

Risk Behavior and Performance in Chinese Private Firms: From Regulatory Impact to Owner-Managers

**Chuanyin Xie
The University of Tampa**

Given the background that private firms in China were risk taking in once an unfavorable regulatory environment, this study examines their risk behavior and performance implications in a new era when the “invisible hand” begins to exert its influence. In the new era, private firms have choices as to whether or not to take risk, so risk behavior needs to be examined beyond the regulatory impact. I shift the research attention to owner-managers who make risk decisions. I argue that owner-managers’ characteristics, including who they are, why they run their own business, and to what degree they control their business, have direct implications for firm risk behavior. These characteristics can also affect the relationship between risk behavior and performance.

INTRODUCTION

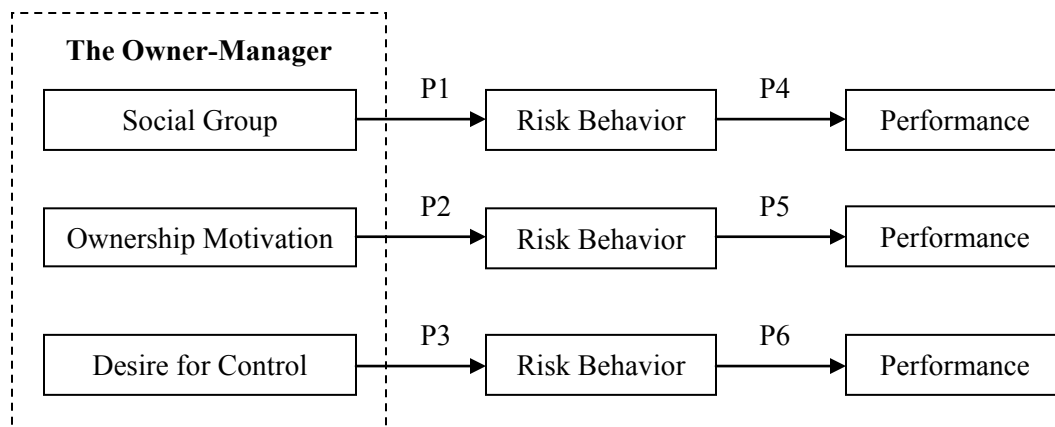
Risk is an important concept in organizations (Miller and Leiblein, 1996; Sitkin and Pablo, 1992). Risk taking has important implications for firm survival and growth (Shapira, 1995). Though risk behavior has been extensively studied in the West, it is still relatively unexplored in a context of transitional economies such as China. Probably, risk research is not important when an economy is dominated by the “iron fist” control. State-owned enterprises (SOEs), a dominant form of business organization, largely serve as manufacturing machines taking orders from the state, so risk almost does not exist from a market perspective. Private firms, often treated as a “fringe group”, have little choice but to take risk because of poorly protected property rights and hostile regulatory attitudes toward them. When the economic transition reaches a point at which the “invisible hand” begins to exert its influence, risk research would become meaningful. Risk behavior such as risk taking can be based on managerial choice, instead of either being unnecessary (the case of SOEs) or indispensable (the case of private firms).

China is the world’s largest transitional economy. Private business has been one main force driving its economic growth since 1980s. China’s economic transition has been subject to two opposing forces: the “iron fist” control and the “invisible hand” control which “co-exist, compete, and counteract” (Tan, 2005). The early phase of economic transition, dominated by the “iron fist” control, presented an unfavorable environment for private firms. In response to regulatory hostility, they were risk taking (Tan, 1996). The struggle between the two forces has finally led to a more market-based, the “invisible hand” control model, though “uniquely Chinese” (Tan, 2005), because of undisputed inefficiency of the “iron fist” control. The regulatory regime has become more favorable to private business (IFC, 2000; Tan, 2005). Laws and regulations have been established to protect property rights. China’s entry into WTO in 2002 has strengthened its obligation of respecting ownership of private properties. As a result, the private sector has seen a fast growth in recent years (He, 2009).

In a market-based economy, the “invisible hand” guides business activities through the combination of self-interest, private ownership, and competition. The self-interest nature of private ownership motivates individuals to allocate resources in pursuit of profitable opportunities (Gibb and Li, 2003). The competitive nature of market makes resource allocation risky due to uncertainty. As China’s economy becomes more market-based (I label as the “competitive phase” of its economic transition), private firms, with their ownership rights being recognized, face new opportunities and challenges. Are they willing to commit resources toward activities with uncertain outcomes? No research has directly addressed this question. This study attempts to fill the gap.

In China’s transitional economy, risk behavior in private firms has been studied from a regulatory perspective (Tan, 1996, 2001) when the “iron fist” was relatively strong. In the competitive phase characterized by the relatively strong “invisible hand”, the impact from the regulatory regime would decrease. In this study, I shift the focus from the regulatory impact to own-managers’ influence on firm risk behavior. In China, three questions related to owner-managers have received research attention: who they are (social groups), why they run their own business (ownership motivation), and to what degree they control their business (business control). I investigate how the characteristics of owner-managers, including their social groups, ownership motivation, and business control, might affect firm risk behavior and how risk behavior might affect performance. I put owner-managers in a context of economic transition to examine their impact. Figure 1 depicts the research model.

**FIGURE 1
RESEARCH MODEL**



Major Sources of Information

This study uses several sources of information. A major source of information is research reports made by He (2009). Based on seven large scale multiple-industry surveys conducted by five Chinese institutions during 1993-2006, He reported information on owners’ backgrounds, ownership motivation, and governance structures in Chinese private firms. Other sources of information include two nation-wide surveys on Chinese private firms, conducted by Asian Development Bank (ADB, 2003) and International Finance Corporation (IFC, 2000) respectively. I also use information provided by Global Entrepreneurship Monitor Reports (GEM, 2002, 2007, 2009) on a global basis.

ECONOMIC TRANSITION AND BUSINESS OWNERSHIP

China’s economic transition makes private business ownership possible. A private firm is defined as “a for-profit organization that is owned by individuals and employs more than eight people” (IFC, 2000). In this section, I explore the two phases of economic transition and how they affect owner-managers’

characteristics. In the entrepreneurship literature, owner-managers are often referred to as entrepreneurs, so I use “owner-managers” and “entrepreneurs” interchangeably.

Economic Transition

As a transitional economy, China shares the following basic features: low-income, rapid growth, underdeveloped legal systems, inadequate protection of private property rights, and market imperfections (Hoskisson et al, 2000). During the early phase of economic transition, all these features were salient. SOEs dominated the whole economy. Their inefficiency, along with the inefficiency of the centrally planned system, created serious shortages in most markets, information and resource asymmetries (Peng, 2001), and “institutional holes” (Yang, 2004). Private firms were presented with both opportunities and challenges. On the one hand, they could take advantage of the inefficiencies of SOEs and the planned system and exploit numerous market niches or fill institutional gaps. On the other hand, they had to deal with adverse situations brought about by the regulatory regime, including political threats and restricted access to resources. These opportunities and challenges shaped private firms’ behaviors: using *guanxi* (relationships) or “red hat” (a strategy used to disguise their private ownership by registering as a collectively-owned enterprise) as substitutes for formal institutional support (Xin and Pearce, 1996), pursuing short-term profitability and reluctant to make long-term investments (Nee, 1992), and acting proactively to identify and occupy market niches (Peng, 2001).

China’s economy has now become more market-oriented. Accompanying the establishment of market-based rules is intensified competition. For private firms, they not only compete against each other, but also confront more formidable competitors: domestic SOEs and foreign firms. SOEs have gradually been weaned from their dependence upon state budget allocations during the economic transition. With a separation from the government and clarified rights and responsibilities, SOEs have greatly transformed themselves. Endowed with abundant resources and oriented toward the market, they are now globally competitive (Ralston et al, 2006). Foreign firms have rushed to China in response to the “opening-up to the outside world” policy and preferential treatments. Because of its consistency in implementing the policy and its huge internal market, China has now become the largest foreign direct investment recipient (Chang and Xu, 2008) and the most appealing host for investments (UNCTAD, 2009) in the world. As Stuttard (2000) commented, “everyone is here” in China – Americans, Europeans, Japanese, and others – “whether it be automotive, consumer products, electricity generation, electronics, or new technology.” Foreign firms are often equipped with advanced technologies, know-how, and management and marketing skills, as well as plentiful financial resources (Ralston et al, 2006).

Domestic SOEs and foreign firms have put private firms at a competitive disadvantage. Reports by IFC (2000) and ADB (2003) indicate that Chinese private firms are resource-constrained. They have limited access to formal sources of finance, poor availability of information, and difficulties in hiring highly qualified employees. In addition, many private firms have management-related problems such as nontransparent and inconsistent implementation of policies.

Business Ownership

Why do people own and run a private business? According to GEM Report (2002), individuals perform entrepreneurial activities for two major reasons: pursuing an opportunity (opportunity motivated) or seeing entrepreneurship as their “last resort” (necessity motivated). More than 97% of entrepreneurs can be identified as either opportunity or necessity motivated. Opportunity entrepreneurs run a business “as one of several possible career options”. Necessity entrepreneurs are forced to run their own business because “all other options for work are either absent or unsatisfactory”. In this study, I use the “opportunity vs. necessity” categorization to distinguish individuals’ motivation for business ownership. He’s (2009) survey reports suggest that in the early phase of China’s economic transition, a majority of entrepreneurs were necessity-based. Continued economic transition has seen more opportunity-motivated entrepreneurs.

Who run private firms in China? Based on He’s (2009) survey reports, private business owners come from five social groups: individual household business owners, industrial workers, peasants, former

cadres, and professionals. I regroup these individuals into three broad categories: blue-collar, former cadres, and professionals. The blue-collar group represents private entrepreneurs from a lower social class. Many of them lived in poor rural areas or lost their job from poorly-run SOEs before starting their own business. Their entrepreneurial career is more often motivated by necessity than opportunity. Blue-collar are close to craftsman entrepreneurs described by Smith and Miner (1983). They are characterized by “narrowness in education and training”, “low social awareness” and “a limited time orientation”. Former cadres were government officials or SOE managers. They gained social and political capital and owned business networks during their employment. Compared with blue-collar, former cadres are less necessity-driven when running their own business. Professionals largely use their own specialized skills and knowledge to develop new products or services and fill unserved markets. They tend to be well-educated and have options for an employment career. Like cadre entrepreneurs, professional entrepreneurs are often driven by opportunity.

Ownership Form and Control

In Chinese private firms, ownership takes different forms, including proprietorship, partnership, and limited liability. He’s (2009) survey reports show that proprietorship was a dominant form of business ownership during early 1990s, but it has been declining since then. In contrast, the number of private firms adopting a limited liability form was low in early times, but has gradually been increasing since then. The proportion of partnership among the three ownership forms has been remaining low. The increased adoption of the limited liability form during the economic transition reflects to some extent the improvement of the regulatory regime and the progress of marketization. This ownership form is aimed at achieving professionalism in business management. The three ownership forms by themselves are clear, but ownership in private firms was not defined well in the early phase of market transition. Because of inadequate protection of private property rights, private ownership had high property risk (IFC, 2000). In order to keep their private firms safe, owner-managers put on a “red hat” to cover up the private nature of their firms (Chen, 2007). “Red hat” existed throughout 1980s and 1990s.

Ownership and control can be aligned or separated. Survey reports (ADB, 2003; IFC, 2000) indicate that most private firms in China are managed by owners, suggesting an alignment between ownership and control. In addition, ownership concentration is often high. The major decision makers tend to be owner-managers. However, there is a small percentage of private firms whose board of directors has begun to exercise influence.

In summary, China is transitioning from a more planned economy to a more market-based economy. The two phases of economic transition present different characteristics, which are summarized in Table 1.

RISK BEHAVIOR IN A COMPETITIVE ENVIRONMENT

As argued earlier, risk behavior in Chinese private firms needs to be examined beyond the regulatory impact in the new competitive era. Firm risk behavior is managerial choice of projects with uncertain outcomes (Desai, 2008; Li and Tang, 2010). Given that most private firms in China are small and managed by owners (ADB, 2003; IFC, 2000), it is reasonable to assume that owner-managers play a key role in their firms’ risk behavior. In this section, I investigate how owner-managers’ characteristics such as their social groups, ownership motivation, and business control might affect firm risk behavior.

Social Groups and Risk Behavior

In the early phase of economic transition, most private firms in China were started by people from lower social classes such as farmers and industrial workers (He, 2009). The former planned economy left numerous unfilled market niches yet to be exploited. Those who were bold enough ventured into an uncertain world with a hope of “earning money” or “getting rich”. They were often “pushed” into self-employment due to poor living conditions or job losses. Prospects for making money also attracted cadres such as government officials and SOE managers. A few of them were motivated to quit their job and “pulled” into the uncertain but exciting private sector. With privileges in accessing information and

mobilizing resources, former cadres were in a good position to exploit arbitrage opportunities generated by the old system. Compared with the blue-collar and cadre groups, the group of professional entrepreneurs was relatively small in the early phase.

TABLE 1
ECONOMIC TRANSITION, BUSINESS OWNERSHIP AND CONTROL

	Economic Transition	
	The Early Phase	The Competitive Phase
Environment		
Characteristics	Market imperfection: High Competition: Low Private property protection: Low	Market imperfection: Decreasing Competition: Increasing Private property protection: Increasing
Implications	Opportunity: Unfilled market niches Threat: Regulatory	Opportunity: Fewer market niches Threat: Competition
Business Ownership		
Who (Social groups)	Blue-collars: High Former cadres: Medium Professionals: Low	Blue-collars: Decreasing Former cadres: Decreasing Professionals: Increasing
Why (Ownership Motivation)	Opportunity-driven: Low Necessity-driven: High	Opportunity-driven: Increasing Necessity-driven: Decreasing
Business Control		
Ownership Forms	Proprietorship: High Partnership: Low Limited liability: Low “Red hat”	Proprietorship: Decreasing Partnership: Low Limited liability: Increasing
Control	Owner-manager: High Board of directors: Low	Owner-manager: High, but decreasing Board of directors: Low, but increasing

After more than two decades of economic transition, China has become more market-based. First, competition has heated up in most industries. Compared with SOEs and foreign firms, private firms are often poor in resources. Previously, they were able to take advantage of former SOEs’ inefficiency, but now SOEs have become formidable competitors (Ralston et al, 2006). Second, a large number of industries have become more or less mature during many years of development. Unfilled market niches do not exist as widely as before. Recent GEM Report (2009) shows that entrepreneurs in China have perceived fewer opportunities in the future.

The economic transition has also rendered private firms’ strategies less effective. In the early phase, private firms largely used guanxi, quick response, and flexibility to compete and survive. Guthrie (1998) found that the significance of guanxi began to decline in China’s economic activities during 1990s. Li and colleagues’ study (2008) provides further support for the declining role of guanxi: increased competition reduced the role of managerial networks in China. Probably, private firms will continue to rely on quick response and flexibility for survival when facing powerful SOEs and foreign firms (Ralston et al, 2006). I argue that quick response and flexibility are less effective in generating profits in the new competitive era, given that profitable opportunities are becoming fewer and are more difficult to exploit.

Among the three groups of entrepreneurs, the blue-collars could be in the most disadvantageous position in the competitive environment. They were able to exploit shortages in many markets previously due to their courage, not necessarily their competitive skills. In the competitive phase, however, skills are

becoming important. Because of their limited education and short-term orientation, blue-collar workers would be “rigid in nature” (Smith and Miner, 1983). As a result, they are less likely to develop competitive skills for the new era. He’s (2009) survey reports show that the proportion of blue-collar entrepreneurs has already decreased recently. Cadre entrepreneurs succeeded because they were able to exploit arbitrage opportunities during the early phase. Equipped with social and political capital, they are likely to be more adaptive than blue-collar workers during the economic transition. However, cadre entrepreneurs compete on relational and informational advantages. This “dominant logic” (Prahalad and Bettis, 1986) may hardly change. Based on He’s (2009) survey reports, the number of cadre entrepreneurs would decline as marketization continues.

Compared with blue-collar workers and former cadres, professionals are more likely to have the right skills to deal with competition. Their strengths are less based on exploiting failures of the old economic system, but more on their professional knowledge and skills related to technologies, products, or markets. According to He’s (2009) survey reports, the proportion of professional entrepreneurs has been increasing recently, suggesting that professionals may be more willing to take business risk in the new era. The current environment in China also seems to favor professional entrepreneurs. For example, the Chinese government has established large incubation programs (Lalkaka, 2002) and science and technology parks (Watkins-Mathys and Foster, 2006) to facilitate technology entrepreneurship and innovation. Clearly, professionals would benefit more from those programs than non-professionals.

The competitive era seems to pose more challenges to non-professional entrepreneurs because of their less effective skills. Skills contribute to perceived control over behavioral activities. Low perceived control is less likely to initiate a behavior (Ajzen, 1991). Scholars in the field of entrepreneurship have similar arguments. According to McClelland (1961), entrepreneurs do not take risk deliberately. Instead, they pursue initiatives that are achievable and controllable, using their own skills to realize a profit (Cunningham and Lischero 1991). Thus, I make the following proposition:

Proposition 1: Private firms whose owner-managers are professionals are more likely to commit resources to risky projects than those whose owner-managers are not professionals.

Ownership Motivation and Risk Behavior

Entrepreneurs are often opportunity or necessity motivated to own and run a business. Ownership motivation may affect the direction and nature of their existing and future businesses (GEM, 2002). Opportunity entrepreneurs choose to run their own business out of “a burning desire”, not because they have no other choices (Bailey, 2002). GEM Report (2002) shows that opportunity entrepreneurs are more likely to expect business growth and new market creation than necessity entrepreneurs. GEM Report (2007) reveals that high expectation and high growth entrepreneurs are more likely to display entrepreneurial attitude and behavior. The different expectations between opportunity and necessity entrepreneurs may also be explained by different opportunity costs they face when choosing an entrepreneurial career. Compared with necessity entrepreneurs, opportunity entrepreneurs incur higher opportunity cost when they switch from salaried employment to more uncertain self-employment. Therefore, they are likely to pursue a “higher upside potential” (GEM, 2007). High aspirations were found to have positive impact on risk taking (Bromiley, 1991).

In the Chinese context, cadre and professional entrepreneurs are more likely to be opportunity-driven than their counterparts in the blue-collar group (He, 2009). They incurred high opportunity costs when leaving their salaried positions, so they have a reason to set high goals, which would prompt them to commit resources to projects with “higher upside potential”. In addition, cadre and professional entrepreneurs tend to be better educated than blue-collar entrepreneurs. GEM Report (2007) shows that education has positive impact on entrepreneurs’ aspirations in both high and low income economies. From the education point of view, the two groups of entrepreneurs would set higher aspirational goals than the blue-collar group.

Necessity may also encourage people to take risk. Based on prospect theory (Kahneman and Tversky, 1979), when people are in a loss situation, they tend to be risk taking. Blue-collar entrepreneurs in China seem to fit this situation. Given their limited education and skills, however, they can be more “rigid” (Smith and Miner, 1983) than adaptive in a competitive environment, so innovative behaviors are less likely. Cadres and professionals may also be driven by necessity, such as unemployment or dissatisfaction with current jobs, to run a business. If they are forced to be self-employed, they would hope “a job comes along in the meantime” (Bailey, 2002). This hope may become strong in a competitive environment where opportunities are hard to identify and exploit. As a result, they would be less interested in pursuing risky activities.

Proposition 2: Private firms whose owner-managers are motivated by opportunity are more likely to commit resources to risky projects than those whose owner-managers are motivated by necessity.

Business Control and Risk Behavior

As China’s economic transition reaches the competitive phase, ownership rights are being recognized. Ownership makes it possible for owner-managers to control their business. The relationship between ownership and control has been extensively studied, particularly from an agency perspective (Fama and Jensen, 1983). Scholars have emphasized the role of ownership and control alignment in innovative activities with uncertain outcomes (Francis and Smith, 1995; Wright et al, 2000), but Chandler (1990) advocated professional management of the firm. Survey reports (ADB, 2003; IFC, 2000) suggest that many owner-managers in Chinese private firms are not willing to cede control over their business.

Owner-managers’ desire for business control often leads to concentrated ownership. Though ownership can provide strong incentives that may encourage risk taking and innovation (Wright et al, 2000), its effect on risk taking may be limited to the extent that owner-managers do not bear too much risk. Risk bearing occurs when managers’ wealth is tied to firm performance (Wiseman & Gomez-Mejia, 1998). Research suggests that ownership, as an incentive device, makes managers risk averse because they bear risk resulting from their stake in the firm (Beatty and Zajac, 1994; Ortega-Argiles et al, 2005). In a Chinese context, Kao (1993) argued that Chinese family firms, whose owner-managers often have a high desire for control, tend to be risk averse. Carney and Gedajlovic (2002) found that Hong Kong-based firms with coupled ownership and control were more likely to pursue short-term profitability and less likely to invest in capital-intensive projects.

If owner-managers’ desire for control is low, ownership is likely to be less concentrated and risk bearing can thus decrease. The reduction of risk bearing may be particularly important for entrepreneurial activities in a competitive environment. Competition increases uncertainty of investment projects. Risk sharing could increase owner-managers’ willingness to launch risky projects. A diffuse ownership structure also help ease resource constraints through resource pooling from different owners, providing conditions for risk taking.

Proposition 3: Private firms whose owner-managers have high desire for control are less likely to commit resources to risky projects than those whose owner-managers have low desire for control.

PERFORMANCE IMPLICATIONS

Risk taking has direct implications for firm performance, causing performance variations (Palmer and Wiseman, 1999) or negative outcomes (Naldi et al, 2007). In the Chinese context, research on the relationship between risk taking and firm performance is limited. Two studies, conducted in China’s transitional economy characterized by uncertainty, provide implications for this relationship. Tan and Litschert’s (1994) study found that defensive strategies led to higher overall performance than proactive, future-oriented, and risky strategies. When using Chinese private firms and SOEs as a sample, Tang and

colleagues (2007) found that entrepreneurial orientation, reflected by innovativeness, proactiveness, and risk taking, had positive impact on performance. The results of the two studies appear to be conflicting, indicating that risk taking may have both positive and negative relationships with firm performance.

In private firms, owner-managers' industry and technical skills were found to have positive impact on firm growth (Baum et al, 2001). GEM Report (2007) suggests that right skills are important for entrepreneurial success. It may be argued that firm risk taking is more likely to have positive performance implications when owner-managers have right skills. The early phase of economic transition in China was characterized by market shortages and imperfections. If individuals were willing to take risk to be private entrepreneurs, they were always able to find profitable opportunities and had chance to earn more money than those in SOEs. "It's financially better to wield a barber's razor than a surgeon's scalpel" and "It's financially better to sell tea-boiled eggs than to make guided missiles" (Young, 1991). Risk taking paid off because of their courage, not necessarily their sophisticated skills.

Those situations do not seem to exist anymore in the competitive phase. It's not likely that blue-collar are able to use courage and gut feelings to make money; it's also less likely that cadre entrepreneurs can make their business successful only based on their social and political connections. In the competitive environment, competitive resources and capabilities could be more effective than networks and relationships (Peng, 2003). As argued earlier, blue-collar and cadre entrepreneurs may not have right skills for the competitive environment, so their ability to choose and control risky projects would be questionable. If they do take the risk, they would not be as lucky as they were in the early phase.

Proposition 4: Committing resources to risky projects will be more likely to lead to upside outcomes in private firms whose owner-managers are professionals than in those whose owner-managers are not professionals.

GEM Report (2002) suggests that opportunity entrepreneurs can be more optimistic than necessity entrepreneurs when running their business. Based on Brown and Marshall (2001), there is a curvilinear relationship between optimism and performance across many different activities. When individuals are low in optimism, they often achieve low performance because they tend to "lack motivation" and "focus on negative information" (Hmieleski and Baron, 2009). Performance increases with optimism but decreases when optimism passes a certain point. The reason is that overoptimistic individuals often set unrealistic goals. Optimism leads to best performance when it is moderate. Opportunity entrepreneurs tend to have high expectations (GEM, 2002), which may lead to overoptimism when initiating a new business, but they would become more realistic when running their business (GEM, 2007). I argue that in a context of China, opportunity entrepreneurs are not likely to be highly unrealistic because of their resource constraints.

When necessity-based people choose to be self-employed, they have no other choices. Self employment may be "against their will", so they are less likely to have growth intentions and more likely to use business as an income substitute and employ only themselves (Bailey, 2002), indicating low optimism. They are less prepared to take risky actions than opportunity entrepreneurs. If they do take risk, however, their risk taking can be more like gambling. They already lost their job, so they would feel that they have nothing else to lose. They could be tempted to pursue high risky projects with expectations of quick returns. For gamblers, success can only be left to chance.

Proposition 5: Committing resources to risky projects will be more likely to lead to upside outcomes in private firms whose owner-managers are motivated by opportunity than in those whose owner-managers are motivated by necessity.

When owner-managers' desire for business control is high, they often make all important decisions by themselves. Internal and external monitoring is less likely and less effective. Opportunistic investments can be made on the basis of "animal spirits" or "gut feel" and "without regard to internal and external processes of accountability" (Carney, 2005). Such a decision making process is flawed and less

successful. Naldi and colleagues (2007) found that risk taking was negatively related to performance in family-controlled firms.

If owner-managers have a low desire to control their business, their personal influence would decrease. Firm risk behavior can be less likely to reflect individual owners' will and value and monitoring from both internal and external environments is more possible. The improved decision making process helps the firm to commit resources to right projects. Recently, an increasing number of Chinese private firms have adopted a limited liability form of ownership (He, 2009). In a limited liability company, ownership is spread and a board of directors is installed. As a result, the company could avoid "animal spirits" and "gut feel" in risky decisions. Cooke (2008) studied 30 top performing Chinese private firms and found that family-owned firms have moved away from family control to professional management. Therefore, I propose the following:

Proposition 6: Committing resources to risky projects will be less likely to lead to upside outcomes in private firms whose owner-managers have high desire for control than in those whose owner-managers have low desire for control.

DISCUSSION

China's economic transition has made it possible to own a private business. Given the background that private firms were risk taking in the early phase of economic transition, this study investigates their risk behavior and performance implications in the competitive era. I argue that different phases of economic transition may have different impacts on private firms' risk behavior. In the early phase, private firms did not seem to have choice but to take risk because of regulatory hostility. In the competitive phase, however, they have choices as to whether or not to take risk, so decision makers, that is, owner-managers, would become important. I focus on three basic issues related to owner-managers: who they are, why they run their own business, and to what degree they control their business, and examine how these issues may affect firm risk behavior.

I also explore performance implications of risk behavior. In a competitive environment, committing resources to new projects is important for gaining or sustaining competitive advantage, but resource commitments may not bring positive results. Private firms in China are now facing a different environment. It is not likely that they can make profits on the basis of courage, as they could in the early phase of economic transition. I argue that risk taking is more likely to lead to upside outcomes if owner-managers are equipped with right skills for the competitive era, are driven by opportunity rather than necessity, and are willing to share control of their business.

This study contributes to our understanding of risk behavior in private firms. Private ownership is a key feature of private business. On the one hand, private ownership provides "high powered" incentives that may encourage risk taking (Wright et al, 2000); on the other, private ownership makes owner-managers risk averse due to risk bearing (Beatty and Zajac, 1994; Wiseman and Gomez-Mejia, 1998). It seems that risk behavior is a result of two opposing forces: ownership incentives and risk bearing. Based on this study, the relative strength of the two forces may be affected by ownership motivation and business control. Opportunity motivated owner-managers could be more likely to take advantage of ownership incentives than necessity-motivated ones; owner-managers who control their business tightly may be more influenced by risk bearing than ownership incentives.

Firm risk behavior can also be affected by organizational factors (Rajgopal and Shevlin, 2002; Singh, 1986; Wright et al, 2007), but I only focus on the impact of owner-managers. I believe this focus is appropriate for Chinese private firms, given that most of them are small and managed by owners. Scholars have emphasized the importance of managerial perception of organizational factors on organizational activities (Jauch and Kraft, 1986). Future research may focus on how decision makers mediate the relationship between organizational factors and firm risk behavior. For example, slack resources have been found to have both positive and negative impact on risk taking (Palmer and Wiseman, 1999; Singh, 1986). It is likely that the decision maker perceives the role of slack resources in

different ways. Slack may be viewed as a “buffer” absorbing shocks (Palmer and Wiseman, 1999), as a resource for innovation (March and Shapira, 1992), or as a sign of organizational success (Bromiley, 1991). I suspect that managerial perception of slack affects the relationship between slack and risk behavior.

CONCLUSION

As the largest and fastest growing transitional economy in the world, China provides a research context in which almost all entrepreneurial activities can be studied as “natural experiments” (Phan et al, 2010). In this study, I explore private firms’ risk behavior and performance implications. My central argument is that in a competitive environment, risk behavior in Chinese private firms needs to be examined beyond the regulatory impact. Since private firms can choose to take risk in the new era, the owner-managers would play a key role in making that decision.

REFERENCES

- ADB (Asian Development Bank). (2003). *The Development of Private Enterprise In the People’s Republic of China*. Manila, Philippines.
- Ajzen, I. (1991). The Theory of Planned Behavior. *Organizational behavior and human decision processes*, 50, 179-211.
- Bailey, J. (2002). Enterprise: Desire - More than Need - Builds a Business - Entrepreneurs by Choice, rather than Necessity, Create Firms that Grow. *Wall Street Journal - Eastern Edition*, 239, 99: B4.
- Baum, R., Locke, E., & Smith, K. (2001). A Multidimensional Model of Venture Growth. *Academy of Management Journal*, 44(2), 292-303.
- Beatty, R. P., & Zajac, E. J. (1994). Managerial Incentives, Monitoring, and Risk Bearing: A Study of Executive Compensation, Ownership, and Board Structure in Initial Public Offerings. *Administrative Science Quarterly*, 39(2), 313-335.
- Bromiley, P. (1991). Testing a Causal Model of Corporate Risk Taking and Performance. *Academy of Management Journal*, 34(1), 37-59.
- Brown, J. D., & Marshall, M. A. (2001). Great Expectations: Optimism and Pessimism in Achievement Settings, in *Optimism & Pessimism: Implications for Theory, Research, and Practice*. Ed. E. C. Chang. Washington, DC: American Psychological Association, 239-255.
- Carney, M. (2005). Corporate Governance and Competitive Advantage in Family-Controlled Firms. *Entrepreneurship Theory and Practice*, 29(3), 249-265.
- Carney, M., & Gedajlovic, E. (2002). The Coupling of Ownership and Control and the Allocation of Financial Resources: Evidence from Hong Kong. *Journal of Management Studies*, 39(1), 123-146.
- Chandler, A. D. (1990). *Scale and Scope: The Dynamics of Industrial Capitalism*, Cambridge, MA: Harvard University Press.
- Chang, S. J., & Xu, D. (2008). Spillovers and Competition among Foreign and Local Firms in China. *Strategic Management Journal*, 29(5), 495-518.

- Chen, W. (2007). Does the Color of the Cat Matter? The Red Hat Strategy in China's Private Enterprises. *Management & Organization Review*, 3(1), 55-80.
- Cooke, F. L. (2008). Competition and Strategy of Chinese Firms: An Analysis of Top Performing Chinese Private Enterprises. *Competitiveness Review*, 18(1/2), 29-56.
- Cunningham, J. B., & Lischeron, J. (1991). Defining Entrepreneurship. *Journal of Small Business Management*, 29(1), 45-61.
- Desai, V. M. (2008). Constrained Growth: How Experience, Legitimacy, and Age Influence Risk Taking in Organizations. *Organization Science*, 19(4), 594-608.
- Fama, E. F., & Jensen, M. C. (1983). Separation of Ownership and Control. *Journal of Law and Economics*, 26(2), 301-325.
- Francis, J., & Smith, A. (1995). Agency Costs and Innovation: Some Empirical Evidence. *Journal of Accounting and Economics*, 19(2-3), 383-409.
- GEM (Global Entrepreneurship Monitor). (2002). *Executive Report*. Babson College; Ewing Marion Kauffman Foundation; London Business School.
- GEM (Global Entrepreneurship Monitor). (2007). *Global Report on High-Growth Entrepreneurship*. Babson College, Babson Park, MA, US; London Business School, London, UK.
- GEM (Global Entrepreneurship Monitor). 2009. *Global Report*. Babson College, Babson Park, MA, United States; Universidad del Desarrollo, Santiago, Chile; Reykjavik University, Háskólinn Reykjavík, Iceland; London Business School, London, United Kingdom.
- Gibb, A., & Li, J. (2003). Organizing for Enterprise in China: What can We Learn from the Chinese Micro, Small, and Medium Enterprise Development Experience. *Futures*, 35(4), 403-421.
- Guthrie, D. (1998). The Declining Significance of Guanxi in China's Economic Transition. *The China Quarterly*, 154, 254-282.
- He, X. (2009). The Development of Entrepreneurship and Private Enterprise in the People's Republic of China and its Relevance to Transitional Economies. *Journal of Developmental Entrepreneurship*, 14(1), 39-58.
- Hmieleski, K. M., & Baron, R. A. (2009). Entrepreneurs' Optimism and New Venture Performance: A Social Cognitive Perspective. *Academy of Management Journal*, 52(3), 473-488.
- Hoskisson, R. E., Eden, L., Lau, C. M., & Wright, M. (2000). Strategy in Emerging Economies. *Academy of Management Journal*, 43(3), 249-267.
- IFC (International Finance Corporation). (2000). *China's Emerging Private Enterprises: Prospects for the New Century*. IFC: Washington, DC.
- Jauch, L. K., & Kraft, K. L. (1986). Strategic Management of Uncertainty. *Academy of Management Review*, 11(4), 777-790.
- Kao, J. (1993). The Worldwide Web of Chinese Business. *Harvard Business Review*, 71(2), 24-36.

- Kahneman, D., & Tversky, A. (1979). Prospect Theory: An Analysis of Decisions under Risk. *Econometrica*, 47, 262-291.
- Lalkaka, R. (2002). Technology Business Incubators to Help Build an Innovation-based Economy. *Journal of Change Management*, 3(2), 167-176.
- Li, J. J., Poppo, L., & Zhou, K. Z. (2008). Do Managerial Ties in China always Produce Value? Competition, Uncertainty, and Domestic vs. Foreign Firms. *Strategic Management Journal*, 29(4), 383-400.
- Li, J., & Tang, Y. (2010). CEO Hubris and Firm Risk Taking in China: The Moderating Role of Managerial Discretion. *Academy of Management Journal*, 53(1), 45-68.
- March, J., & Shapira, Z. (1992). Variable Risk Preferences and the Focus of Attention. *Psychological Review*, 99(1), 172-183.
- McClelland, D. C. (1961). *The Achieving Society*. D. Van Nostrand, Princeton, NJ.
- Miller, K. D., & Leiblein, M. J. (1996). Corporate Risk-Return Relations: Returns Variability versus Downside Risk. *Academy of Management Journal*, 39(1), 91-122.
- Naldi, L., Nordqvist, M., Sjöberg, K., & Wiklund, J. (2007). Entrepreneurial Orientation, Risk Taking, and Performance in Family Firms. *Family Business Review*, 20(1), 33-47.
- Nee, V. (1992). Organizational Dynamics of Market Transition: Hybrid Forms, Property Rights, and Mixed Economy in China. *Administrative Science Quarterly*, 37(1), 1-27.
- Ortega-Argiles, R., Moreno, R., & Caralt, J. (2005). Ownership Structure and Innovation: Is There a Real Link? *Annals of Regional Science*, 39, 637-662.
- Palmer, T. B., & Wiseman, R. M. (1999). Decoupling Risk Taking from Income Stream Uncertainty: A Holistic Model of Risk. *Strategic Management Journal*, 20(11), 1037-1062.
- Peng, M. W. (2001). How Entrepreneurs Create Wealth in Transition Economies. *Academy of Management Executive*, 15(1), 95-110.
- Peng, M. W. (2003). Institutional Transitions and Strategic Choices. *Academy of Management Review*, 28(2), 275-296.
- Phan, P., Zhou, J., & Abrahamson, E. (2010). "Creativity, Innovation, and Entrepreneurship in China," *Management & Organization Review*, 6(2), 175-194.
- Prahalad, C. K., & Bettis, R. A. (1986). The Dominant Logic: A New Linkage between Diversity and Performance. *Strategic Management Journal*, 7(6), 485-501.
- Rajgopal, S., & Shevlin, T. (2002). Empirical Evidence on the Relation between Stock Option Compensation and Risk Taking. *Journal of Accounting and Economics*, 33(2), 145-171.
- Ralston, D. A., Terpstra-Tong, J., Terpstra, R. H., Wang, X., & Egri, C. (2006). Today's State-Owned Enterprises of China: Are They Dying Dinosaurs or Dynamic Dynamos? *Strategic Management Journal*, 27(9), 825-843.

- Singh, J. V. (1986). Performance, Slack, and Risk Taking in Organizational Decision Making. *Academy of Management Journal*, 29(3), 562-585.
- Sitkin, S. B., & Pablo, A. L. (1992). Reconceptualizing the Determinants of Risk Behavior. *Academy of Management Review*, 17(1), 9-38.
- Smith, N. R., & Miner, J. B. (1983). Type of Entrepreneur, Type of Firm, and Managerial Motivation: Implications for Organizational Life Cycle Theory. *Strategic Management Journal*, 4(4), 325-340.
- Stuttard, J. (2000). *The New Silk Road: Secrets of Business Success in China Today*. New York, John Wiley & Sons, Inc.
- Tan, J. (1996). Regulatory Environment and Strategic Orientations in a Transitional Economy: A Study of Chinese Private Enterprise. *Entrepreneurship Theory and Practice*, 21(1), 31-46.
- Tan, J. (2001). Innovation and Risk-Taking in a Transitional Economy. *Journal of Business Venturing*, 16(4), 359-376.
- Tan, J. (2005). Venturing in Turbulent Water: A Historical Perspective of Economic Reform and Entrepreneurial Transformation. *Journal of Business Venturing*, 20(5), 689-704.
- Tan, J., & Litschert, R. J. (1994). Environment-Strategy Relationship and its Performance Implications: An Empirical Study of Chinese Electronics Industry. *Strategic Management Journal*, 15(1), 1-20.
- Tang, J., Tang, Z., Zhang, Y., & Li, Q. (2007). The Impact of Entrepreneurial Orientation and Ownership Type on Firm Performance in the Emerging Region of China. *Journal of Developmental Entrepreneurship*, 12(4), 383-397.
- UNCTAD (United Nations Conference on Trade and Development). (2009). *World Investment Prospects Survey 2009-2011*. New York and Geneva.
- Watkins-Mathys, L., & Foster, M. J. (2006). Entrepreneurship: The Missing Ingredient in China's STIPs? *Entrepreneurship & Regional Development*, 18(3), 249-274.
- Wiseman, R. M., & Gomez-Mejia, L. R. (1998). A behavioral Agency Model of Managerial Risk Taking. *Academy of Management Review*, 23(1), 133-153.
- Wright, M., Hoskisson, R. E., Busenitz, L. W., & Dial, J. (2000). Entrepreneurial Growth through Privatization: The Upside of Management Buyouts. *Academy of Management Review*, 25(3), 591-601.
- Wright, P., Kroll, M., Krug, J., & Pettus, M. (2007). Influence of Top Management Team Incentives on Firm Risk Taking. *Strategic Management Journal*, 28(1), 81-89.
- Xin, K., & Pearce, J. L. (1996). Guanxi: Connections as Substitutes for Formal Institutional Support. *Academy of Management Journal*, 39(6), 1641-1658.
- Yang, K. (2004). Institutional Holes and Entrepreneurship in China. *Sociological Review*, 52(3), 371-389.
- Young, S. (1991). Wealth but not Security: Attitudes towards Private Business in China in the 1980s. *The Australian Journal of Chinese Affairs*, 25, 115-135.