreted as a lack of clear definitions of property rights and their enforcement by the state. However, scholarship by China historians working on legal and economic issues has convincingly documented the widespread use of contracts in Chinese business culture for centuries and their role as primary instrument for the definition of property rights which were supported by the state.[31] At the same time, it is important to recognize that China did not lag too far behind Western legal corporate reform in the late 19th century. Britain, for example, only codified limited liability with its Companies Act of 1862, and from the mid 1860s through the 1880s British companies doing business in China experimented with adapting the Act and British law to the needs of overseas enterprise. Most major British firms in Shanghai only became limited liability companies in the 1880s, and before 1907, most Shanghai-based British firms typically registered their official domicile in Hong Kong in order to avoid the ambiguities of a treaty port legal environment — governed as it was by a multitude of nationalities.[32]

In the 1870s and 1880s, the Western corporate model itself was evolving to address the challenges of international investment and business enterprise. The fact that shares of British firms traded as early as 1866 in Shanghai suggests that China was exposed quite early to the developing financial technology of British-style corporate capitalism. The creation of the China Merchants' Steamship Navigation Company as a Chinese corporate enterprise of sorts in 1872 — ten years after the Companies Act — indicates that China was, even at that time, chose to take its own financial

[31] The most recent contribution to the literature is Madeleine Zelin, Jonathan K. Ocko, and Robert Gardella, *Contract and Property in Early Modern China*. See especially part II on contracts and the practice of business.

course in the context of an evolving structure of capitalism in the late 19th century. Thus, the code of 1904 should not be viewed as a beginning of corporate capitalism in China in any sense, but rather a top-down "revision" of the course that large-scale Chinese business enterprise had taken over the previous three decades — a course that had already freely interacted with, and adapted from, Western-style business models.

A new legal framework was certainly not inevitable, given the developments up to this time. The alternative to promulgating a code in 1904 was the *laissez-faire* course of allowing the continuation of firm level adaptation and development under local official patronage. The code took an approach different from previous government forays into business enterprise. Rather than the "hands on" inclusion of government officials in the governance structure, the code was "hands-off" — eliminating the direct participation of the government in the corporate entity, and instead replacing that presence with a set of external rules and structures designed to make the corporation responsive to shareholders. It thus sought to encourage the establishment of Chinese companies modeled on Western corporate structures which would be able to compete with foreign companies producing and selling goods in China. With regard to existing Chinese company structures, the company law was supposed "to overcome the constraints of the partnership" which, lacking the limited liability concept, in William Kirby's words "could be limiting, but not limited."[33]

The 1904 Company Law, translated into English that same year by the Chinese secretary to the U.S. legation in Beijing[34], contained 131 articles in 11 sections and stipulated issues such as company organizational forms, ways to report a company's founding, methods of business management and shareholder rights.[35] For example, it stipulated that the Board of Directors be

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[32] W.A. Thomas, *Western Capitalism in China: A History of the Shanghai Stock Exchange*. p. 28 and ff.
[33] William C. Kirby, "China Unincorporated", quote p. 47.
[34] E.T. Williams (transl.), *Recent Chinese Legislation relating to Commercial, Railway, and Mining Enterprises.*
[35] Zhu, Ying, "Lun Qing mo de jingji fagui".

elected at a general meeting of the shareholders who also obtained the right to pass resolutions at those meetings. According to the code, businesses in the form of partnerships with unlimited or limited liability, joint-stock companies with unlimited or limited liability, and sole proprietorships with unlimited liability were allowed to register.[36] Between 1904 and 1908, some 272 companies registered with the Chinese government, over half of them as joint-stock companies with limited liability.[37] Although these numbers are impressive, they represent only a fraction of the unlisted Chinese enterprises operating in China at the time.

Here are some examples of how existing Chinese businesses responded to the new Company Law. The Nanyang Brothers Tobacco Company was registered under English law in Hong Kong in 1905 and later as a joint-stock company with the Beijing government under Chinese law in 1918.[38] The management of the company, especially its debts and credit arrangements, had always been problematic because of the use of former compradors, because it was never clear whether they acted as agents or principals. With the new holding structure of the business company, Sherman Cochran documents a managerial innovation in the appointment of a financial controller in 1919 who was responsible for reorganizing the company's finances.[39]

Many families opted not to register their firms for fear of losing control over management and equity. Even those family firms that registered with the Chinese government (and most family firms in the treaty ports did not), did not necessarily give up their family business structure. The Yong'an (Wing On) company, famous for its department stores in Shanghai and founded by the Guo family in Hong Kong in 1907, is an example of a large family business that was registered under English law and continued to exist as a joint-stock limited liability company in 1912.

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[36] Shangwu Yinshuguan Bianyisuo, *Da Qing Guangxu xin faling*, 'gongsi lü' (Company code), 2:a.
[37] Wellington K. K. Chan, *Merchants, Mandarins and Modern Enterprise in Late Ch'ing China*, pp. 180-82.
[38] Sherman Cochran, *Big Business in China,* pp. 56, 100-101.
[39] Ibid., pp. 151-152.

However, the family continued to exert its strong financial control over the company's shareholding structure.[40] Despite taking the company public, the Guo brothers were able to achieve almost a consolidation between ownership and control through shareholdings from extended family, their overseas and native place networks, interlocking directorships and inter-company loans.[41]

Needless to say, the treaty ports, not rural areas, became preferred locations for Chinese to establish their new incorporated enterprises. Treaty ports were of course the places where foreign corporate capitalism presented the greatest competition to domestic enterprises — and also the places where new "financial technology" was first introduced to China. Compradors working for foreign firms quickly understood and mastered the structure of corporate capitalism, and were among the first to introduce these methods to Chinese businesses. Chinese merchants and businessmen in turn valued the cooperation with compradors in the treaty ports in order to gain access to new financial sources and foreign products and technology. Finally, Chinese investors used the presence of foreign settlements and their special legal administration in order to register their companies under the protection of foreign legal statutes.[42]

The role of the imperial government in the registration process was remarkably restrained. According to the 1904 law, businessmen had to register their companies with the local chamber of commerce, not with the local government as one would expect. Then the registration was forwarded to the central government in Beijing. As a clear affirmation of the much more visible hand of the Republican government coming to power in 1911, this practice was abolished in the law's 1914 revised and expanded form when registration now had to take place directly with the government.

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[40] Shanghai Shehui Kexueyuan Jingji Yanjiusuo, *Shanghai Yong'an gongsi de chansheng, fazhan he gaizao*, p. 7.
[41] Wellington K. K. Chan, "The Origins and Early Years of the Wing On Company Group in Australia, Fiji, Hong Kong", especially p. 89.
[42] Foreign registration of Chinese companies in Shanghai's foreign concessions became a particularly important device for Chinese businessmen to protect their assets during the Japanese occupation beginning in 1937. This option ceased in December of 1941 with Japan's occupation of the settlements. See Parks Coble, *Chinese Capitalists in Japan's New Order*, pp. 25-29.

In order to assess in detail the impact of the company law on the lifecycle of a Chinese business from the late 19th to the early 20th century, we shall now turn to the Dasheng cotton mills, by any measure a major business enterprise at the time. Its experience in many ways is typical of firms studied by economic historians interested in business history of the late Qing and Republican period. It reveals the strengths and weaknesses of industrial enterprises founded in the wake of 1895, and the transition that came about with the privatization process. Dasheng was originally conceived in a government initiative as a regional enterprise on the northern bank of the Yangzi river in Jiangsu province near the city of Nantong, northwest of Shanghai. Zhang Jian (1853-1926), a famous scholar with family ties to the region (but without business experience) who had left government service, was invited to found and manage the enterprise. Governor-general Zhang Zhidong lent his support as the patron in the beginning and officially initiated the Dasheng cotton mills as an operation under joint government-merchant management in 1895. However, in contrast to the previous patronage system under Li Hongzhang, Zhang Zhidong who represented the *guan* or official side in the enterprise, did not represent the government as a corporate body but acted as an individual official. In this position he offered patronage and ineffective official protection for the enterprise, but not much else.[43]

One could say that the watering down of government patronage to individual official patronage eventually led to the complete disappearance of involvement by individual officials in the enterprise. Zhang Zhidong was unable to offer Dasheng crucial financial support, and without financial leverage his official influence faded from the picture. The originally government-sponsored enterprise thus soon became a privatized operation under the strong impact of the founder's, i.e. Zhang Jian's, family without ever developing into a family business with majority

[43] For a detailed study of the development of Dasheng business and its role as a regional enterprise in northern Jiangsu from the late 19th century to the early 1950s see Elisabeth Köll, *From Cotton Mill to Business Empire.*

shareholding by kinship networks. A more detailed discussion of the company's shareholders and their investments can be found in the following section of this paper. Registered officially as a shareholding company with limited liability in 1907, Dasheng then grew into a major industrial complex with considerable financial success and a substantial life-span that took the enterprise, even though with changing managerial and financial structures, into the early 1950s when it became a state-owned enterprise in China's new socialist economy.

Despite required company registration it is difficult to establish the exact date when Chinese enterprises like Dasheng, or more precisely the Dasheng No.1 Cotton Mill, acquired private, corporate status as a legal entity. After extensive search in various archives it is safe to say that no documents exist that formally dissolved the initial form of the enterprise at its foundation as a 'joint government-merchant management' operation. The text printed on share certificates from 1897 and from 1903 still stated that the Dasheng spinning mills

> ... were established in Tongzhou [i.e. Nantong] with approval granted by edict in response to a memorial from the Minister of the Southern Ports [i.e. Zhang Zhidong]..., by contract set up for perpetuity to be jointly managed by officials and gentry...[44]

In March 1905 the *Dagongbao* newspaper published an announcement which listed the Dasheng No.1 Cotton Mill as approved and registered by the Ministry of Commerce (*shangbu*) together with ten other companies (*gongsi*) established by Dasheng's founder, Zhang Jian.[45] This was the official recognition of the company registration required by the Company Law as promulgated in 1904.[46] Finally, we know from the published report of the first shareholder meeting in 1907 that the

[44] Nantong Textile Museum (Nantong fangzhi bowuguan), hereafter NFB: doc. 247; doc.182. Share certificates from the years 1898 to 1903 with the same text are also kept in the Nantong Municipal Archives (Nantong shi dang'anguan), hereafter NSD: B 402-111-1.
[45] *Dagongbao*, March 4, 1905, 2a-2b; March 6, 1905, 2a.
[46] Shangwu Yinshuguan Bianyisuo, *Da Qing Guangxu xin faling*, 'gongsi lü', 10:3b.

Dasheng No.1 Cotton Mill had now taken on the form of a stockholding company with limited liability (*gufen youxian gongsi*).[47]

What did the shareholders of the newly incorporated companies say? We must not forget that although Dasheng had been operating with private share capital since its establishment in1898, shareholders had no public forum within the enterprise to voice their suggestions or criticism regarding the company's policies. Thus the new legal status of the company seems to have been met with great enthusiasm from the shareholders. Zheng Xiaoxu (1860-1938), one of the most prominent shareholders with an active career in business and national politics[48], is quoted in the 1907 shareholder report, which documents the lively discussions at Dasheng's first ever shareholder meeting:

> Formerly all the organization of this mill was unlimited and untouched by any law[49]. Now that we have shareholder meetings, the unlimited and without-law status should be changed into a company that is limited and with a complete law. We should first decide on its name as Dasheng Stockholding Company With Limited Liability (Dasheng gufen youxian gongsi).[50]

One would expect that the new share certificates of the Dasheng No.1 mill from 1907 onwards would bear reference to the new legal status of the company — but they do not. The certificates only refer to the Dasheng Spinning and Weaving Company (Dasheng fangzhi gongsi) without indicating its new legal status. However, the text on share certificates from the years 1915 and 1919 at least no longer mentions the previous involvement of the government in the establishment of the company.[51]

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[47] NSD: B 402-111-445, 13b.
[48] For the biography of Zheng Xiaoxu see Howard L. Boorman, *Biographical Dictionary of Republican China*. vol. 1, pp. 271-275. Zheng Xiaoxu is probably most famous for his Manchu loyalism and his refusal to recognize the Republic of China. Between 1925 and 1932 he served as assistant to the former Xuantong emperor Puyi.
[49] To translate '*wufa*' with 'illegal' would be beside the point, as there was no company law with required registration before 1904, and thus a company without official registration was not an illegal operation.
[50] NSD: B 402-111-445, 12b.
[51] NFB: doc. 193 ; doc. 198.

While some companies like Dasheng, through incorporation, rid themselves of government patronage, some enterprises actively continued to seek and exploit government patronage during the Republican period when political power became even more fragmented. The Lanzhou Mining Company (Beiyang Lanzhou guankuang youxian gongsi) and the Qixin Cement Company (Qixin yanghui gongsi) are examples of such privatized enterprises under rejuvenated patterns of political patronage. Their founder, the government official Zhou Xuexi (1869-1947), enjoyed the political patronage of Yuan Shikai who, first as governor-general of Zhili and later as president of the Republic, had great influence in the Beijing government. Yuan's support of the Qixin company through partial exemption from custom duties and its placement as major supplier of cement for the government-owned railways fortified the positive relationship between the most successful industrialist in northern China and the Beijing government. Although the establishment of the Nanjing government in 1927 meant a drastic change in the political scenario and thus a shift in the patronage advantages for Zhou Xuexi, his companies were already so well established that they continued their business with success in the 1930s.[52]

In general, the change to limited liability did not evoke great changes in terms of the business organization of Chinese enterprises. The introduction of annual shareholder meetings appears as the most significant result of their legal transformation into private, incorporated companies. The new legal status did not affect the internal managerial or the overall structure of the business. The line of hierarchy remained basically unchanged as the department heads were still appointed by the managing director, but now in consultation with the board of directors.[53]

In addition, according to the stipulations of the 1904 Company Law, two auditors were appointed to examine the company's finances. However, the law did not specify that these auditors

[52] Albert Feuerwerker, "Industrial Enterprise in Twentieth-Century China: The Chee Hsin Cement Co.", in particular pp. 287-302; Ellsworth C. Carlson, *The Kaiping Mines*, pp. 105-17.

had to be independent, only that company directors could not simultaneously serve as auditors for their own companies.[54] This meant that legally auditors could still be selected from the remaining members of the board. For example, in the case of Dasheng, auditors were recruited among the board members and thus from within the company management under Zhang Jian's immediate influence.[55] These auditors more or less rubber-stamped Dasheng's annual reports and signed the minutes of the shareholder meetings. We should not interpret their role as controllers who represented the interests of shareholders regarding financial clarity and critical examination. In fact, as part of the management, the auditors were there to defend the financial decisions they had approved on the board earlier on.

On the whole, it seems that the new legal status of incorporation, which we tend to associate with the form of a 'modern' business enterprise in the Western sense, did not lead to significant improvements with regard to protecting shareholders' rights or curbing the power of the managing director. In fact, judging from the complaints at shareholder meetings of Zhang Jian's enterprises, their complete ineffectiveness in every respect still placed shareholders at a disadvantage, despite all the potential prospects of openness and accountability through Dasheng's incorporation. The balance of power did not change in the company. Apparently the top-down approach encountered resistance at the managerial level, while the company founder stayed in control.

In line with common business practice used previously in government-sponsored enterprises, shareholders in companies that started after 1895 and incorporated relatively early, received guaranteed interest payments at a fixed rate of eight per cent on their share investment.

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[53] NSD: B 402-111-445, 17a-b.
[54] Shangwu Yinshuguan Bianyisuo, *Da Qing Guangxu xin faling*, 'gongsi lü', 10:7a-8b.
[55] NSD: B 402-111-445, 4a.

They collected their interest annually in person from the accounting office at the factories.[56] Thus the common shares resembled what we now think of as preferred shares — at least insofar as the dividend payments were fixed and relatively high compared to the few existing investment options through financial instruments before the emergence of the modern banking system in China in the mid-1910s.[57] This practice clearly increased the risk of the enterprise: while reducing the fluctuation of income to shareholders, it also reduced the discretion of management to fund growth and investment from cash generated by operations. This would not be a major problem in a liquid capital market, in which managers could raise needed funds by issuing additional debt or equity. However, the domestic Chinese share market still suffered from the illiquidity of the 1880s crash — it did not provide the means to easily finance growth.

Why, then, were dividend payments comparatively high and fixed? It is tempting to consider a modern explanation founded in the limitations of corporate governance — the "free cash flow" hypothesis.[58] In essence, Michael Jensen's free cash flow theory posits that cash from the operations of a company is a temptation to the manager who seeks to use it to his own ends rather than return it to shareholders. One way to prevent management from diverting corporate funds — or one way for the manger to prove to shareholders he is not diverting funds — is to set a high, fixed payout ratio. This could be achieved through a high debt-equity ratio, or a mechanism like preferred shares. An alternative way to discipline the managers is to have a market for corporate control, i.e. the ability to take over the company by buying all the shares, and then replacing bad management with good. This, of course, necessitates an open and active

[56] Elisabeth Köll, *From Cotton Mill to Business Empire,* p. 130. As Ellen Hertz (*The Trading Crowd: An Ethnography of the Shanghai Stock Market*, p. 37) points out, even in China today dividends from Shanghai's stock market are distributed in person and not through the mail.
[57] On the emergence of modern banking and expansion of investment options in China see, for example, Brett Sheehan, *Trust in Troubled Times*; Linsun Cheng, *Banking in Modern China*.
[58] Michael Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers."

public market for the shares — something largely lacking for domestic Chinese companies until roughly the third decade of the 20th century. Given the documented concerns that Chinese shareholders might naturally have about diversion of funds by managers and the lack of a market for corporate control, high fixed dividends might be expected to naturally arise as a means to assuage investor concerns.

The capital of the Dasheng No.1 Cotton Mill remained unchanged at 1.13 million taels[59] between 1903 and 1914.[60] The new legal status of limited liability did not attract tremendous interest or create greater trust among investors and did not prompt the management to seek a capital increase through the public offering of new share subscriptions. Shares of the Dasheng No.1 mill were traded for the first time by the Shanghai Stock Merchants Association in 1917, but the trading volume of this trading association operating with government approval since late 1914 seems to have been rather limited.[61] When the Chinese Merchants Stock and Commodity Exchange opened in 1920, shares of the Dasheng No.1 and No.2 Cotton Mill were officially listed and their market prices regularly reported in the *Shenbao* newspaper published in Shanghai.[62] Despite a new boom in domestic stock market speculation after 1920, it is unlikely that this public float of shares served in any meaningful way to discipline management. When the speculative bubble in the market burst at the beginning of 1922, public interest in shares again subsided to the point where, by 1931, virtually all the action on the domestic Shanghai exchanges was in government debt.[63]

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[59] As a rough generalization, 1 tael, a silver unit of account, equaled 1.55 Chinese silver dollars or yuan. Thomas G. Rawski (*Economic Growth in Pre-War China*, p. 162, footnote 94) calculates an annual inflation rate of 2.0 percent in China for the period between 1910 and 1936.
[60] Nantong Shi Dang'anguan et.al., *Dasheng qiye xitong dang'an xuanbian*, pp. 18-19, 93-103.
[61] Andrea McElderry, "Shanghai Securities Exchanges", in particular p. 6 and footnote 1 which gives a partial list of the government securities and government shares traded in 1917.
[62] *Shenbao*, August 1920.
[63] Andrea McElderry, "Shanghai Securities Exchanges", p. 9.

In the context of financial transparency and control, the question arises whether the new company legislation of 1904 changed the process of creating and controlling accounts in Chinese enterprises. According to the stipulations in the 1904 Company Law, corporations were required to produce a detailed company report at least once every year. The annual report had to contain a profit and loss statement, a written statement on the company's commercial situation, the exact loss or profit figure, the amount of money paid out as dividends and set aside for reserves as well as a balance of the company's assets and liabilities.[64] Most of the companies complied with all these basic formal requirements in their annual company reports.

In fact, from existing published and unpublished company records it is clear that companies like Dasheng were fulfilling these basic publication requirements even before the 1904 legislation, and as a general trend accounting practices did not change significantly in the following decades.[65] One would expect certain changes in the reporting style or at least a more detailed, lucid presentation of the accounts as a result of the introduction of new company legislation. However, a look into the Company Law from 1904 reveals that no regulations specified the way company accounts should be compiled and recorded, whereas the regulations for the annual financial statement were summarized in just two lines.[66] Even the revised Company Law from 1914 under the section 'company accounting' did not contain any further specifications for standardized bookkeeping.[67]

In short, the law required an annual company report, but no uniform system for company accounting. Modern, western-style bookkeeping methods found their way into China only in the

[64] Shangwu Yinshuguan Bianyisuo, *Da Qing Guangxu xin faling*, 'gongsi lü', 10:9a.
[65] See the annual company reports in Nantong Shi Dang'anguan, *Dasheng qiye xitong dang'an xuanbian*, covering the period between 1899 and 1930.
[66] Shangwu Yinshuguan Bianyisuo, *Da Qing Guangxu xin faling*, 'gongsi lü', 10:9a.
[67] Zhongguo Di'er Lishi Dang'anguan (ed.), *Zhang Jian nongshang zongzhang renqi jingji ziliao xuanbian*, 'gongsi tiaoli', pp. 46-47.

1930s[68], and to judge from archival evidence, most companies officially began to use a standardized, modernized accounting system only in the 1940s.[69] Nevertheless, this is not to say that traditional forms of bookkeeping were inefficient or irrational; even in large-scale industrial enterprises they obviously served their purpose. Companies maintained, at least to the outsider, a complex bookkeeping system which provided some internal control within the branches, factories, and offices.[70]

All these observations confirm William Kirby's analysis of the 1904 Company Law in relation to its very limited impact on the development of Chinese enterprises and modern industries. Only a relatively small number of enterprises registered at all, and of those registered as stockholding companies with limited liability only a few were of substantial size and actually grew into sustainable enterprises.[71] Kirby also mentions the uncertainty of how commercial disputes of corporations would be settled by the imperial court system as a factor that might have deterred investors and discouraged seeking incorporation in the first place.[72] Here we are reminded of the present situation in China where foreign investors are allowed to buy shares that are available to Chinese investors, and where legal disputes between domestic and foreign enterprises like the settlement of intellectual property rights are complicated by different legal frameworks and regimes. Due to the entrenchment of management and founder anchored in Dasheng's detailed corporate charter and a business legislation with many loopholes, disgruntled shareholders had no recourse with the government to protect their rights and interests through legal action. But

[68] For the introduction of Western-style accounting to China see Gao Zhiyu, *Zhongguo kuaiji fazhan jianshi*, pp. 84-91. From the 1920s onwards the frequent advertising of bookkeeping manuals for industrial and commercial enterprises in newspapers and journals indicates the increasing demand for modern accounting expertise.
[69] Nantong Museum (Nantong bowuyuan, hereafter NBY): E 123/1334, pp. 6-17, 19-20.
[70] Elisabeth Köll, "Controlling Modern Business in China".
[71] William C. Kirby, "China Unincorporated", p. 48.
[72] Ibid.

then, judging from the interaction between founder/director, management, and investors, most shareholders seem to have willingly accepted their silent role as along as they received their annual dividend payments.

Corporate Ownership and Control in early 20th Century China

So, why did people bother to register their companies at all? The fact that Zhang Jian registered the No.2 branch mill in Chongming with the Ministry of Commerce as early as 1905, two years before this mill was even ready to go into operation, shows that he was actively interested in having his industrial companies registered with the government.[73] Obviously the expectation that incorporation would make the company more attractive to potential investors must have played a role in his decision.

The issue of corporate ownership informs all the other contributions in this volume, yet in this paper so far we have mainly discussed structures and mechanisms of control in Chinese corporate enterprises emerging in the early 20th century. Apart from the fact that it is extremely difficult to establish the identity of the investors and the exact amounts of their investments based on Chinese accounting records, the issue of control over the enterprise was not so much determined by ownership of shares in terms of majority shareholding but rather by means of establishing institutional structures of control in combination with social networks. For the purpose of clarifying this crucial point, let us now further investigate Dasheng's shareholding in the context of incorporation and the identity of the shareholders and their investments in 1907.

The regulations in the Company Law of 1904 required, on registration of any company, a statement of how many people were providing the capital, their names and addresses, and the

[73] *Dagong Bao*, February 28, 1905, 2b.

overall amount of capital and number of shares.[74] These regulations concerned the initial setup and changes in the company's shareholding due to expansion and growth as would occur over time. Periodic shareholding inventories found in the Nantong archives are thus invaluable sources for the examination of shareholding structure and the practice of disguising personal accounts in the form of business accounts.

Holding capital under a business account was a common business practice in the late Qing dynasty. In fact, using a business name (*ji* or *hao*) for daily operations and holding property under another name in a family trust (*tang*), was a custom already adopted by merchants in the Ming dynasty.[75] The use of front men, names of ancestral halls for individual families or associated groups, and assumed names was a frequent method to conceal ownership and true identity from the government which imposed restrictions on the involvement of gentry members in business due to the official low esteem for merchants and their activities according to the rigid Confucian social hierarchy.[76] The practice of using these disguised accounts created problems in terms of establishing the identity of the owners as private persons and because of the ambiguous legal nature of these accounts in case of litigation. As Stephanie Chung points out in her analysis of a court case filed in Hong Kong in 1910, neither *tang* nor *hao* were recognized by the law as legal persons (*faren*).[77] Even if this decision was made in the context of a legal system under strong Western influence, it confirms the private nature of the *tang*, *hao*, and *ji* and the legal difficulties in case of legal action.

However, since the early 20th century, gentry investment in industrial enterprises had become a legal and approved activity, and there existed no government taxation of income or

[74] Shangwu Yinshuguan Bianyisuo, *Da Qing Guangxu xin faling*, 'gongsi lü'.
[75] David Faure, *China and Capitalism*, p.17.
[76] See Wellington K. K.Chan, *Merchants, Mandarins, and Modern Enterprise,* pp. 36-37.
[77] Stephanie Po-yin Chung, "Faren' gainian de yizhi: xifang shangfa zai Zhongguo", in particular p. 60.

capital gains which holders of these business accounts would have preferred to avoid. Reasons for concealment of identity now lay in the inappropriate use and transfer of company funds to these disguised private accounts that were difficult to detect by auditors and other shareholders.[78] The Dasheng enterprise provides a model example for this peculiar shareholding practice.

The somewhat informative 1903 shareholding inventory shows that, first of all, most of the Dasheng shares were not held under the personal name of a shareholder, but are recorded in the books under the business name of a *tang* (family trust) or *ji* (business).[79] For example, Zhang Jian's son, Zhang Xiaoruo, is recorded as holding shares under family-related account names of Zhang Xu, Zhang Liang, Zhang Wu, Zhang Chen, under the family's ancestral trust name of Zunsu *tang*, but also under the business accounts of Ruo *ji*, Xiao *ji*, and Xuyin *ji*. Of course, if we take into consideration that the founder's son was only five years old in 1903, it is clear that these were in fact Zhang Jian's own personal accounts disguising his personal assets as company assets in the records.

One has to suspect that in reality Zhang Jian was the actual owner behind many more business accounts which cannot be clearly identified from the records, because in the majority of cases the entry under the personal name of the shareholder is left blank. For example, the account listed as holding shares under the business name Fengsi *tang* was in fact the account representing the charity land in possession of Zhang Jian's own family trust. Another family trust account, Zunsu *tang*, can be identified as an account associated with Zhang Jian's family residence in Haimen county. It is only possible to gain this type of information from Zhang Jian's obituary in 1926, where the distribution of his personal assets is described; the actual relationship between shareholding account and ownership identity is not clear from the company's shareholding

[78] Dasheng's financial crisis due to this inappropriate transfer of funds in order to support ailing subsidiaries and affiliated companies is analyzed in detail in Elisabeth Köll, *From Cotton Mill to Business Empire*, pp. 158-208.

register.[80] Needless to say, also investors from outside the family circle were listed with their investments under the names of business accounts.

Even allowing for a considerable margin of error due to the fact that many of the family accounts may not have been identified, it is evident that control was not tied to majority shareholding in the Dasheng business complex. The 1907 shareholding inventory of the No.1 mill supports this argument with straightforward numbers: The capital stock of 630,000 taels was subscribed by altogether 553 shareholders. The largest single shareholder was the Salt Bureau with its investment of public funds (*gongkuan*) at a value of 23,000 taels or 4 percent of the total stock capital. Then follows a group of 17 shareholders with investments between 15,000 to 8,000 taels each which gave them ownership of 2.4 percent to 1.3 percent of the capital stock each (27 percent altogether). The remaining capital stock worth 435,000 taels (69 percent altogether) was subscribed by 535 shareholders who individually owned less than 5,000 taels each in equity. The overwhelming majority of these shareholders owned between one and five shares at 100 taels each. Accounts which can be linked to Zhang Jian's family in one form or another reveal an ownership of 40,300 taels or altogether 6.4 per cent of the total capital stock; a modest percentage even if it was higher than that of the largest single shareholder.[81] This shareholding pattern of a large number of minority shareholders, mostly cotton yarn traders and local businessmen from Nantong as well as members of the founder-director's kinship and social networks, was common among Chinese companies in the early 20th century.

Another significant aspect of Chinese companies' incorporation is whether the new Company Law and its requirements like shareholder meetings really led to an empowerment of the shareholders with a simultaneous decrease in personal influence of the company founders and

[79] NSD: B 402-111-1.
[80] *Nantong bao tekan*, October 29, 1926.

directors. The minutes of the meetings prove that Dasheng shareholders were only vaguely familiar with the stipulations of the new Company Law and the implications that limited liability brought for the enterprise and for their personal involvement with regard to rights and obligations. Nevertheless, it appears that there was a general consensus among those shareholders who voiced their opinion at the first meeting in 1907, that the law supported their claims as owners of the company and provided them with a tool to control the corporate management — or so they thought.

In this spirit, shareholders used their newly won influence to protest for the first time publicly against the reduction of the company's profit caused by Dasheng's generous donations to Zhang Jian's welfare and educational projects.[82] Again, Zheng Xiaoxu, as a concerned and critical shareholder but with no financial leverage in form of majority shareholding, expressed his opinion in an outspoken way:

> Subsidies spent on the costs of the Normal School ... are the virtues of the general manager [i.e. Zhang Jian] himself and have nothing to do with the company. Now in accordance with the law, we have to discuss separately new regulations for the allocation of bonuses.[83]

Obviously, Zheng Xiaoxu interpreted the law as a new protective mechanism for the benefit of shareholders against arbitrary bonus allocation to managers and fund distribution by the managing director. However, since Zhang Jian as the founder and managing director of the Dasheng mills had never been forced to seek appointment by a director's board but had automatically slipped into this position when transforming Dasheng from a government-sponsored into a private enterprise, Zheng Xiaoxu's criticism could not endanger Zhang Jian's position in any way.

In fact, the 1907 shareholder report is an excellent document revealing Zhang Jian's authoritarian management of Dasheng and the simultaneous ineffectiveness of the shareholders'

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[81] Numbers are extracted from NSD: B 402-111-2.
[82] NSD: B 402-111-445, 20b.
[83] Ibid.

criticism and demands for change. The 1907 document, in recognition of the No.1 mill's incorporation, contains eight clauses composed by Zhang Jian as the managing director for the regulation of issues such as managing working capital, reserves, and the election of members of the board.[84] Interestingly enough, there is no regulation for the election of the managing director. Reading his response to shareholders' complaints in the context of the discussions at the meeting, his words are defensive, and instead of addressing some of the shareholders' complaints, he appeals to their integrity and moral conscience. Several other shareholders continued to voice questions in regard to bonus allocation and salaries for the managers; Zhang Jian never replied in person but had other members of the board explain Dasheng's, i.e. his personal, position.

The founder/director's control over management, shareholders, and the flow of funds between company and personal accounts disguised as business accounts would not have been possible without certain institutional mechanisms. Dasheng's central accounts office (*zhangfang*) in Shanghai served as clearing house for the corporation whose head accountant was accountable only to Zhang Jian but not to the shareholders. This central accounts office, originally an institution in the traditional silk industry and widely used in large family firms, was adopted by many of the new incorporated enterprises in early 20th century China. It conveniently concentrated managerial and financial power over the enterprise, including family and social networks, in one office under the ultimate control of the business founder/manager but still remained outside the formal structure of the corporation.[85]

A look into Dasheng's corporate charter, a lengthy document written by Zhang Jian in a highly autocratic and paternalistic fashion in 1897, shows how he designed the entrenched role

[84] Ibid., 9a-12b.
[85] On the role of the accounting office see Elisabeth Köll, *From Cotton Mill to Business Empire*, pp. 136-46.

of the managers who were tied into a strict company hierarchy confirming his own personal and absolute control. The lack of accountability and transparency facilitated Zhang Jian's transfer of company funds to his private accounts, risky inter-company loans to financially unstable subsidiaries in the form of deposits instead of equity without approval by the shareholders. These practices together with problems following the WWI economic boom such as rising raw cotton prices, decreasing cotton yarn prices, a dangerous degree of debt due to expansion and business fragmentation led Dasheng close to bankruptcy in 1922.[86] Modern banks like the Shanghai Savings and Commercial Bank stepped in as major creditors and imposed various financial and managerial reforms, including the first external audit ever and Zhang Jian's removal as director, after taking over Dasheng in a bank consortium in 1924. However, these attempts for greater accountability and transparency reflected above all the financial interests of the banks and were not motivated by general concerns for the rights of Dasheng's shareholders and the protection of their investments in the company. In fact, as shareholders in an incorporated Chinese enterprise their level of power and control did not improve over the next decades.

Conclusion: Characteristics of Chinese Corporate Ownership Past and Present

In addition to exploring the incorporation process in late Qing China, we have tried, in this paper, to shed some light on the relationship between control and ownership in Chinese corporate enterprises. Historians have shown that in Chinese businesses under strong family influence the control of equity was rarely separated from the control of management, and that succession disputes were of great significance for the continuity of the company.[87] We argue that the same characteristics apply to corporate enterprises: although the Dasheng No.1 Cotton Mill had adopted the legal form of a

[86] Ibid., pp.158-208.
[87] David Faure, "The Control of Equity in Chinese Firms"; Chi-cheung Choi, "Competition among Brothers".

limited liability company as early as 1907, it was not managed in such a way as to allow the shareholders to curtail the power of the founder-director. Like the famous China Match Company, a large joint-stock limited liability company founded and controlled by Liu Hongsheng and his family without majority shareholding, the newly incorporated companies combined traditional business practices and institutions rooted in Chinese family business with modern corporate structures to successfully gain and maintain control.[88] Paradoxically, even the issue of succession applies to some extent to Chinese corporations because members of the Zhang family continued to be involved in the financial and managerial organization of the company, even as a hierarchy of salaried executives came into existence to manage different parts of the business, which created an additional set of problems for Dasheng and its shareholders.

Nevertheless, the new code clearly brought Chinese business structures more in line with global corporate practice — from creation of limited liability to the attempted enactment of transparency and accounting requirements meant to protect the rights of shareholders. In many ways, it resembles corporate governance legislation that is being adopted today in the world's emerging markets. Then, as now, the hope was to create a capital market to support the development of domestic business enterprise. In this respect the 1904 code was a visionary document. Why, then, was its effect so limited?

One explanation is cultural. Until recently, China business historians have tried to capture the essence of Chinese enterprises by focusing on personal relations, in particular in family businesses. Frequently, a business organization has been more or less reduced to the interpretation of being a network, often in the context of a search for the 'spirit of Chinese capitalism'.[89] Scholars have argued that "kinship and collegiality in China play roles analogous to those played by law and

[88] On the China Match Company see Sherman Cochran, *Encountering Chinese Networks*, pp. 147-76.
[89] See, for example, Gary G. Hamilton and Cheng-shu Kao, "The Institutional Foundations of Chinese Business".

individuality in the West", and the growth of the Chinese economy has been explained with increased economic opportunities and the simultaneous expansion of networks.[90] Of course, business by its nature always involves networks. Considering the emergence of corporate ownership in Chinese companies in the early 20th century, the real problem lies in the conflict of interest between the founder-director and his shareholders, and divided loyalties between people whose positions relied either upon the authority of the founder or the holding of shares.

Another explanation is institutional and to some extent historical. The top-down approach to creating a robust corporate sector in China around the turn of the last century overlooked the public capital markets as an important disciplinary and motivational institution for corporate managers. One cannot explore the development of early corporations in China without considering the serious effects of the boom and bust cycles in the Chinese capital markets over this same period. In some sense, they are two sides of the same coin — one cannot exist meaningfully without the other. Without an active market for corporate control, i.e. a setting in which shareholders can fire the management, it is impossible to build public trust in equity investment. On the other hand, without the existence of a liquid capital market, managers have no motivation to relinquish control. Without a share market to provide new capital — or at least a market that would allow entrepreneurs to diversify their investment holdings, there is little to induce them to accept shareholder rule.

It is easy to argue in hindsight that the 1904 legislation was doomed from the start because it was not accompanied by a regulatory framework for the capital markets. Another possibility may exist, however. Perhaps the crashes of 1883 and 1922 were simply accidents of history. Perhaps corporate capitalism itself is a more fragile phenomenon than most believers in the invisible hand

[90] Gary G. Hamilton, "The Organizational Foundations of Western and Chinese Commerce", in particular pp. 43 (quote), 53-54.

would like to believe. Some visionary thinkers in the 1870s set China on a vigorous course to development of share capitalism that involved its own blend of government patronage and state ownership. Might this new sector have matured and developed along its own course, had the share markets not collapsed? Why did American markets survive the era of crony capitalism and Chinese markets succumb? Perhaps the American markets were just lucky. American markets experienced another crisis in public confidence following the boom and crash of the 1920s. Had the Securities and Exchange Commission not taken steps to restore public confidence, might the U.S. markets have gone the same way as the Chinese exchanges in 1922?

The importance of history in the analysis of markets is that history contains the record of many alternative possible paths that today's markets might have taken. Specific historical circumstances and personalities rather than economic theory may at times better explain why some markets succeed while others — even those built from the same "genetic code" — ultimately fail. This is why China's first foray into capitalism a century ago is immediately relevant to the development of world capital markets today. Governments around the globe are currently eagerly adopting new codes of corporate governance. Russia and China are both engaged in pushing towards greater corporate transparency and shareholder accountability – both leading themes in the Chinese Company Act of 1904. This top-down approach is certainly laudable, for these are most likely necessary conditions for creating a well-functioning capital market. The early Chinese experience, however, suggests that they are not necessarily sufficient. The development of Chinese domestic stock markets suffered from a series of crashes that caused sustained mistrust in share trading. Whether these crashes and consequent shifts in investor opinion can be avoided through market regulation is an open but important question.

Finally, our historical analysis has serious implications for the transformation of property rights in the context of shareholding systems emerging in China today. This process is particularly significant for China's rural economy where the state allows some collective and private, i.e. family or household, enterprises, to turn into shareholding companies while maintaining their property rights in these companies. However, what to Western observers might look like solid incorporation with protected ownership of shares, is called "property rights subversion" by scholars working on the transition process.[91] As Nan Lin and Chih-jou Chen document for the North China countryside, the local elites in control of these shareholding enterprises divert the power away from the state and local government but also from the worker stockholders and transfer the property rights into their owns hands.[92] Similar to the trajectory of corporations founded at the turn of the 20th century, we witness a "convergence of the corporate elite leaders and local elite family networks"[93], i.e. the convergence of political power by party cadres or government officials and social power by influential families with no regard for shareholder rights at the turn of the 21st century.

For China today, on the course of vigorous economic development, shareholder rights and protections are of immediate importance. Poor disclosure and weak regulations are well-known and persistent problems of companies and the stock market in contemporary China, and new legislation with respect to corporate practice is a work in progress. Tumultuous shareholder meetings with protest by angry minority shareholders are not unheard of. The question is whether the visible hand of the state will succeed in creating structures of capitalist ownership with more success this time.

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[91] Lin, Nan and Chih-Jou Jay Chen. "Local Elites as Officials and Owners", quote p. 168. See also the other chapters on enterprise reform and property rights in Jean C. Oi and Andrew G. Walder, *Property Rights and Economic Reform in China*.
[92] Ibid., pp. 146, 168-69.
[93] Ibid., p. 169.

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NFB (Nantong Textile Museum (Nantong fangzhi bowuguan):
doc.182, share certificate from 1903.
doc. 193, share certificate from 1915.
doc. 198, share certificate from 1919.
doc. 247, share certificate from 1897.

NSD (Nantong Municipal Archives (Nantong shi dang'anguan)):
B 402-111-1, Dasheng diyi fangzhi gongsi laogu, guben dipu (Copy of inventory of old shares, Dasheng No.1 Textile Company), 1898-1903.
B 402-111-2, guben cunkuan (sharecapital), 1907.
B 402-111-445, Tongzhou Dasheng shachang diyici gudong huiyi shilu (Record of the first shareholder meeting of the Dasheng Cotton Mill), 1907.

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Equal-Weighted Index of Chinese Stocks in Shanghai 1882-1887

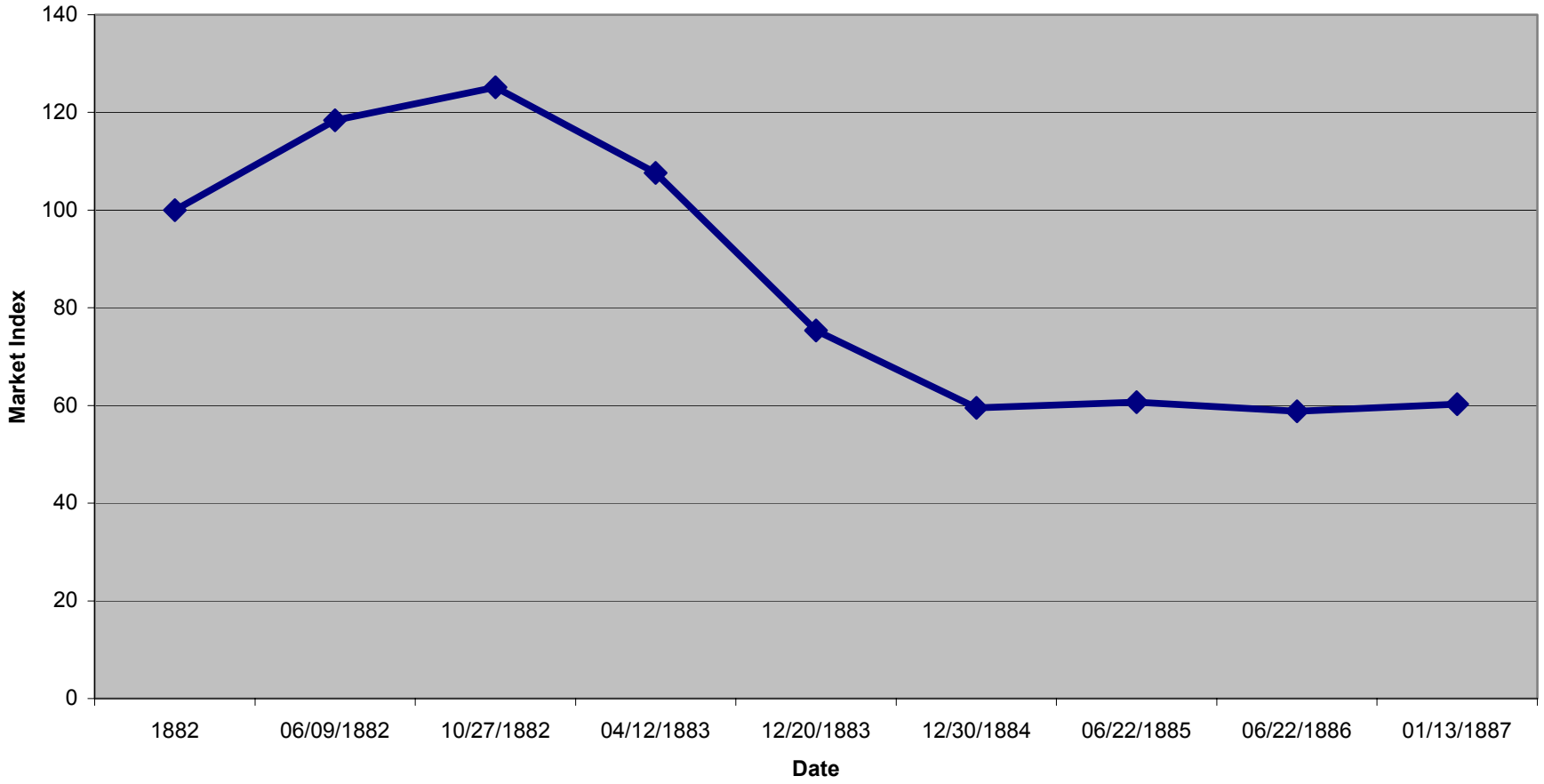

Figure 1: Equal-Weighted Index of Chinese Stocks in Shanghai, 1882-1887. (Source: Goetzmann, Ukhov, and Zhu, 2001). The figure represents an equal-weighted index of the capital appreciation of 35 shares of companies listed in the Chinese language newspaper *Shenbao* published in Shanghai.