

**CHINESE ENTREPRENEURSHIP  
AND CLUSTER FORMATION:  
MULTI-CASE STUDIES FROM EAST CHINA**

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A thesis submitted in partial fulfilment for the requirements of the degree of  
Doctor of Philosophy at the University of Central Lancashire

Lancashire Business School  
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**July 2011**

## **ACKNOWLEDGEMENTS**

The process of completing this PhD is a tremendous challenge, effort and achievement. I would like to thank all the people who have helped, supported and inspired me throughout the long journey of my doctoral studies.

First of all I would like to thank my supervisor Professor Bob Ritchie for his advice, support, encouragement and great patience throughout all stages of my PhD. Secondly, I would like to thank Professor John Wilson, who was my Director of Studies before 2008, his departure from UCLan made him my external supervisor since then. Thanks him for helping me mould the ideas of this research in the initial stages of my PhD. Thirdly, I would like to thank Dr Wing Lam for getting me interested in the research, inspiring me in many thought-provoking conversations and most importantly sharing research experience with me not only as a mentor but also as a valued friend. I would also like to thank my examiners, Professor Bill Keogh and Dr Pete Thomas, for a challenging but enjoyable viva examination and for their comments, which I believe have led an improved thesis.

I would also like to thank my friends who shared my PhD journey in the last few years. Thanks to Trista, as a friend and a fellow PhD student, for being there, listening, understanding and encouraging in good and difficult time. Thanks to Chris, Vickie, Amy, Zoe, Eric, Ivy, Donna and Nina for bringing me so many joyful moments in my student life.

Finally, I would like to express my sincere gratitude to my parents, Shunxing and Rongzhen, for their full support, trust, encouragement and love, which provide me with the great driving forces to complete this PhD.

## **ABSTRACT**

### **CHINESE ENTREPRENEURSHIP AND CLUSTER FORMATION: MULTI-CASE STUDIES FROM EAST CHINA**

Cluster is not a new phenomenon, having existed in different forms for a long time. Although a large amount of work has been dedicated to cluster research (Marshall, 1920; Krugman, 1995; Schmitz 1997; Porter, 1998; Wilson and Popp, 2003), there is still a lack of convincing explanations as to how and why clusters are created. Reviewing the different definitions of ‘cluster’ from previous studies, produces the interesting finding that most of the cluster definitions neglect one key element – the ‘actor’ – that is, the individuals who are involved in the process of founding new businesses that give rise to cluster formation.

Recognising the values and shortcomings of the extant studies on clusters, this thesis aims to establish a conceptual framework and attempt to advance the understanding of the cluster formation process from an alternative view. The purpose is to answer the research questions of how and why cluster are formed, how different actors interact with key institutional factors relevant to cluster creation and how these actors themselves make sense of the cluster creation process, particularly in the Chinese context.

This research employs a qualitative approach comprising semi-structured in-depth interviews, which seek to uncover the depth and richness of the living experiences of different actors with the SME clusters. Fieldwork was completed in multi-phases involving a preliminary data collection in phase one, followed by a further data collection in the second and subsequent phases through re-interviewing the key informants.

The findings of the three empirical case studies echoed the claims that the very notion of a cluster is a dynamic, and for some a ‘Chaotic’ one (Martin and Sunley, 2003). This highlights the importance of a comprehensive framework to address the complex web of elements that are involved in cluster formation. The result of the thesis also indicates that individual (entrepreneurs & social relations), and the social interactions among individuals and their institutional context are the key ingredients for forming clusters. It is suggested that the established conceptual framework, based upon the theories of institutionalisation, social embeddedness and sensemaking, can help to fill the gap in the extant cluster research and pave the way for future research.

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## **Chapter One: Introduction**

### **1.1 Research background**

Increasing recognition is being given to the significant role that clusters play in today's economic development. As a 'hot potato', clusters have begun to attract more attention from different disciplines, including economists (e.g. Krugman, 1995), geographers (e.g. Piore and Sabel, 1984; Amin, 1989), sociologists (e.g. Granovetter, 1985), historians (e.g. Wilson and Popp, 2003) and policy makers (e.g. DTI; OECD; UNIDO, World Bank).

Evidence of research into clustering has been extensively reported not only in developed economies, but also in developing economies (e.g. Goodman, *et al.*, 1989; Sengenberger *et al.*, 1990; Humphrey and Schmitz, 1995; Nadvi, 1995a,b). Research into clustering in developing countries has been inspired by the competitiveness of the industrial districts established in advanced countries, such as the success stories of semiconductors in Silicon Valley; financial services in London; ceramic tile and leather and footwear industries in Italy; and automobiles and engineering in Southern Germany and other European regions (DTI, 2003).

The cluster approach also appears to be playing an increasingly important role in China's contemporary economic development. To some extent, clusters have now begun to influence the economic domain of China, since many regional governments have started to put the 'cluster development' strategy on their agenda, and to use it as an important approach to push and promote the local economic development.

According to Sonobe *et al.* (2002) most of the clusters tend to be formed by small and medium sized enterprises, especially in developing countries (Schmitz, 1995a; Schmitz and Nadvi, 1999). Thus, encouraging the growth of small and medium-sized enterprises (SMEs) is also widely seen as a key driving force for a country's economic

development.

In most nations in the world, the majority of SMEs are small micro-businesses or family firms. Irrespective of where they are located, SMEs have several common limitations, such as small size, limited management capability, etc. (Hamilton, 1991; Redding, 1993; Jacob *et al.*, 2004). SMEs encounter often quite normal problems and challenges which as a consequence of such limitations may prove difficult to resolve when acting alone. Although governments in different countries establish various policies and take measures to solve such problems and challenges, the results do not seem to have proved particularly effective. Sengenberger and Pyke (1991) point out that the problems for most SMEs are not merely related to their size, but more their isolation and the fact that they develop separately from one another. For this reason, the *cluster*, as a form of industrial organisation, is viewed as a possible solution providing a means of developing horizontal cooperation (with the firms at the same stage in the value chain), vertical cooperation (with both small, medium and large sized firms along the value chain), and inter-firm cooperation, which can provide natural fertile soil for SME development. According to Marshall (1920) there are three major advantages of clusters: (1) the information spillovers among enterprises, (2) the division and specialisation of labour among enterprises and (3) the formation of skilled labour markets, which are thought to be beneficial to SMEs. Thus, an important issue for sustaining and developing the SMEs may be the formation of clusters. Rabellotti (1997) thought that the traditional industrial clusters (primarily family enterprises), (e.g. in the Third Italy), were built on the foundation of family and neighbourhood relationships. This kind of informal social relationship network was the adhesive and important driving force behind family enterprise networks. Redding (1993, p.5) undertook a long-term observation of those Chinese SMEs (primarily family firms) in Taiwan, Hong Kong, and South-East Asia, concluding that these were 'weak organisations and strong linkages'. Similar research in mainland China concerning SME suggests that clustering has not proved popular until recently (Li, 2002; Wei, 2003; Zhou and Li, 2004; Wang 2001, 2007).

A review of the SME Cluster literature has identified two major knowledge gaps. First, although a large amount of work has been dedicated to cluster research (Marshall, 1920; Krugman, 1995; Schmitz, 1997; Porter, 1998a,b; Wilson and Popp, 2003), there is a lack of convincing explanation as to how and why clusters are created, especially in the Chinese context. Most of the literature applies to adapting Western models to the Chinese context, without taking into account the institutional context in a different culture. Secondly, the roles played by ‘individuals’ or ‘actors’ (e.g. entrepreneurs, their families, their social networks and relationships, etc.), representing one of the key contributors to the process of founding new businesses, have been largely ignored in the extant literature. The link between founding new businesses and the formation of supportive clusters is highly dependent on the behavior of such individuals and actors. Insufficient knowledge exists to provide an explanation or understanding of the individuals’ motives, aspirations and activities in forming clusters.

This research intends to draw upon the evidence from empirical studies to develop a theoretical framework for cluster creation which incorporates new perspectives to advance the understanding of cluster formation, and to argue that the clusters *per se* are ‘entrepreneurial clusters’.

## **1.2 Research aim and objectives:**

China is now one of the largest transitional economies in the world. After three decades of sustained economic reform, the significant increase and development of small and medium sized enterprises (SMEs) has proved to be one of the key driving forces behind China’s rapid economic development (Asian Development Bank, 2003; Tsui *et al.*, 2006). According to Rong (2004, p.8), the number of SMEs registered in industry and commerce has reached 37,500,000 in China, accounting for 99 per cent of the total registered enterprises and offering 75 per cent of employment opportunities in both urban and rural areas in China. The main body of Chinese SMEs

tends to be formed by families, relatives and friends. It is believed that the familial and neighbourly ties among Chinese SMEs enable the business owners to enjoy more access to financial credit and other resources. This might be regarded as the key characteristic for the success of Chinese business (Hamilton, 1991; Redding, 1993). Countering such benefits is the impact of greater competition both nationally and globally resulting from reducing barriers to competition and entry to the Chinese markets. The majority of SMEs, especially small family businesses, do not have sufficient scale economies or market scope when working in isolation, to survive and compete against the large domestic state-owned enterprises and strong multinational firms. The principle of clustering, advocated by Porter (1990), has been proposed as a better model for SMEs to cope and develop themselves in such circumstance. However, it should be recognised that little is known in general about how clusters are formed and developed in the Chinese context. Thus, it is interesting to tackle this question, emphasising the unique nature of Chinese business (i.e. strong family and relationship-oriented) and their potential involvement in the process of cluster formation.

This aim of this research, therefore, is to advance the understanding of SME cluster formation in China through investigating cluster development approaches; the role of individuals and their interrelationship and with the institutional context. The primary research objectives are as follows: to investigate what a cluster is; how different individuals interact with key environmental and institutional factors relevant to cluster creation; how different individuals interrelate with one another against the backdrop of a complex network of social and business relationships and their relevance to forming a cluster; how different individuals within an SME cluster make sense of the cluster creation process; and to establish an understanding of the unique and distinctive attributes of cluster creation in China.

### **1.3 Thesis layout**

This thesis comprises seven chapters. Chapter 1 offers a general picture of this research, i.e., describes the research background, identifies the research gaps and explains the aim and objectives of this research on the basis of relevant literature reviews of cluster studies. In-depth reviews, discussions and implications will be presented in detail in the subsequent chapters.

Chapter 2 provides a critical review of the literature on cluster studies in relation to two main aspects: the definition of the term ‘cluster’ and the approaches to cluster formation and development. First, the definitions of cluster and how they have been analysed and implemented by different disciplines are discussed. This, on the one hand, helps to identify the shared characteristics from these different definitions of cluster, but on the other hand, also reveals the limitations, i.e. reproducing the cluster according to the shared characteristics cannot guarantee the formation or the success of a cluster. This led the present researcher to investigate further, the approaches to cluster formation and reviewing their potential contribution. The results suggest that more attention needs to be paid to the social perspective when understanding cluster formation. This links to the further discussion in Chapter 3.

Chapter 3 establishes a conceptual framework to aid understanding of the process of cluster formation and how individuals and their environment interact with each other through employing an integrated approach with particular emphasis on social perspectives. A model consisting of five elements, derived from the Literature Review Chapter (Chapter 2), was developed, improved and used to present the key elements of the clustering formation process. The theories of institutionalisation, social embeddedness and sensemaking are combined together to explain the clustering phenomenon, emphasising the embeddedness of the individual, their social networks and their interactions with different institutional factors within the institutional context they are engaged in, more specifically, in the Chinese context.

Chapter 4 is the methodology chapter. This chapter discusses the methodological approach and research design of this research in order to explore the answers to the research questions that have arisen from the Literature Review Chapter (Chapter 2) and the Conceptual Framework Chapter (Chapter 3). Qualitative methods are utilised as the core of the research design. In-depth interviews, multi-stages of fieldwork and multi-case studies are employed to uncover the vividness and richness of the living experiences of the informants in the Chinese context related to cluster formation. In addition, problems in the fieldwork are also discussed in this chapter. The nature of the results of this chapter is established as a basis to set out the discussion of the following three chapters.

Chapter 5 provides an overview of the three empirical case studies of this research. The description and discussion are mainly based on the model established in the Conceptual Framework Chapter (Chapter 3), which covers 5 key elements associated with cluster creation, i.e., 'location', 'relationship', 'mutual benefit', 'institutional context' and 'individuals'. The detailed information and initial analysis in this chapter serve as a foundation for further discussion in the next chapter.

Chapter 6, the finding and discussion chapter, further investigates the backcloth and conditions for cluster formation in China. Discussions are carried out not only to answer the question of how individuals make sense of the entrepreneurial activity, raising the possibility for the clustering phenomenon, but more importantly to explain the dynamics of individuals' entrepreneurial activities, i.e. what makes them start the entrepreneurial activity? How this relates to cluster formation? The implications of this research are based on both theoretical and practical aspects, by examining whether theoretical concepts can be employed and fitted well in the Chinese context, and what lessons can be learned in respect of the individual's entrepreneurial activities and the cluster formation process through investigating the case studies in China.

Chapter 7 is the conclusion chapter, which brings together all the arguments,

discussions and findings throughout the research. Contributions of this research are proposed. Moreover, taking account of some discussion of the limitation of this research, this chapter finally provides some suggestions for future research.

## **Chapter Two: Literature Review**

### **2.1 Introduction:**

Clusters are not a new phenomenon, but have existed in many forms for a long time (Heusers, 2005). The idea that national economic success depends, in part, on the development of localised concentrations of industrial specialisation, can be traced back more than a hundred years to Alfred Marshall. He argued that Britain's economic growth and leadership during the 19<sup>th</sup> century was founded on the development of several examples of localised industries (DTI, 2003, Marshall, 1919). More recently, researchers have updated Marshall's concept of industrial localisation. In particular, Michael Porter (1990, 1998a, b, 2000), utilising a large-scale sample, identified several existing local agglomerations. Porter's notion of 'cluster' has become very fashionable and influential in this field, not only because clusters can be used as a strategic means to advance the competitive advantages for different industries or firms, but also because they can be used as a useful tool for policy makers to promote national or regional economic development. Since the 1990s, examples of successful clusters, (e.g. Silicon Valley, Third Italy, Baden-Württemberg, etc.), combined with the development and promotion of academic literature on clusters (Piore and Sable, 1984; Becattini, 1990; Cooke and Morgan, 1993; Porter, 1990, 1998a,b), policy makers worldwide have been encouraged and begun to create or develop clusters in their own localities (OECD, World Bank, UNIDO, and other national or regional government, such as UK, USA, Germany, Italy, Spain, etc.).

The developments in China reflect this heightened interest in adopting cluster based concepts. Cluster research in China became popular following Porter's promotion of the cluster concept. However, most of the research on clusters in relation to China, whether conducted domestically or internationally, are largely based on Western models and theories, and thus there is a lack of an 'inside-looking out' perspective. This might highlight distinctive features of Chinese clusters. In China, as in many



other countries, the cluster is a 'setting' concept, adopted from outside, which cannot be completely adapted to the Chinese context, especially when transferring the theories into practice.

This chapter will critically review the literature on cluster research in relation to two main aspects: the definition of clusters and the approach to cluster creation and development. The review of different definitions of clusters and their development process suggests further investigation is needed to fill the gaps in the existing literature. A common starting point for research into clusters, seeks to analyse the definitions of cluster and how the concept has been understood, interpreted and applied by researchers from different disciplines. Three shared characteristics have been extracted from the various definitions of cluster. These are: geographical concentration, relationship and mutual benefit. However, even if all these three boxes are ticked, there is still no guarantee that a cluster will be instigated or successfully developed. This suggests the need for further investigation, paying special attention to the approaches to cluster formation, which can be broadly classified into three groups: the economic approach, the political approach and the social approach (Parrilli, 2004a; Crone, 2009). These investigations and subsequent review and discussion highlight the potential of the social approach, which has not being given enough attention to date. This may provide the key to answer the research questions concerning how clusters are formed in the first place and what motivates people to gather together to form a cluster.

## **2.2 Definitions of clusters**

In order to better understand the concept of 'cluster', a common starting point is the definition. Seeking a definition for the term 'cluster' that would find widespread acceptance and support is highly problematic. The multi-disciplinary nature of the interest in the term and the varying perspectives of researchers, policy makers and practitioners, generate a variety of definitions. It is pointed out by Rosenfeld (1997,

p.8) that ‘there are as many definitions as there are types of organisations using the term’. Additionally, the dynamics of the context within which the future potential or existing clusters operate, require the cluster to adapt to short, medium and longer-term developments and changes in competitive positioning and pressures. This will also raise additional issues for defining the term, and therefore make the definitions of ‘cluster’ more ‘chaotic’ (Martin and Sunley, 2003).

The Oxford Dictionary defines a ‘Cluster’ as ‘a group of things of the same type that grows or appears close together’ or ‘a group of people, animals or things close together’. This emphasises the dimension of closeness or proximity of those involved, typically in a spatial or geographic sense. However, this closeness may also relate to the type of activities undertaken or to the size of the businesses involved. The term cluster employed in the economic context is more complex than simply grouping by type or geographical proximity. The active engagement between members in the group represents an important dynamic of the functioning of business-related clusters. This dimension of active engagement is reflected in much of the earlier research and developmental work in the field. The seminal works of Alfred Marshall (1919, 1920) and subsequent researchers, e.g. Porter (1998a,b), Asheim (1999), Enright (2000), Martin and Sunley (2003), Wilson and Popp (2003), are representative of the development of the cluster concept and its effective application.

Alfred Marshall, at the end of the nineteenth century, developed a powerful insight into what he termed ‘the localised industry’, highlighting the important distinctions between the concepts of: the ‘external economy’ and the ‘internal economy’ in his seminal work ‘Principles of Economics’ (1920). Through sustained and detailed research on traditional localised industries in Britain and elsewhere, Marshall argued that ‘those very important external economies [which] can often be secured by the concentration of many small businesses of a similar character in particular localities: or, as is commonly said, by the localisation of industry’ (Marshall, 1920). In terms of Marshall’s claim, the reasons for the concentration of specialised industries in

particular localities can be summarised into three perspectives. First, the aggregation of a large number of enterprises in a certain area provides the local market with special skills, thus saving the search and possible development costs for skilled labour. Second, the existence of subsidiary industries lowers the production costs and offers support to more specialised production. Compared with single firms working in isolation using expensive highly specialised machinery to produce subsidiary products, those firms operating in a concentration of specialised industries, producing products for a large number of enterprises in aggregate, are more economical and professional (i.e. economies of scale benefits). Third, knowledge spillover makes the production efficiency for those aggregated firms higher than for single isolated firms, especially as a result of the communication between people, that facilitates the knowledge spillover in that area.(Marshall, 1920).

Marshall also recognised that the relationships between the enterprises in the industrial district are based on their interdependence, mutual co-operation and trust. This in turn has beneficial effects for the spread of information, the generation of innovation and the implementation of new developments and methods. Marshall (1920) observed that:

‘When an industry has thus chosen a locality for itself, it is likely to stay there long: so great are the advantages which people following the same skilled trade get from near neighbourhood to one another. The mysteries of the trade become no mysteries; but are as it were in the air, and children learn many of them unconsciously. Good work is rightly appreciated, inventions and improvements in machinery, in processes and the general organisation of the business have their merit promptly discussed: if one man starts a new idea, it is taken up by others and combined with suggestions of their own; and thus it becomes the source of further new ideas.’(ibid, p. 225)

These observations on the relationships between enterprises in industrialised districts led to Marshall’s much accredited contribution to recognising the presence of the ‘industrial atmosphere’. The industrial atmosphere pervading a district cannot be quickly or easily acquired, nor can it be easily moved, replicated or transferred.

People living in that area feel the industry, as if ‘it were in the air’’. Wilson and Popp (2003) emphasise that such localised industries, or industrial districts must be understood as being ‘located; not only in a physical sense, but also with regard to specific social space, each space having its own structure and history.’ (ibid, p.5).

Marshall’s seminal research and interest in clusters, industrial districts and their economic benefits has subsequently spawned a considerable growth in interest by others from a variety of disciplines. Marshall’s concept of the benefits of ‘external economies’ provides the fundamental theoretical foundation for the continued existence of small and medium sized enterprise clusters, especially when viewed from the industrial perspective of production costs and scale economies. However, his work provides less insight and explanation regarding the emergence of these external economies in the first instance. Thus several questions remain less than fully answered. For example, ‘How was the formation of ‘localised industries’ initiated?’ (Atherton, 2003; Parrilli, 2004a; Crone, 2009) and ‘Why do industries themselves choose to locate in certain areas but not others?’ (Martin and Sunley, 2003; Parrilli, 2004a, 2005). The presence of primary physical resources in a given locality provides a partial rather than a complete explanation. These questions will be investigated in the following chapters of this thesis. Moreover, the explanation given by Marshall and others for the formation and evolution of industrial districts has also been challenged. Martin and Sunley (2003), for example, questioned Marshall’s assertion that industrial districts progress towards greater local specialisation and differentiation just as different natural organisms evolve towards greater complexity. They considered this generalisation of the direction of economic growth and development as questionable and inappropriate for different industries and economic contexts.

Almost a century later, the concept of ‘cluster’ was rejuvenated through the work of large numbers of researchers, who based their insights and perspectives on the earlier work of Marshall, and also expanded Marshall’s work. However, this rejuvenation has further highlighted the difficulties in reaching a unified definition of the term,

especially given the variety of disciplines now engaged in this field. Porter's work in particular has been highly contested. Porter's clusters vary in size, form, breath, depth, state of development and level of aggregation (Martin and Sunley, 2003), thus their presence can be found '...in large and small economies, in rural and urban areas, and at several geographical levels (for example nations, states, metropolitan regions, and cities)' (Porter, 1998a, p.204), and their geographical scope can even encompass 'a network of neighbouring countries' (ibid, p.199). This interpretation of the concept of a cluster has been criticised by Martin and Sunley (2003) as 'highly and ridiculously elastic' (ibid, p.11). Accepting the validity of such views provides researchers with almost unlimited scope when seeking to define and apply the concept of a cluster.

Although there is no clear consensus on the definition of clusters, it is nevertheless helpful to examine the most commonly accepted definitions. Identifying common elements or parameters and distinctive areas of differences can lead to an enhanced understanding and more importantly, contribute to the construction of a working definition of 'cluster' within the context of China, as an emerging economy, which is the central theme of this thesis. A summary of the key attributes of the definition of 'cluster' from a number of authors in relevant fields is provided in Table 2.1. The first section of the table comprises those authors predominantly engaged in researching clusters in Western developed economies. The second section draws upon authors whose work relates more to emerging and developing economies. Comparisons will be drawn between these two groups of definitions.

**Table 2.1: Definitions of a cluster**

Author	Definition
<i>Developed economies</i>	
Michael Porter (1998a)	'Geographic concentrations of interconnected companies, specialised suppliers, service providers, firms in related industries, and associated institutions (for example, universities, standards agencies, and trade associations) in a particular field that compete but also co-operate' (p.197).
Enright (1998)	'...groups of firms in the same industry or in closely related industries that are in close geographical proximity to each other and are meant to

	include geographically concentrated industries including so-called ‘industrial districts’ (p.337)
Humphrey and Schmitz (1995)	‘a sectoral and geographical concentration of enterprises which produce and sell a range of related or complementary products and are, thus, faced with common challenges and opportunities’... Such a concentration will benefit from external economies – ‘the emergence of suppliers who provide raw materials and components, new or second-hand machinery and spare parts; the emergence of a pool of wage workers with sector-specific skills. A cluster may also attract agents who sell to distant markets and favour the emergence of specialised services in technical, financial and accounting matters.’ (p.8)
Best (1990)	‘a group of geographically concentrated firms specialising in similar and complementary activities and developing greater skills and productive knowledge’ (p.233)
Wilson and Popp (2003)	‘a wide agglomeration of industries that may be connected by common products, technologies, markets (either of supply or demand) or institutional frameworks.’ (p.3)
UNIDO (2001)	‘Clusters are agglomerations of interconnected companies and associated institutions. Firms in a cluster produce similar or related goods or services and are supported by a range of dedicated institutions located in spatial proximity, such as business associations or training and technical assistance providers.’ ( <a href="http://www.unido.org/index.php?id=o4297">www.unido.org/index.php?id=o4297</a> )
<i>Developing economies</i>	
Qiu Baoxing (1999)	Qiu defines a cluster as a kind of organisation, consisting of a group of independent and self-determined but also interdependent/related enterprises, which was established based on the specialised division of labour and cooperation. With the aid of this kind of special organisational structure (i.e. the form of cluster), small enterprises can establish long term business relations with one another, furthermore, mainly cooperating through trust and pledges and not always needing contracts to maintain them.
Wei (2003)	An industrial cluster is a kind of global economic phenomenon. It is large number of related firms concentrated in a defined area according to certain economic relationships, then formed resembling a biological organic cluster.
Uzor (2004) based on the research of Schmitz (1997)	‘a group of small firms operating in a defined geographic location, producing similar products or services, cooperating and competing with one another, learning from each other in order to overcome internal problems, setting common strategies to overcome external challenges, and reaching distant markets through developed networks’. (p.8)

### **2.3 Shared characteristics**

Examining the different definitions of ‘cluster’ from both sets in Table 2.1, encompassing Western developed and Eastern developing economies, suggests the presence of three shared common characteristics, which are ‘geographical concentration’, ‘relationship’ and ‘mutual benefit’.

#### **i) Geographical concentration**

Geographical concentration probably represents the most widely accepted characteristic. The explicit or sometimes implicit requirement is that the businesses are spatially close (i.e. in a certain relatively small geographical space). In other words there is a high density of enterprises distributed within a defined geographical space. This defined geographical space provides the location for the nexus of interdependencies, and the proximity of enterprises in a geographical space is far from incidental to a range of economic outcomes (Wilson and Popp, 2003). Alfred Weber argued that the degree of industrial concentration present in one area is a balance resulting from the positive and negative pressures of the two forces, agglomeration and deglomeration (Chen and Li, 1982).

Becattini (1991) reinforces this view that a cluster is a geographical agglomeration of enterprises and organisations associated with one specific industry, that are mutually related. Fu (2002) also views this as a large number of enterprises (in the same industry) agglomerated in geographical space. He points out that enterprises in clusters are in close proximity to each other, emphasising geographic proximity as the key characteristic of a cluster, which corresponds with the interpretation and practices of clustering in developing countries. Marshall (1919) also emphasised the concentration of smaller businesses with similar characteristics in particular industries. However, developments on the scale of certain industries may not be restricted to small businesses alone in today’s context. Changes in Information and Communication Technologies (ICTs) may weaken the requirement for close geographic proximity, in particular in service industries where the service may be

provided without the need for direct personal contact.

## ii) Relationship

A second characteristic on which there is a consensus, is the recognition that there is some form of relationship between firms in the cluster. The nature of this relationship may take many forms (e.g. technical, economical, familial, etc.). Such relationships may exist not only between those firms involved in commercial arrangements but also between competitors in the same industry, producing the same, similar or related products (i.e. at similar stages in the supply chain).

Visser (1996), for example, views a cluster as the geographical agglomeration of a group of enterprises, producing the same, similar or correlated products. Those enterprises may or may not cooperate with each other in relation to specialised production, the division of labour among the enterprises, or subcontracting. Only in the more established and advanced clusters, will different enterprises begin to cooperate and learn from each other in order to implement their enterprise strategies, and try to make their cooperation more institutionally beneficial. Wu (1992) contended that a cluster is a combination of independent but also mutually related enterprises. Such enterprises engage in the specialised division of labour, resources, additional developments and innovations, whilst maintaining long-term non-specific contractual relationships with the other enterprises in the cluster. Thus, it is argued that the long term business relationships between the small enterprises in a cluster do not necessarily need to use a contract to maintain their relationship, but can cooperate through trust, pledge and tacit/unwritten agreement. Rinaldi (2002), claims that the presence of a 'network of social relations', helps to ensure that 'People in the districts shared a cultural homogeneity which lubricated social relations among economic actors, reinforced consensus and group loyalty among entrepreneurs, ensured the social ostracism of rule-violators, provided a common language to speed innovation and information exchange and established the basis for trustful behaviour.' (ibid, p.3).



iii) Mutual benefit:

It is perhaps self-evident that the establishment and maintenance of a cluster is dependent on the members of the cluster receiving some benefit, either real or perceived. An enterprise in a cluster can obtain tangible and intangible benefits, i.e. 'extending the capabilities, resources and responses to levels that would not be achievable as an individual firm' (Lyon and Atherton, 2000, p.2). More specifically, such benefits may include the maintenance of barriers to entry by others outside of the cluster, financial and technical information and advice, joint market exploration, community brand development, as well as resource efficiency processes and systems (Li, 2003). As Crone (2009) concluded 'Clustering is about firms working together on joint activities and projects for mutual gain.' (ibid, p.7).

Enterprises in a cluster do not merely cooperate, compete, and learn from each other, but also formulate strategies to cope with the external challenges, and expand their market through the development of a network to gain more benefit (Uzor, 2004). There is a sense in which clusters can simultaneously be viewed as working together to achieve some degree of protection from competitive pressures (i.e. risk avoidance) and also to enhance the competitive position of individual firms or all firms collectively. Mutual benefit may thus be defined as an actual realisable or future expected potential contribution to the firm. In a rational decision context, the firm's owners would balance the actual or perceived benefits against the anticipated costs associated with continued involvement in the cluster and act accordingly. Evidence would suggest that such rational behaviour is unlikely and cluster membership may be continued despite any adverse economic evaluation. The influence of location and relationship factors may prove important contributors to this.

Allocating the shared characteristics into these three factors contribute to an understanding of the primary drivers behind cluster formation, development and

survival. However, this may do little to overcome the diversity, complexity and dynamism associated with clusters in practice. Seeking a universal definition of a cluster may prove fruitless, given the multi-dimensional and multi-disciplinary perspectives applied to the concept. Although diverse connotations of the term ‘cluster’ can be seen as a positive strength, that allows a wide range of interpretations to be included. It is still considered to be much more difficult to precisely define what a cluster is. The obvious problem raised by these definitions is the lack of clear boundaries and scales in both the industrial and the geographical sense (Martin and Sunley, 2003).

The concept of cluster has been criticised by Martin and Sunley (2003, p.11) as ‘highly and ridiculously elastic’. They pointed out that Porter’s cluster concept can be found at almost any level of spatial aggregation: ‘They are present in large and small economies, in rural and urban areas, and at several geographical levels (for example nations, states, metropolitan regions, and cities’ (1998a, p.204); their geographical scope can even encompass ‘a network of neighbouring countries’ (1998a, p.199). In terms of these, it has given researchers unlimited scope when defining and applying the concept of a cluster. It even builds up obstacles when doing the fieldwork, because in practice, almost all the firms can match these common characteristics, but can all these firms be considered as the members of a cluster? A lot of districts fully comply with these conditions, but can they be considered as a potential or even an existing ‘cluster’? Obviously, the answer is ‘no’. In order not to further heighten the confusion and take account of the context of a developing economy (i.e. China), it is worth clarifying the definition of cluster in a more sensible way, i.e. (distinguish between industrial cluster and enterprise cluster), before moving on to look at the approaches to cluster formation.

## **2.4 Industrial and enterprise clusters**

The difficulty in establishing a generic definition for the term cluster and the diversity

of contexts within which clusters operate suggests the need to define a typology to differentiate between the composition, context and functioning of different clusters. One such typology differentiates between an 'industrial cluster' and an 'enterprise cluster.' Clarification of the essential differences between these two types may assist in clarifying and refining the definition of the term cluster in the present study.

The term 'industrial cluster' was normally used to discuss the competitive advantage of the nation state (for example Porter, 1998a,b). No special requirement was made concerning the geographical or spatial proximity of an industrial cluster, although the primary emphasis was placed on the existence and nature of the industry relationships. On this basis the industrial cluster could be local, regional, national or even multinational.

Some researchers use the terms 'industrial cluster' and the 'enterprise cluster' interchangeably and treat them as the same thing (Gu and Wang, 2003). According to their view, an industrial cluster tends to suggest a focus of attention on the interwoven vertical and horizontal supply chain links and consequent industrial relationships. On the other hand, the enterprise cluster suggests that attention is directed towards the enterprises' geographical concentration characteristics within the cluster.

Most definitions of the term cluster have the requirement to incorporate some reference to the geographical concentration scale. Fu (2002) argues that there are differences between the definition of an industrial cluster and an enterprise cluster. The enterprise cluster requires some degree of geographical proximity, whereas the industrial cluster could be characterised by either geographic proximity of its members or alternatively geographic dispersion, even to the extent of being across the nation or multinational. The distinguishing feature of the industrial cluster in this view is the presence of direct industrial and commercial linkages. Schmitz (1997) considers the enterprise cluster as the collection of different departments and enterprises in a geographically concentrated area. Porter's work on industrial clusters featured the

concentration of a large number of industries in one country displaying strong vertical supply chain relationships, but without the strict requirement concerning their geographical proximity. Subsequent work by Porter (2000) emphasised the important role of the geographical location of an industry, defining the cluster in a specified location, and referring to this as an agglomeration of geographically concentrated firms and associated institutions, such as universities, standards agencies, and trade associations.

Drawing on this literature, it is possible to distinguish between an ‘industrial cluster’ and an ‘enterprise cluster.’ The key differences may be summarised as:

- 1) An ‘industrial cluster’ emphasises the industrial relationship between enterprises, with the requirement for geographical concentration or proximity being less important. To some extent, the degree of geographical concentration may be either high or low. For example, Holland’s flower industry cluster and Chile’s wine industry cluster operate across a very large geographic area, displaying a low degree of geographic concentration or proximity, in many cases operating across different countries. The car manufacturing industry is an example of an industry cluster with widely dispersed members, operating around their key operational units and manufacturing plants, typically in different countries. Alternatively, the scale of geographical proximity may be more concentrated, for example, in the case of the City of London’s financial clusters or Italy’s ceramic tile industry clusters.
- 2) An ‘enterprise cluster’ emphasises not only the industrial relationship, but increasingly the commercial and technical relationships between enterprises, addressing issues associated with competition and cooperation among firms in the cluster. Arguably, an enterprise cluster requires greater intensity of geographic concentration and proximity, since the commercial relationships are stronger and more prevalent than the industrial or supply chain

relationships and potentially require more personal contact and interaction to engender and sustain confidence and trust.

- 3) The boundaries and scale of activity implied in the concept of an industrial cluster remain rather vague. For example, the California wine cluster mentioned by Porter spans several different industries, e.g., grape planting, brewing, manufacturing and bottling, warehousing and logistics and wine distribution. The ceramic tile industry in Italy is defined relatively more tightly in terms of boundaries and scale than the wine industry, mainly focusing on the ceramic tile manufacturing stage itself. The historical development of a particular industry and the constituent businesses may result in a comparatively concentrated set of activities and a relatively narrow span of interest for cluster members. Zhu (2003) argues that these potential differences in the boundaries and scale of the industrial cluster provide a barrier to the development of a meaningful definition which in turn may generate difficulties in conducting empirical research and undertaking comparative analysis. Incorporating geographical boundaries into the definition may improve the prospects for understanding the internal structure and operational mechanisms of industry clusters. The definition of the term industrial cluster in the conceptual or theoretical context poses particular challenges and imposes certain limitations. Most empirical studies are conducted using local industrial clusters, employing some definition of the geographical boundaries to provide greater certainty concerning the geographical context of the cluster. It should be recognised that this imposes an implicit restriction on the span of the clusters engagement beyond geographical boundaries that may be arbitrary. Since it is less likely that an enterprise located in one relatively small geographical area will enjoy a large span of industrial influence, the concept of a local industrial cluster is much closer to that of an enterprise cluster (Wang, 2001; Li, 2006).

- 4) The constitution of an industry cluster is often considered to be more diverse than that of an enterprise culture, incorporating universities and other organisations associated with research and the early stages of innovation and new product development. The enterprise cluster, on the other hand, is a more profit motivated organisation, comprising member firms that are primarily profit-driven enterprises and generally excluding not-for-profit organisations. Inputs from the not-for-profit organisations will often arise as a spontaneous response to a specific developmental or knowledge need within the enterprise cluster, offering their services to the whole enterprise cluster (e.g, university knowledge transfer services, Chamber of Commerce). Recognising that many enterprise clusters are likely to be located in the rural, village or small town area, institutions like universities are likely themselves to be part of a much larger scale industrial cluster (i.e. operating within more widely defined geographic boundaries with a wider span of industrial engagement). Universities by virtue of these factors combined with their structures and strategic objectives may find it difficult to operate as an integral and organic member of an enterprise cluster. Li (2006) argues that it is not appropriate to view institutions such as universities as constituent and active members of an enterprise cluster, since such clusters represent a 'cluster for enterprise', which may prove inconsistent with the not-for-profit or public service aims of organisations such as universities.
- 5) The concept of an industrial cluster is not dependent on the number or size of the enterprises involved. The number of enterprises in a particular industry in a given country or region might be small, but if the scale of each of these enterprises is sufficiently large, the cumulative scale of production within that industry could itself be significantly high. This would generate the conditions for an industrial cluster according to Porter's (1998a,b, 2000) criteria. This, however, may not be sufficient to designate this as an enterprise cluster, even though there exists a geographical concentration of enterprises. The

designation as an ‘enterprise cluster’ would generally require a larger number of firms, which may be small and medium sized enterprises, that collectively generate a significant scale of operation, with the primary orientation towards commercial rather than industrial association.

The majority of prior and current cluster research undertaken in China relates to enterprise clusters rather than to industrial clusters. According to DTI (2003), the cluster development can be divided into three stages: ‘embryonic’, ‘established’ and ‘mature’. An embryonic cluster can be assumed to be at the early stage of development and therefore with obvious growth potential. An established cluster will have room for further growth and a mature cluster will find further growth difficult. In this sense, there are only a few clusters in developing countries like China that could be referred to as a ‘classical’ cluster in the mature phase of their lifecycle, but most of them are in the embryonic stage, i.e. Critical mass and Takeoff.

Research on the life cycle of cluster development is hardly new. For example Marshall’s (1987) seminal work on the British regional development, to the comparative work of Swann et al. (1998) on the dynamics of industrial clustering in computing and biotechnology industries at international level. Leading to the work of Wilson and Singleton (2003) on clustering, networking and performance of the Manchester industrial district, to the work of Chapman (2005) on the growth and restructuring of the regional development of Teeside chemical industry. Empirical materials available for understanding the life cycle of cluster development are massive. Until recently, this area of study has been taken forward by Popp and Wilson (2007) with the integration of both works from the aforementioned researchers and their empirical experiences, which offer a clear classification of different stages in the cluster development life cycle, and help to better illustrate the practical impact of characteristics of each stage. According to Popp and Wilson (2007), the life cycle of cluster development can be classified into six basic stages: ‘

- **Critical mass** – the initial clustering of expertise and factors of production.
- **Takeoff** – often associated with key inventions or innovations, which alongside the clustering of expertise and factors of production give the district a significant competitive advantage.
- **Cooperative competitiveness** – balancing the lateral and vertical advantages of clustering and networking and achieving competitive advantage over rival clusters.
- **Saturation** – the costs of clustering start to outweigh benefits, with rate of growth falling away, innovation rare, and competition increasing from lower cost producers.
- **Maturity** – rival clusters offer superior advantages for new firms, and decline sets in across the older district.”
- **Renaissance** – new industries locate in the cluster, attracted by either cheap factors or production, demand for their products, or the activities of regional planners.’ (ibid, p.2978).

The available evidence suggests that cluster formation appears to have resembled the more usual cluster phenomenon based on the industrial agglomeration in particular geographic districts (in China, for example, the professional town and blocked economy in Zhejiang and in Jiangsu Province). However, it would arguably be inappropriate to analyse and evaluate such cluster development utilising the same criteria and characteristics associated with clusters formed in the developed nations of the West. Clusters in China have been formed under significantly different conditions (e.g. political, economic and social) from those pertaining in the West at the time of their formation and subsequent development. Therefore, it is necessary to examine the distinctiveness of Chinese clusters not only in terms of their general characteristics, but also recognising their different institutional factors operating within a unique context and their embeddedness. The distillation of the nature, characteristics and operations of enterprise clusters in the West should provide a substantive basis for the



analysis of the enterprise clusters that have evolved in the Chinese context. Before further investing in the cluster formation in the Chinese context, it is worth reviewing the theoretical approach to cluster development based on the extant literatures.

## **2.5 Approaches to the development of SME clusters**

Small and medium sized enterprises, the key agents that form clusters, have attracted increasing interest from academics, policy makers and practitioners. This is not only because they represent more than ninety percent of the total number of enterprises worldwide, but also because they play important roles in increasing employment and sales capacity (Ceglie and Dini, 1999; Peres and Stumpo, 2000; Tambunan, 2005; Parrilli, 2005). Although the focus has changed more from large or stated-owned firms to (private) small and medium enterprises, the support and service offered to SMEs are still inadequate and ineffective. The numbers of initiatives and the take up of services appear to be out of proportion, dropping from a very high to notoriously low levels (Henderson and Morgan, 2002; Whitehurst, 2006). However, the problems faced by most SMEs, such as access to finance, technology, international markets and government support can be improved by means of a cluster approach. The difficulties that stem from their small size and isolation can also be solved through the benefits of geographical proximity, which involves different level of contacts and cooperation within clusters (Sengenberger and Pyke, 1991, Morgan, 1996; Karaev *et al.*, 2007). Thus, the cluster approach for promoting SME development has appealed not only to the many multi-disciplinary academic researchers but also to national and international policy makers (e.g. Department of Trade and Industry, European Commission, UNIDO, US Department of Commerce, etc.).

However, not every cluster story has a happy ending. It is argued that initial research and implementation relating to clusters was over-concentrated on the competitive advantages generated by firms in a cluster, i.e. saving transaction costs, upgrading technology and know-how, increasing productivity, facilitating innovations (Porter,

1998a,b, 2000; Gordon and McCann, 2000; Malmberg and Maskell, 2002). Such studies failed to pay adequate attention to investigating and learning lessons on how the clusters are formed in the first place. This stream of research has not gained sufficient attention until recently (Parrilli, 2004a; Feldman *et al.*, 2005; Karlsen, 2005; Lorenzen, 2005). The key aspect of cluster research is not merely about what can be derived from clusters, but the origins and dynamics for forming clusters. This needs the researcher to investigate what the SMEs (more specifically the key agents, i.e. entrepreneurs and other related actors) want and need, what makes them gather together and work cooperatively as the potential and basic agents for forming clusters. In both the theoretical and practical sense, this research argues that these concerns are the essential elements which could help SMEs to survive and develop, and then make the cluster they formed generate greater competitive advantage and become more sustainable. However, the focus on the cause and effect of clusters has always been reversed. Since this study emphasises the importance of the causes of cluster formation, the following section will review relevant literature on the cause of cluster development.

Studies of SME cluster development can be classified into three main categories, focusing on different approaches, i.e. the economic approach, the political approach and the social approach (Parrilli, 2004a; Crone, 2009).

### **2.5.1 Economic approach**

In the first category, most studies argue that the development of clusters is based on the initiatives of (small and medium) enterprises to meet market needs. ‘Market liberalisation’ (Parrilli, 2005, p.92) is the driving force behind the dynamics of cluster formations (Schmitz, 1995a,b; Nadvi and Schmitz, 1999). This is mainly based on Marshallian ‘external economies’, i.e. factors such as the geographical agglomeration, knowledge spillovers, technology know-how, the co-location of united or competitive

companies, specialised suppliers and adequate customers, etc. (e.g. Ghani and Stewart, 1991; Humphrey and Schmitz, 1995; Porter 1998a; Keeble *et al.*, 1999; Mitra, 2000; Malmberg and Maskell, 2002).

However, it is argued by many researchers that the forces of market liberalisation cannot guarantee the successful formation of a cluster, and the ability of SMEs to respond to market needs is not born automatically (Piore and Sabel, 1984; Brusco, 1990; Nadvi, 1999b; Parrilli, 2001; 2004a). In fact, it is the result of ‘spontaneous’ agglomerations of SMEs in proximity to one another, i.e. different levels of cooperative relationship (inter- and intra; horizontal and vertical cooperation) created among them, that generate and enhance their collective efficiency and flexibility to react to the market changes (DeWitt *et al.*, 2006; Kim and Zhang, 2008). The enhancement of collective efficiency and flexibility reflect the improvement of key variables which determine the capability and competitiveness of a specific region, that is, the local pool of labour, technology spillovers, market access and intermediate input, and more importantly, help to facilitate joint actions (Ghani and Steward, 1991; Nadvi, 1999a; Parrilli, 2004a, Zeng, 2008). Such factors give rise to clusters.

In short, this category of studies that follows an economic approach mainly based on Marshall’s traditional external economy (Marshall 1920), views the origins and development of a cluster as the result of spontaneous agglomerations of enterprises. Parrilli (2004a) claimed that this spontaneous agglomeration is due to ‘the endogenous dynamism of the local context’, generated through ‘its rich economic and social basis’, thus facilitating a ‘bottom-up movement’ to cluster development (*ibid*, p.1117-1118).

However, the common weakness of the spontaneous approach is, clusters take time to form, and the endogenous forces beneath their dynamism makes it difficult to imitate elsewhere (Pallares-Barbera *et.al.*, 2004; Parrilli, 2004a). With the rapid openness and globalisation of markets, firms begin to face more intense competition and challenges

from international, national or even regional levels. Therefore, developing clusters from a purely spontaneous approach is not sufficient or efficient enough to respond to the new market changes. The feature of spontaneous development, which is based on specific conditions of one region, begins to become a potential barrier. In order to respond to the new market conditions more efficiently and effectively, another perspective to cluster development is proposed, i.e. the political approach (Musick and Schmitz, 1994; Boekholt and Thuriaux, 1999; Curran, 2000).

### **2.5.2 Political approach**

The second category of studies views cluster formation and development through governmental or institutional policies. These studies mainly concentrate on the relationship between policies and clusters (Rosenfeld 1997; Porter, 2000; Brown, 2000; Parrilli, 2004a; Ketels and Memedovic, 2008; Crone, 2009). The aspects that attract most attention in this approach include policy intervention or inducement, policymaking processes, and policy application in practice, all emphasising the role and impact of public policies in shaping the dynamics for cluster development (Parrilli, 2004a; Palazuelos, 2005; Whitehurst and Siedlok, 2006; Zeng, 2008). Cluster policies have proliferated and increasingly been implemented throughout both developed and developing economies since the 1990s, for example: Europe (Humphrey and Schmitz, 1995; Raines, 2000), North America (Rosenfeld, 1995; Porter, 1998a,b), Asia (Segal and Thun, 2001; Tambunan and Supratikno, 2004), Africa (Parrilli, 2003; Morris and Barnes, 2007; Zeng, 2008), and other parts of the world. It is widely believed that government decisions have a major influence on the trajectories of cluster formation in various ways (Wolfe and Gertler, 2004) and geographical agglomeration (even) initiated by government can enhance the networks in a local context, facilitate knowledge and technology exchange, and thus facilitate cluster development (Camagni, 1991; Scott, 1994; Wang, 2007).

However, Enright (2000) argues that there is a risk of those cluster policies to become a ‘one size fit all’ therapy, with policy makers pursuing the same clusters with similar

polices with little consideration of context differentiation issues. Furthermore, with the ambiguity and diversity of definitions of clusters, in most cases, cluster concepts have been used very broadly to ensure political needs (Martin and Sunley, 2003). Thus, both from the theoretical and practical perspective, the majority of the studies in this category have still not offered clear implications and guidance for readers (Parrilli, 2004a; Whitehurst and Siedlok, 2006).

Although, government policies represent the legal framework of a certain geographical space and are believed to guarantee a 'top-down' movement for cluster formations, views on the efficacy of strategies and implementations based solely or predominantly on the 'top-down' trajectory still remain contentious (Atherton, 2003; Atherton and Price, 2008; Crone, 2009). Additionally, the actions taken by policy makers to boost cluster formation are often criticised as 'starting from a desk-based cluster mapping exercise' (Crone, 2009, p.3; Enright 2003; Martin and Sunley, 2003). Furthermore, the development of a cluster is a stage process, yet most governments merely rush to apply the cluster idea and attempt to cross too many stages at once (Parrilli, 2004). Therefore, even if a physical cluster has been built up in the geographical sense, its success and sustainability still cannot be guaranteed.

### **2.5.3 Social approach**

On the basis of the aforementioned, some researchers have proposed combining these two approaches (Porter, 2000; Lyon and Atherton, 2000; Perry, 2004, Crone, 2009) to improve understanding of cluster formation. However, this proposition can still be challenged. One such challenge is that, although some regions have characteristics that would suggest they might be suitable for the formation of clusters, they have but never actually formed clusters (for example, South Italy) (Amin, 1994; Parrilli, 2004a). Equally, some regions with supportive policies and initiatives for forming or supporting clusters do not succeed in creating successful clusters, for example, the marine and offshore engineering cluster in northeast England (Whitehurst, 2006), the

ICT sector in North West of Ireland (Crone, 2007), examples in Southern Italy (Amin, 1994) and Chile (Parrilli, 2004b), and among others. In response to these concerns, a further approach, i.e. social approach, is proposed to fill the gap, and to answer the question why clusters are formed and developed in certain places but not in others (Gordon and McCann 2000; Pallares-Barbera, *et al.*, 2004; Parrilli, 2004a, Fromhold-Eisebith & Eisebith, 2005; Feldman and Bercovitz, 2005; Dickson, *et al.*, 2006).

Parrilli's (2004a, 2005) attempt to conceptualise cluster formation has shed new light on this category of studies. Parrilli (2005) attempts to build a framework by combining these different approaches, that especially endorse and take forward the understanding of cluster formation from the 'spontaneous development' perspective, but with a different focus. According to Parrilli (2004a), the majority of theorists tend to take the role of social features for granted and group them into one of the many features of the 'spontaneous approach'. In respect of this, Parrilli (2004a) suggests including social features as one of the key determinants of cluster formation as well, since the dynamic for a region to form and develop clusters does not merely rely on economic (profits, competitions, risks, etc) or political motivations, but also depends on social elements (social networks, social embeddedness, social values, etc.) of that region.

Parrilli's attempt is very useful because it takes into account the role of local agents (i.e. individual actors) and their human behaviours attribute to the integrated factor, in particular emphasising the concept of 'trust' and 'self-realisation' from the social perspective, since they 'jointly produce a 'positive sum game' for the local system as a whole' (Parrilli, 2004a, p.1118). However, Parrilli's approach for understanding cluster development still has some limitations. Although he mentions the importance the role of individuals' and their related behaviour, particularly emphasising the social approach, he also points to the importance of learning more about the dynamism of what encourages individuals to group together to form the cluster. Questions

concerning how and why a cluster is formed related to individuals are still left unanswered. Another limitation of Parrilli's analysis is that, although he integrates different approaches and pays special attention to the social one, he also claims that the absence of one of the three 'factors' (economical, political and social) will not prevent the formation of a cluster but rather weaken its competitive potential. This would seem to contradict his previous arguments, that social aspects play a key role in the cluster formation process. From the present researcher's perspective, this fails to take into account the interrelationship and interaction among different factors in an ongoing system, that will in turn influence individuals' understanding and actions, thus determining whether a cluster can form successfully or not. The tasks of this thesis, therefore, are not only to identify the social characteristics related to cluster formation, but also to investigate how individuals interact with an ongoing context which generated by the interplay among different elements (social, economic, political, etc) and then what shape the way individuals understand and behave, then relate these to cluster formation. These issues will be further discussed in the next Chapter (Chapter three: conceptual framework), with a focus on the Chinese context.

## **2.6 Summary**

This chapter has examined the literature on cluster research from two main aspects: the definitions of cluster and the approaches to cluster development. The review of various definitions of cluster has helped to identify three basic common characteristics, i.e. geographical concentration, relationship and mutual benefit. However, due to the diversity and complexity associated with cluster concepts in practice, the utilisation of these three characteristics cannot explicitly define a cluster, due to their broad coverage. This leads the present researcher to clarify the boundaries of cluster even further. Thus, two types of clusters (i.e. industry cluster and enterprise cluster) have been discussed and compared. The results show that most clusters in developing countries tend to be enterprise clusters, as in the case of China. Thus, to enrich the understanding of this aspect, the approaches of SME cluster development

have then been presented. A review of three different approaches (i.e. economic approach, political approach and social approach) of cluster formation has showed that not enough attention had been paid to the social approach. Thus, in the next chapter, this argument will be further extended and thoroughly investigated, especially focusing on the Chinese context. A conceptual framework will be established to complement the extant studies while attempting to advance the understanding of cluster formation from an alternative view.



## **Chapter Three: Conceptual Framework**

### **3.1 Introduction:**

The values and shortcomings of the different approaches to explaining cluster formation i.e. the economic approach, the political approach and the social approach were highlighted in the previous Literature Review Chapter. This chapter will develop this area with particular focus on the social approach to cluster formation on the basis of the contribution of extant literature. However the emphasis and perspectives will be different in this research.

The social approach is proposed by some researchers to explain the formation and development of clusters (Gordon and McCann, 2000; Parrilli, 2004a; Fromhold-Eisebith & Eisebith 2005; Feldman *et al.*, 2005), because the economic and political approaches cannot fully explain all the effective elements that give rise to clusters, whether used alone or in conjunction with each other. To understand the dynamics of cluster formation, many researchers advocate using the economic concept of ‘entrepreneurship’ in their explanation (Schumpeter, 1934; Harrison, *et al.*, 2004; Karlsen, 2005; Watkins-Mathys and Foster, 2006). However, Parrilli (2005) argues that, whilst we should be aware of the importance of the roles and values of entrepreneurship in the process of cluster formation, the origins of entrepreneurship derive not only from economic or political factors, but also, and most importantly depend on social characteristics of a region, including social relations and networks, social features and rules. These play a key role in creating and facilitating a positive environment for cluster formation (Becattini, 1990; Platteau, 1994; Minguzzi and Passaro, 2001; van Dijk and Sverrisson, 2003; Rong, 2004).

Following Parrilli’s approach, the first task of this chapter is to investigate the social characteristics that are believed to foster cluster formation in China. Firstly, networks and cluster formation are discussed in general, and the specific situation in China is

then discussed. This section identifies in particular the crucial importance of networks or 'guanxi' in Chinese business and the importance of family to Chinese people, which extends into business, business networks and cluster formation. To consolidate this approach, institutional theory, social embeddedness and sensemaking concepts will be adopted complementarily to pull all the arguments together, particularly taking into account the role of individuals and their interaction with the social context. A conceptual framework will be developed based on these elements.

### **3.2. Social relations and networks**

Previous research on clusters recognised the importance of social characteristics, tending to concentrate on the influence of social relationships and family that give rise to cluster formation (e.g. Becattini 1990; Jack and Anderson, 2002; Pallares-Barbera *et al.*, 2004; Kalantaridis and Bika, 2006). These studies indicate that the formation of a cluster is not solely determined by economic activities and public policies in certain geographical territories, but more importantly, depend on the social characteristics that shape the behaviour of local agents (i.e. entrepreneurs and related individuals), given that the behaviour of those agents is deeply embedded in their social relations and social context (Granovetter, 1985). A review of the existing literature associated with the structure and functioning of business in China, also concurs with this proposal, and identifies the critical importance of social networks and family (e.g. Redding, 1990; Hamilton, 1991; Fei, 1992; Poutziouris *et al.*, 2002). A distinctive feature of China is the degree of overlap between family and social networks, which have a significant degree of mutual interaction and influence on each other. These social networks have the capacity to extend, develop and re-orient themselves, often evolving into sustainable industrial networks.

Despite the significant time and effort devoted to the study of social networks, there still remains a lack of universal agreement concerning the definition, the composition or the ways in which social networks may be usefully employed. This is partly

because of difficulties identifying the composition of a social network. Boissevain (1974, p.24), observed that the ‘social relations in which every individual is embedded may be viewed as a network’. Thus, it may not be appropriate to view families, relatives, friends, and other personal relationships separately in social network studies. This is particularly true in the Chinese context, where there is a large degree of overlap among networks of family and friends and social networks. Thus there is a need to treat these influences as one network. The next section will review literature on networks.

### **3.2.1 Networks**

According to Todtling and Trippel (2004), networks or networking are seen both as a precondition and result of cluster formation and development. However, there is still no generally accepted definition of the term ‘network’. According to Easton’s (1992) reviews of definitions of networks, they can be classified into three types. The first type of definition concentrates on the exchange dimension in two or more connected relationships (Anderson et al, 1994; Cook and Emerson 1978; Ghauri *et al.*, 2003). The second type concentrates on the bond or social relationship that links loosely connected organisations (Aldrich 1979; Lundgren, 1995; Ghauri *et al.*, 2003). The final type of definition identifies the network as a pattern of relationships created among a group of organisations, that not only contains simple vertical connections, but also horizontal or even complex network relationships (e.g. Van de Ven and Ferry, 1980; Hakansson, 1989; Ring and Van de Ven 1994; Ghauri and Prasad, 1995). A review of these definitions makes it clear that there are different types of networks with different implications and requiring analysis at different levels.

Moreover, networks can be categorised into business and social networks; formal and informal networks, and vertical and horizontal networks. Although, there are a number of definitions in operation and a wider application of the network concept in networks studies, all these studies concur that networks are important as a means to

access resources, information, opportunities and support (e.g. Birley, 1985; Hamilton, 1991; Gartner, 2001; Steier, 2003). Some authors also view networks as a mechanism that helps to break down the barriers and achieve the goals in a business context (e.g. Weidenbaum & Hugnes, 1996; Visser, 1996; Ceiglie and Dini 1999, Nadvi, 1995a, etc). However, one weakness of these studies is their common view that networks are already in existence in the business context and can be utilised as required at different stages for different purposes. Johannisson (1995) argues that a network is a social construction rather than an independent pre-existing entity, whose emergence and development is the consequence of individual interactions and not just simply the outcome of a response to the environment (Granovetter, 1985; Weick, 1995). Therefore, a better understanding of networks, including their operation and dynamics, requires an alternative perspective, in order to understand cluster formation.

Van de Ven (1976) concludes that, at the initiation stage of the emergence of a network, relationships between organisations are formed either because there is a shared need for resources within the group or a shared commitment to co-operate in resolving external problems or opportunities. This is echoed by Meulenbergh *et al.* (1998), who list three conditions for the emergence of a successful network. Firstly, common or shared problems or opportunities exist in the market. Secondly, companies prefer to respond jointly, and thirdly, if the product is marketed by a co-operative this should be important for the income generation of those related companies. Welch and Joynt (1987), researching into the process of network development, identified the success of network development as being attributable to the solidarity, cohesion and commitment among the network members. However, Robbins (1994) argued that the expansion of the network would increase the difficulties in achieving effective interaction among the group members and may not be able to guarantee their common goal in the long term. Instead, competitive situations are likely to replace cooperation, especially when the products produced by group members are readily substitutable across their network (Rosson and Blunden, 1985). This potential breakdown in co-operation and its replacement with competition

was addressed by Lawal (1974), who suggested that the appointment of a relatively independent third party could help to manage such internal competition to some extent and co-ordinate members' activities in responding to a common external threat (Ghauri, et al., 2003).

However, this response is somewhat idealistic in a business sense, raising two evident questions. Firstly, even if independent parties, such as public organisations, business agents, or facilitators volunteer to mediate in such competitive situations, their influence might prove effective only temporarily and may not guarantee that the harmonisation elements, identified by Meulenberg *et al.* (1998), (i.e., solidarity, cohesion and commitment) will prove sustainable in the longer term. The assumption that the relationships among group members will remain as before and unaffected by significant contextual changes is difficult to sustain. Secondly, the evidence from other network studies (e.g. Forsgren and Johanson, 1992; Hertz and Mattsson, 2001), suggest that viewing the network from a purely business perspective is too narrow and merely views networks as comprising activities carried out explicitly by business actors, striving towards achieving their set goals. Such studies enhance the realisation that the ability to make the networking concept work effectively depends on the actors' (especially business actors) involvement and their ability to work cooperatively (see Stenborg, 1982, p.732). However, they may also be challenged on the basis that they fail to recognise the importance of the social contribution, by excluding consideration of the social perspective and role of networks. The interconnectivity of companies within the competitive socio-economic environment, results in multiple connections with other actors, resulting in both business and non-business actors engaging in a variety of roles and responsibilities as members of multiple networks. This reinforces the recognition of the importance of individuals in initiating, developing and sustaining networks.

A significant number of network studies, relating to cluster research view the network's social role and economic role separately. Traditionally, the views relating to

the social role of networks originate from a family or social group basis. Hendrischke (2004) comments that, although based on shared family values or social background, network members have a tendency to cooperate more in businesses to survive because of their collective commitment and the trust created by the network. Researchers may view this as dealing with comparatively static structures, because in this kind of network 'their intentions and reach is predetermined; they are confined in size and expansion, as they serve the core or extended family unit and their expansion is ultimately restricted by the need to professionalise, either because of size or complexity, or because of personal and generational change after the founding generation' (Hendrischke, 2004, p. 98). Moreover, as discussed above, it is idealistic to view the role of the network from purely an economic or business perspective, given that the institutional environment in some countries might not be strong enough to provide business procedures, conflict resolution, assets, finance, knowhow and other business support services. Thus Hendrischke (2004) argues that networks will be more flexible and dynamic if they have been viewed as a form of social institution created for the purpose of entrepreneurial activity according to 'demand and adapted to a changing institutional environment' (ibid, p.99).

Most network studies also fail to explain explicitly the process of how individuals interact with their environment, generate and develop the network, and how this in turn gives rise to a cluster. In light of the shortcomings of the studies relating to networks, and the anticipated lack of insight concerning the creation and development of clusters, this study seeks to achieve this through the exploration of related issues, e.g. social embeddedness, institutional factors, etc. and the contribution this may provide to understanding what makes individuals behave in certain ways to form clusters. Before moving on to this discussion, the next section will review the Chinese network system.

### **3.2.2 Chinese network system**

The most distinctive feature of the Chinese economy or even the Asian economies, may be expressed succinctly in a single word ‘network’. It has been suggested that Chinese businesses (including overseas Chinese businesses) are deep-rooted and closely entwined with other networks and social relationships (Malik, 1997), which can be described by the term ‘Guanxi’ (Discussed below in Section 3.2.3). Redding (1998), concluded after long-term observation of Chinese businesses operating at home and overseas, that Chinese businesses were heavily reliant on their networks. These networks operate primarily through family or kinship ties, based largely on personal trust due to the inability to institutionalise trust in the Chinese society. ‘Weak organisation and strong linkage’ highlighted by Redding (1991) has since become an associated feature of Chinese business the world over.

Jacobs *et al.*, (2004) claim that, the most valuable asset for a potential businessman starting his/her career in the private sector is not simply securing funding for business start-up, but more importantly the social capital he/she possesses, often referred to as ‘social relations’, especially in China. Social capital, as ‘an attribute of societies from which individuals or collectives may benefit, derived from community-like relationships of reciprocity, favour-exchange, trust, dependability, and open communication’ (Cooke, 2000, p.2), is believed to ‘improve the efficiency of society by facilitating coordinated actions’ (Putnam, 1993, p.167), therefore, raising the possibilities for forming clusters.

In the West, the concept of entrepreneurship and starting a business is focused on the individual’s ability to find profitable opportunities, compared with China, where ‘who you know’ is more important than ‘what you know’ (Kirzner, 1973; 1985). Krug and Mehta (2004, p.60) emphasise the importance of recognising those people best suited to forming an alliance as those who ‘possess or control the financial assets, physical assets, or specific human capital needed for broking market entry, that is, for starting production, securing supply, and gaining access to distribution channels (Cheng and

Rosett 1991; Nee 1989; Boisot 1995)'. The possession of such attributes unquestionably provides distinctive competitive advantages for the entrepreneur not only 'by making production possible in the first instance, but by reducing the level of risk and increasing the expected net returns to a venture' (Krug and Mehta, 2004, p.60).

The significance of social networks, or more specifically, social relations and personal ties, has not only been experienced by practitioners but is also discussed in academic literature. It is clear that improved understanding of the Chinese conceptualisation of social networks can help us to advance understanding of the behaviour (of individuals) within social networks. The Chinese word 'Guanxi (关系)' predominantly reflects the notion, that is widely believed to lie at the centre of China's booming economy and the success of Chinese businesses (Redding, 1996; Boisot and Child 1999; Jacobs *et al.*, 2004; So and Walker, 2006).

### **3.2.3 Guanxi**

The term 'Guanxi' has been universally used to represent the Chinese form of social network. Generally, the Chinese word 'Guanxi' is translated as 'relationship', 'networking' or 'connection'. The term can be used in Chinese 'either to refer to people, when the word means human relationship or non-human issues, e.g. in 'guanxi between price and quantity demanded' (So and Walker, 2006, p.3). However, when the word has been translated and adopted in English, it is spelt as *guanxi* and is based on the Chinese pin-yin system. Its use in English is restricted to describing relationships between people (So and Walker, 2006).

A review of the literature reveals a number of different interpretations of guanxi which shows the differences in underlying concepts. Definitions include, 'Chinese particularistic ties' (Jacobs, 1982); 'personal ties' (Pye, 1992), and 'necessitating very personal interactions' (Leung et al, 1993), However, it is argued by So and Walker



(2006) that a simple English translation is insufficient to bring out the special nature of *guanxi*. This is in line with the claim made by Bell (2000) that, although the emphasis of *guanxi* is on relationships, the term means more than that. ‘*Guanxi* refers to relationship in the most profound sense of the term, with implications that are beyond the customary English usage’ (p.133). Although it is hard to use one line to define *guanxi* in practice, no businessmen (either overseas or in mainland China or others who have a working relationship with Chinese business) can fail to become familiar with the term *guanxi* and regard it as an important and vital condition for achieving long term business success (Chu and Ju, 1993; Yeung and Tung, 1996; Jacobs *et al.*, 2004).

A significant number of Chinese network studies regard *guanxi* (Chinese business network) as exogenously given or a remnant of Chinese tradition (Krug and Polos, 2004, p.73), which are thought to be inappropriate. It is argued by Hammond & Glenn (2004) that ‘the marketplace environment is the primordial soup from which the Chinese notion of *Guanxi* arose’ (p.25). In this environment ‘where some degree of relational and economic certainty was essential for survival, rules and traditions for social engagement arose that allowed for individual role definition, relational ethics, and social and economic sustainability’ (Gao & Ting-Toomey, 1998)” (ibid). Thus it is the Chinese marketplace environment that gives rise to the idea of *Guanxi*. Also as discussed earlier, the environment itself cannot be perceived and interpreted without recognising the action of individuals. Thus it may be further argued that the *Guanxi* network did not exist exogenously, but emerged through the interactions between individuals and their environment. *Guanxi* may be viewed as intangible but nevertheless transferable, whilst shaping and reshaping itself appropriately in response to individual and environmental changes. Redding and Ng (1982) argue that *Guanxi* is emergent and dynamically changing, reflecting a similar argument to that raised previously in relation to the term network.

Jacobs *et al.* (2004), attempting to conceptualise the Chinese business network *guanxi*,

have moved the study in this area a step forward. They divide the existing guanxi literature into two categories, firstly, guanxi as a form of extended familial tie, and secondly, guanxi as a form of instrumental tie. Their study takes into account the cultural influence, especially that of Confucianism, which is thought to shape guanxi in general, and in business relations in particular. Table 3.1 summarises the differences between the two categories and the associated models. According to Jacobs *et al.* (2004), the first model suggests that ‘guanxi is based on familial obligations and sentiments. These ties can be extended to other social relations when the achievement of a strong reputation implies fulfilling the moral obligations derived from familial relationships. A strong reputation will in turn within a group offer access to social resources’ (p.174). In contrast to the first model, the second model assumes guanxi to be an exchange network defined by its functional value and the specific mode of reciprocity employed for coordinating individual actions (see for instance Jacobs, 1979; Hwang, 1987; Yang 1994)’ (ibid). However, the second model is not limited to the family or close friends, but expanded to ‘any range of social and work-related relationships, most commonly a shared past at the base of the personal relation’ (Jacobs *et al.*, 2004, p.174). Therefore, unlike the first model ‘reputation is earned by keeping promises and by returning favours. Likewise, ‘face’ is not gained by fulfilling moral and ethical obligations but by following the reciprocity norms, while guanxi capital is based on mutual trust and loyalty between the favour exchanging parties (Yang, 1994; Hwang 1987)’ (Jacobs *et al.*, 2004, p.175).

**Table 3.1 Comparison of the two guanxi models**

	<i>Model of extended family ties</i>	<i>Model of particular instrumental ties</i>
Relational orientation	Sentimental ties	Instrumental ties
Relational base	Pseudo-family	Any group but mostly one of people sharing a ‘past’
Source of guanxi capital	Closeness and sentiments	Mutual trust and loyalty
Social mechanism	Fulfilling moral obligations	Adhering to reciprocity norms

(Source: Jacobs, Belschak and Krug, 2004, p.175)

This study by Jacobs *et al.*, (2004) is very useful, since they regard *guanxi* as social capital and argue that social capital is shaped by culture, i.e. those inherited institutions, norms and customs by which people interact with each other (p.167). However, although their studies acknowledge the important roles of individuals, they fail to explain how and why it happens. Moreover, it also ignores the individual's social embeddedness, because, as well as cultural factors, there are also other aspects such as political, economical and historical factors influencing the ongoing social context within which individuals are embedded.

### **3.2.4 Trust**

Although there is no universally accepted definition of 'guanxi' or 'network' in the literature, there is nevertheless a general agreement that networks are based on trust (e.g. Schallenkamp and Smith, 2007; Neegaard and Madsen, 2004; Dollinger, 2003; Aldrich and Zimmer, 1986), described by So and Walker (2006, p.17) as the 'magic behind guanxi (network)'. It could be argued that there are more things in a network or guanxi than merely the power of trust (So and Walker, 2006), but in the absence of evidence or argument to the contrary, trust appears to be a good starting point for understanding networks.

Dollinger (2003) defines networking as the process of enlarging the individual actors' (entrepreneurs) circle of trust. But what makes trust work in the process of networking? Why should people trust one another? What is the reason or the basis for people to trust? And how is trust developed and related to the cluster formation?

Trust, as a particular form of social capital, is viewed as 'a facilitator of economic transactions' (Parrilli, 2005, p.100). The benefits of trust can be summarised into five aspects: it reduces transaction and operation costs; it helps agents cope with internal and external complexity; it facilitates knowledge and information exchange; it

shortens the learning curve and helps to save time (Morgan, 1997; Whitehurst, 2006, p.52). In this sense, trust is believed to create and promote the 'collective efficiency' of a potential or existing cluster (Becattini, 1990; Lorenz, 1992; Schmitz, 1999; Parrilli, 2004a, b). Trust is also believed to play an important role in forming and facilitating what is known as a cluster's 'collective learning', which is achieved through constant social interaction (Keeble *et al.*, 1999; Capello, 1999).

A number of studies indicate that the greater the common shared background in terms of similar beliefs, customs, experiences, rules of behaviour and tacit codes of conduct (Keeble *et al.*, 1999; Pallares-Barbera, *et al.*, 2004; Bathelt *et al.*, 2004), the greater the likelihood of participation in joint/collective activities. Physical proximity is also regarded as the basis for encouraging the establishment of trust (Maskell *et al.*, 1998; Schallenkamp and Smith, 2007). Although, these elements appear to be important factors for creating trust and thus enabling cluster formation, it is argued by McAdam and McAdam (2006) that trust does not automatically emerge as a significant result of these elements. In fact, trust relationships never properly develop in many cases even where the shared elements mentioned above are present. Just as So and Walker (2006) point out, people trust not because he/she is by nature a trusting person, but because he/she finds the other person trustworthy even if selfish.

Thus, apart from the elements that help to form the basis for trust, it is obvious that people as individuals are a vital mechanism for integrating and binding all these elements to establish trust, bond with their peers to form networks, which in turn gives rise to cluster creation.

### **3.2.5 Chinese philosophy**

#### **- The influence of Confucianism**

The engagement and behaviours of individuals are embedded in different networks. For networks to function, Maskell and Malmberg (1999) argue that it is more

important to accept the local rules of the game and the potential sanctions for non-compliance, rather than to focus on active cooperation per se. In this sense, to understand individual behaviour in the Chinese context, it is necessary to start the investigation from the so called local rules, i.e. Chinese culture. Confucian values and ideology are generally seen as the foundation to provide a vital underpinning to the Chinese culture.

Confucian values, created by Confucius (551-479 BC), are an essential part of Chinese culture (Fung, 1952; Lee, 1995; Tu, 1998; Slote and De Vos, 1998; Yan and Soreson, 2004). Confucianism is not a religion, but rather a philosophy or theory of social relations, that provides a set of guidelines for individual human behaviour, shaping the social interaction of people, irrespective of whether they reside in Mainland China, South East Asia, or elsewhere in the world (Fung, 1952; Hofstede, 1991; Redding, 1993; Tu, 1998, Fang 2006; Redding and Witt, 2007). According to Tu (1998), Confucianism has existed ‘for well over 2000 years, served as the source of inspiration as well as the court of appeal for human interaction at all levels – between individuals, communities and nations in the Sinic world’ (Tu 1998, p.3). Confucian values and ideology have remained remarkably persistent, up until now, continuing to exert a major influence on Chinese people’s daily lives. Confucianism also contributes to economic development, forming a consensus among scholars of Chinese business that Confucianism represents the dominant value in the foundations of Chinese philosophy (Tai, 1989; Whitley, 1991; Kirkbride and Tang, 1992; Greenhalgh, 1994; Jacobs *et al.* 1995; Xing, 1995; Lee, 1996; Richter, 2002).

Generally speaking, Confucianism uses five virtues to define the relationships between individuals. These five virtues are humanity/benevolence (ren), righteousness (yi), propriety (li), wisdom (zhi), and trustworthiness (xin). Each link in an individual’s network is defined in terms of a dyadic social relation (*lun*). *Lun* stresses differentiation, which is the order based on classifications. According to *The Book of*

*Rites (Liji)*<sup>1</sup>, there are ten types of principal human relationships: ‘Gods and ghosts, monarchs and subjects, fathers and sons, the noble and the base, the intimate and the unconnected, the rewarded and the punished, husbands and wives, public affairs and private affairs, seniors and juniors, and superiors and inferiors’. (in Fei, 1992, p.65). The presence of different types within the same category may be questioned. Some of these types have clearly defined social relationships (e.g. gods and ghosts, monarchs and subjects, fathers and sons) whilst others represent more abstract positional types, (e.g. noble and the base, the intimate and the unconnected). According to Fei (1992), the fundamental nature of traditional Chinese social structures rests on this kind of hierarchical differentiation. Thus, recognising the distinctions that define the Chinese pattern of social organisation is vital to understanding the networks of human relationships (Fei, 1992).

Following a review of the literature relating to Confucianism, three key values were extracted, the *family*, the *interpersonal* (concepts of *guanxi*, *trust*, *renqing* and *li*) and the *collective* values (Tu, 1984; Hofstede and Bond, 1988; Child and Lockett 1990; Tan, 1990; Redding 1993; Yan and Sorenson, 2004, Fang, 2006). Confucianism sees the family as the prototype of all social organisations, since individuals do not exist as a separate entity, but are connected with and embedded in a family, a clan or other group (Hofstede, 1991; Slote and De Vos, 1998; Jacobs *et al.*, 2004; Yan and Sorenson, 2004; Redding and Witt, 2007). Therefore, the will of the individual is subordinated to that of the family group. Jacobs *et al.* (2004) commented that such an understanding of an individual self is in sharp contrast to the Western view of individualism, which sees people as independent and autonomous, reflected in the emphasis on personal choice or personal achievement. This view is supported by several empirical studies (e.g. Hofstede, 1991; Bond and Hwang, 1986; Javidan and House, 2001; Jacobs *et al.*, 2004; Holt, 1997), which indicate that China achieved a high score on the collectivism dimension, reflecting a strong trend towards categorising people into

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<sup>1</sup> The Book of Rites, one of the Confucian classics, was completed during the Western Han period, (206 B.C.—A.D. 8) and contains early discussion of ritual practices.

different groups (social relations) and treating them in terms of the *Lun* described above (Fei, 1992; Hammond & Glenn, 2004; Yan and Sorenson, 2004). It can be inferred from these results, that the tendency to treat people differently in terms of their relationships to themselves, reflects the reason why social relationships (*guanxi*) are so important in the Chinese context.

However, as Redding (1993) observed, the dominance of Confucianism did not give it a monopoly, since the parallel forces of Taoism and Buddhism cannot be ignored in seeking to fully understand the Chinese culture. According to Fang's (2006) brief explanation, the emphases of these three ideologies are quite different. Confucianism deals with human relationships, Taoism deals with life in harmony with nature and Buddhism deals with people's view of the immortal world. Hence, an interesting phenomenon arises: although these three sets of values are not always consistent with each other, how could they co-exist and co-effect the harmony among Chinese people, no matter whether they live in Mainland China or overseas. Lee's (1995, p.12) description can help to explain this phenomenon:

‘This is a wonderful way of life which Westerners cannot understand – how can a person follow the teachings of three teachers who have always been regarded by many Western and even Chinese writers as the founders of the three religions of China – Confucianism, Taoism and Buddhism? The fact is they are not religions, and that is why the Chinese can follow all three teachings, each for one particular aspect of their life. This foundation of Chinese culture has made the Chinese intensively practical...and given them great power for absorbing all things that are good and beneficial, irrespective of their origin. Chinese culture has survived and has been enriched by this power.’

It might be argued that Buddhism is a religion; however, since it was ‘imported’ to China from India around a century ago, it has already been adapted and embedded into the Chinese social context. Thus it is not regarded as the same as the Buddhism religion in countries such as India, but rather like a philosophical belief among the Chinese people.

This present study assumes that, in order to understand the behaviour of the individual<sup>2</sup>, especially in the Chinese context, a basic understanding of the nature and the influence of Chinese philosophies is required. A complete review of all Chinese philosophy is beyond the scope or requirements of this current research, hence the decision to focus on Confucian values as the dominant foundation, supplemented as appropriate with reference to Taoism and Buddhism.

It is worth pointing out some questions that arise from the review of this Confucian literature. First, almost all studies show that Confucianism, along with other Chinese philosophical ideologies, still works in contemporary Chinese society. If, as is the case in China, social networks have already been in existence for a long period of time, why do people still need to promote them nowadays? Second, most studies on Confucianism tend to be static. It can be argued that, for more than two thousand years, the values and beliefs of Confucianism have remained unchanged, yet the people who perceive and follow Confucianism must themselves have been changed since the environment they live in has changed. Thus we would anticipate changes in their perceptions, interpretation and behaviour accordingly to reflect changes in their environment. Most studies still leave such questions unanswered. However, this present study will contribute to answering such questions and linking the impact of Confucianism in to other factors influencing individual behaviour, that help to understand clustering, such as the family, institutional framework and social embeddedness.

### **3.3 Family and family business**

Discussion of the Chinese network and Chinese philosophy provides an appropriate opportunity to improve understanding of the concept of family and family business. It is argued by many researchers that family is the prototype of all social organisation, especially in the Chinese context (Hofstede, 1991; Jacobs *et al.*, 2004; Yan and

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<sup>2</sup> Individuals are the people who take the action to set up a firm or grouping, and then form clusters.



Sorenson, 2004; Redding and Witt, 2007). However, there are still not many rigorous empirical studies have been undertaken to investigate the dynamism of cluster formation in China (Sonobe *et al.* 2002), and too little research has attempted to link the value of family and family business to the formation of clusters. The task of this subsection is to fill in this gap and explore family and family business in depth, and then relate them to the formation of clusters. The review of this area of interest will start with the concept of family in the Chinese context.

### **3.3.1 The concept of family in the Chinese context**

Full appreciation of the critical role of the ‘family’ in the context of social networks and the wider culture is seen in the work of Mencius<sup>3</sup> who observed that ‘The root of the world is the state, the root of the state is the family’ (天下之本在国, 国之本在家, *tian xia zhi ben zai guo, guo zhi ben zai jia*)<sup>4</sup>. Hence, traditionally and at the present time, Chinese society regards the concept of the ‘family’ as the most fundamental and most important component associated with the sustainability of the country. The notion of the ‘family’ cannot be understood separately from that of the state, since the two notions are interrelated and interwoven together. This is best illustrated by the Chinese expression for the word ‘country’ - ‘国家(*Guo Jia*)’, which comprises two Chinese characters: ‘国’(*Guo*) meaning ‘state’, and ‘家’(*Jia*) meaning ‘family’. The concept of ‘family’, that incorporates a strong link between family members, the associated family values and ethics on which traditional Chinese society is based, continues like an ‘invisible hand’ to influence peoples’ behaviour and is still deeply rooted in many different aspects of their lives.

Within the Chinese context, the concept of ‘family’ is rather ambiguous in terms of its

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<sup>3</sup> Mencius (Chinese: 孟子; pinyin: Meng Zi:372-289 BC), Chinese Confucian philosopher who taught that man is innately good and that one’s nature can be enhanced or perverted by one’s environment. Mencius was arguably the most famous Confucian after Confucius himself.

<sup>4</sup> Another translation is: “the root of the empire is in the state and the root of the state is family”, Mencius IV.A.5 quoted by Hsieh, 1967, please see So, Y.L. and Walker, A., (2006), *Explaining guanxi: the Chinese business network*, Routledge, New York, p.87.

scope, and lacks distinct boundaries. The word ‘家 Jia’ i.e. ‘family’ can be used in many different ways. According to Fei (1992, p.62),

- ‘- 家里的 (Jia li de - i.e. the one at home) can mean one’s wife.
- 家门 (Jia men - i.e. kinsmen) may be directed at a big group of uncles and nephews, aunts and nieces, etc.
- 自家人 (Zi jia ren, - i.e. my own people) may include anyone whom you want to draw into your own circle, and you use it to indicate your intimacy with them.’

People see themselves as the centre, their social relations like ‘the ripples formed from a stone thrown into a lake, each circle spreading out from the centre becomes more distant and at the same time more insignificant’ (Fei, 1992, p.65). People stand at the centre of the circle produced by his/her social influence. Each of these individual circles is interrelated to some degree. Thus, the concept of ‘family’ can be expanded and used in a very general way. ‘自家人 ((Zi jia ren)’ i.e. my own people, is no longer restricted by one’s kinship relations, but can be expanded or contracted according to the specific time and place. At the extreme level the scope may be expanded to include ‘everyone under the sun is a ‘家 Jia’(one family)’ (Fei, 1992, p.62).

This latter point demonstrates that people with certain tenuous relationships could be referred to as being a member of the ‘big family’, which in turn suggests wider social networks in China. A consequence of these wider and prolific social networks is the greater likelihood that they overlap with other networks (e.g. business networks) in which a subset of the same individuals may also be members.

Data shows that over 90 per cent of private businesses in China are family owned businesses (China Digital Times, 2005). Chinese entrepreneurs manage their businesses like a family (King, 1987; Wong, 1985, 1988; Redding, 1988,1990; Redding and Witt, 2007). To this day family business is the most universal and significant form of business organisation, which represents a predominant form of

business not only in China but also globally (Lansberg et al., 1988; Handler 1989; Brockhaus, 1994; Yu, 2001). Researchers from different backgrounds are in agreement with this phenomenon, and it is frequently pointed out that family involvement, in particular the role played by the household, cannot be underestimated, since it is the most important reason for the success of family owned businesses, and the engine for economic growth (Redding, 1993; Baines and Wheelock, 1998; Ram, et al., 2002). Therefore, it is worth examining research relating to family business in both the general and the Chinese context, to learn if it might offer some useful hints that will help us advance our understanding of the cluster formation phenomenon.

### **3.3.2 Family business**

Academic interest in family business has increased rapidly since the 1970s and the 1980s. According to Brockhaus (1994), early authors and researchers on the subject of family business were themselves effectively consultants to family businesses. In the 1980s they acted as financial advisers or family therapists (Lansberg *et al.*, 1988), and subsequently noted and evaluated their observations and suggestions for family businesses to avoid some pitfalls and improve performance. Since then, the research base of family business has broadened and moved forward. General areas of interest have emerged and have received particular attention, including culture and ethnic minority family businesses (Astrachan, 1988; Dyer, 1986; Lam and Ritchie, 2006; Liu and Mackinnon, 2002; Rae, 2005; Redding 1996; Malik, 1997, Redding and Witt, 2007); strategic planning (Ward, 1987; Gerz *et al.*, 2004; Miller 2005 ); succession (Dumas, 1992; Handler, 1989; Lansberg, 1999; Luo, 2006); gender (women involvement) and family businesses (Malow and Carter, 2005), and entrepreneurial dynamics and learning (Rae, 2005) .

However, similarly to the other topics, such as clusters and networks that have been discussed earlier in the thesis, family business research is also confronted with a definitional dilemma. Birley (1994) commented that until now some studies on family

business have not clearly defined the term ‘family business’. Some studies have adopted broad definitions (Cromie *et al.*, 1995), whilst others have defined the term more narrowly. Handler (1989) is one of the earliest researchers, listing a variety of different family business definitions (please see Table 3.2) and indicating several important dimensions for defining the term family business. These include; ownership management, family involvement in the business, availability of family members for generation transfer, multiple conditions for strategic directions. Westhead and Cowling (1998), taking forward Handler’s research, further summarise a variety of previously utilised family business definitions and expand them into five dimensions: 1).family involvement/perceived to be a family business, 2).family ownership, 3).family management, 4).inter-generational ownership transition and 5). multiple conditions.

It can be concluded from the above discussion that a significant number of family business studies have concentrated their studies on 1). the involvement of family members in the business (Astrachan, 1988; Westhead & Cowling, 1998), and 2). family ownership and management (Lansberg *et al.* 1988; Litz, 1995; Lansberg, 1999; Anderson, *et al.*, 2003). The latter group represents the majority of studies in the family business literature. Social networks and cultural perspectives in family business research failed to attract much attention until the 1990s (Hamilton, 1991; Fei, 1992; Redding, 1993; Redding and Witt, 2007). The present study builds on this developing research agenda and draws on concepts related to families and family networks to explain the cluster formation phenomenon. This is considered a particularly useful way to view family business, especially in the Chinese context, as will now be explained.

### **- Family Business and Networks**

According to Hamilton (1991), Chinese family businesses tend to emerge through a series of networks, that expand or contract according to circumstances, time and place.

The boundaries of businesses are ambiguous, because the business cannot be entirely defined by propriety, ownership and management control. The definition needs to include the network that link people together through social relationships and ties (Hamilton, 1991). In fact, this viewpoint was already introduced by Fei (1992) through the concept of ‘Cha Xu Ge Ju’ (差序格局), which is translated by Hamilton and Wang (1992) as a ‘differential mode of association’. According to Fei (1992), the adoption of the ‘differential mode of association’ in Chinese society helps to manage and form the community, run businesses on the basis of a dyadic social tie (*gang*), which defines the basic concept of ‘family’ more broadly, recognising that the family structure should not be limited to parent and children relationships. As mentioned previously in Section 3.3.1, ‘family’ (Jia 家) is an elastic concept and without explicit boundaries. Zijiaren (自家人, my own people) may ‘include anyone who you want to drag into your own circle, and you use it to indicate your intimacy with them’ (Fei, 1992, p.62). The concept of family can be used in a very general way from a single household to ‘everyone under the sun’ (Fei, 1992, p.62). It is suggested by Redding (1993) and Redding and Witt (2007) that the impact of family values and culture make Chinese family business distinctive from its counterparts in other countries. In short, the Chinese ‘family’ culture is the main feature of Chinese business.

However, although the broader sense of ‘family’ in Chinese culture can be extended to people all over the world, this should not be interpreted as evidence that the Chinese do not have an explicit idea of the boundaries between this ‘family’ and that ‘family’. In fact, Chinese have a high sensitivity to the distinction between ‘Zijiaren’ (自家人, my own people) and ‘Wairen’ (外人, outsider). It is argued that Chinese social networks, i.e. *guanxi*, that developed on the basis of Chinese culture, encompasses the insider and the outsider, teaches a person to differentiate one from the other and prescribes rules for dealing with each kind of person (Cheng, 1990; Hammond and Glenn, 2004). Normally, insider relationships are defined by family and as family. As observed by Gao and Ting-Toomey (1998) such relationships cannot be severed or

changed except under extreme circumstances. Outsiders (Wai ren 外人) are less worthy of trust and hence the relationship with them is more unstable (Chu and Ju, 1993) (in Hammond & Glenn, p.26). According to Scallan and Scallan (1991, p.471) ‘discriminating a boundary between insider and outsider is not only a localised and descriptive activity, it is a regulative and moral activity’. Hwang (1987) argues that one is not morally obliged in the same way to those who are outsiders as to those who are insiders. However, it is claimed by Chu (2004) that Chinese people also handle and deal with these relationships subtly. Awareness of the distinction between ‘Zijiaren’ and ‘Wairen’, meanwhile, also having the strong intention to break the boundaries between them are interesting but contradictory phenomena, deserving attention in this study.

The above review suggests that the family and its extended social network are the key features of Chinese business, and a vital dimension for defining family business. On this basis it is possible to understand the grouping phenomenon, groups being formed as a consequence of the family businesses and their extended networks, leading to the process of clustering or creating the conditions that increase the likelihood of cluster formation. If it can be demonstrated that family businesses and their extended social networks are not only the dominant members of existing clusters, but also the solid foundations for both potential and existing clusters, the contribution of family as an institution to cluster formation, development and sustainability will be significantly enhanced.

The Chinese have a strong commitment to family and the meaning of family is the most important imprint of the Chinese culture (Zapalska and Edwards, 2001). The reason why family or family culture are so important in Chinese society is not merely because it offers the family or household a set of social rules and regulations, but more importantly it instills the meaning of ‘family’ into every aspect of social and economic life. In addition to family or household, all other organisations or institutions, for example firms or even a country can be viewed as an extension of a

‘family’. Thus, the elastic concept of family and its values, as the important feature of

**Table 3.2: Alternative Definitions of Family Business**

<b><i>Ownership-Management</i></b>	
Alcorn (1982)	"A profit-making concern that is either a proprietorship, a partnership, or a corporation. ... If part of the stock is publicly owned, the family must also operate the business" (p. 23).
Barry (1975)	"An enterprise, which, in practice, is controlled by the members of a single family" (p. 42).
Barnes & Hershon (1976)	"Controlling ownership [is] rested in the hands of an individual or of the members of a single family" (p. 106).
Dyer (1986)	"A family firm is an organisation in which decisions regarding its ownership or management are influenced by a relationship to a family (or families)" (p. xiv).
Lansberg, Perrow, & Rogolsky (1988)	"A business in which the memebers of a family have legal control over ownership" (p. 2).
Stern (1986)	"[A business] owned and run by members of one or two families" (p. xxi).
<b><i>Interdependent Subsystems (family involvement in the business)</i></b>	
Beckhard & Dyer (1983b)	"The subsystems in the family firm system...includ[e] (1) the business as an entity, (2) the family as an entity, (3) the founder as an entity, and (4) such linking organisations as the board of directors"(p. 6)
Davis (1983)	"It is the interaction between two sets of organisation, family and business, that establishes the basic character of the family business and defines its uniqueness" (p. 47).
<b><i>Generational Transfer</i></b>	
Churchill & Hatten (1987)	"What is usually meant by ‘family business’ ...is either the occurrence or the anticipation that a younger family member has or will assume control of the business from an elder" (p. 52).
Ward (1987)	"[A business] that will be passed on for the family's next generation to manage and control" (p. 252).
<b><i>Multiple Conditions</i></b>	
Donnelley (1964)	"A company is considered a family business when it has been closely identified with at least two generations of a family and when this link has had a mutual influence on company policy and on the interests and objectives of the family" (p. 94).
Rosenblatt, de Mik, Anderson, & Johnson (1985)	"Any business in which the majority ownership or control lies within a single family and in which two or more family members are or at some time were directly involved in the business" (pp. 4-5).

(Source: Handler, 1989, p.260)

Chinese culture, makes the Chinese family businesses distinct from their Western counterparts.

It is argued by Chu (2004) that the institutional behaviour of Chinese businessmen is deeply rooted in and highly dependent on Chinese culture, i.e. the meaning and value of 'family' and 'Cha Xu Ge Ju' (差序格局). From this perspective, the definitions raised by Western researchers (please see Table 3.2. for family firm definitions summarised by Handler, 1989) about family business cannot fully explain Chinese family businesses.

Since culture plays an important role in influencing most aspects of family business, which in turn influences the process of clustering, the next section will further the nature of culture and its influence in this context.

### **3.4 Culture**

There is a rich source of literature relating to the nature of culture itself or undertaking research studies from a particular cultural perspective (Fukuyama, 1996; Brown, 1998; Hofstede, 2001; Poutziouris *et al.*, 2002; Zapalska and Edwards, 2001; Redding 1990, 2004; Liu *et al.*, 2006; Redding and Witt, 2007). The anthropological perspective views the term 'culture' as the 'complex whole which includes knowledge, beliefs, art, moral, law, custom and any other capabilities and habits required by man as a member of society' (Brown, 1998, p.4), whereas the sociological perspective recognises that the term culture can be broader and more direct, also containing informal norms, folkways or ambiguity, etc (Liu *et al.*, 2006). Different perspectives on the term culture have been termed 'cultural explanation' by So and Walker (2006). In the present context this would seek to relate culture to family business and the clustering phenomenon observed within Chinese culture.

It is argued by Chen (2006) that many histories can only cultivate a little bit of tradition, and many traditions can then cultivate a little bit of culture. Therefore,



histories and tradition should not be considered separately from culture, but should be understood as the integral structure comprising the 'culture factors'. According to Porter (1990, p.157), cultural factors are important elements in competitive advantages, as 'they change slowly and are difficult for outsiders to tap and emulate'. In a society, cultural factors shape the environment in which people live and what people aspire to. The environment and aspirations, in turn, guide people's behaviour and the actions they take (Fei, 1992, p.138). This link between culture and competitive behaviour was further strengthened by DiMaggio (1994) who, having reviewed the work in the field of both culture and economy, referred to culture specifically as 'constituting economic actors and economic institutions, defining the ends and means of action, and regulating the relationships between means and ends.' The interwoven relationships and interaction of cultural factors and people help to build up the linkage and cultivate trust between local people in the specific area, thus providing the necessary foundation for starting clusters. Nadvi and Schmitz (1994) concluded that clusters/industrial districts are 'to be historically rooted, to have emerged spontaneously, to be socially embedded, to have an indigenous growth potential', which have deep social roots in the common history and tradition of their region, influenced strongly by their culture (ibid, p.3).

However, it does not follow that the cultural explanation should be accepted uncritically. It can be argued that, although most people would agree that cultural factors, such as norms, inherited institutions or traditions, can assert powerful influences (Schlicht, 1999; Krug, 2002; So and Walker, 2006), and accept that theoretically these cultural norms interact with each other, there is still a lack of systematic explanation as to how in practice these factors interact, and are shaped and reshaped in response to specific contexts or situations (Krug, 2004). Secondly, it is not appropriate to consider such cultural factors as isolated factors shaping and influencing people's behaviour, since this may ultimately cast human beings in the role of 'culture robots' as cautioned by Wrong (1961) in his seminal work 'The Oversocialised Conception of Man'. Third, explanations from the cultural perspective

could also be challenged. Cultural factors are not static and are subject to a continuous process of change over time. However, many researchers fail to take account of this issue. According to Yang (1994), there are two problems with cultural explanations: firstly they fail to situate the aspect of culture in a dynamic with other changing cultural, social and structural features; secondly the approach employed 'represents an historical approach to the culture which fails to take into account the historical waxing and waning of personalism and neglects the examination of the changing and variable form in which personalism is historically constructed and reconstructed.' (in So and Walker, 2006, p.32). Therefore, culture cannot be used to explain the changes in culture by itself. Furthermore, cultural factors are normally thought of as givens and as existing exogenously, similarly to the concept of 'network', 'guanxi' and 'family', mentioned earlier in this chapter. So and Walker (2006) argue that if researchers really want to investigate human institutions, then it seems essential to consider such factors.

Although the explanatory powers of culture, which is constantly changing, can be challenged in different ways, this is not to suggest that we should completely abandon research from this perspective. Rather it is necessary to improve our understanding of the way in which culture has influenced and interacted with other factors identified and clarified in the present research. As culture is not the only factor in the process of interaction, other factors, such as the economical, political and social influences also need to be accounted for in gaining a sound and robust understanding of the process of cluster formation. Douglas North, as one of the few researchers who recognised this issue and tried to incorporate all these into an institutional framework, has helped to provide a better platform to explain the ways in which business works and organises itself in a broader institutional context (North, 1990). Research from the institutional perspective will now be reviewed.

### **3.5 Institutions and institutional factors**

Institutional factors are also important factors, that need to be considered in

understanding the process of cluster formation. As well as culture, institutional factors also include political, economical and historical elements together with other elements relating to the institutional routines and the logic of economic actions, that might in turn affect and shape the social or economic structure of a country (Orru, 1997). Adopting an institutional approach from an economic-geographical perspective, institutions are thought to be able to 'enable, constrain, and refract economic development in spatially differentiated ways' (Martin, 2000, p.79). In general, institutions can be classified into formal (e.g. policies, laws, regulations, standards, etc) and informal (e.g. conventions, cultural norms, codes of conduct, traditions, etc.). Such institutions may be deliberately created, such as the constitution of a country, or simply evolve over time, such as the Common Law in the UK. The main role of institutions in a society is to reduce uncertainty, provide incentives and manage co-operation and competition by setting up structures to enable human interaction (North, 1990; Biggart, 1997; Edquist & Johnson, 1997). They are also considered as key elements that influence the performance of a geographical territory (Storper, 1997).

The studies associated with institutions differ both in form and in the perspectives from which they are viewed. However, most of them can be classified into two main categories. One strand of research views institutions as the rules of the game or embodying the rules of the game in a society. The other strand supports the view that institutions are the outcome of a state of equilibrium in such games. It is suggested by Rong (2004) that combining these two perspectives leads to a better understanding and application of institutional studies. According to Rong (2004), the essence of game rules is the generation of a series of consequences for game equilibrium, with game rules changing in response to the changes of outcomes of game equilibrium. Rong's attempt at integration is useful because it takes into account the dynamic nature of institutions, supporting the view that institutions or institutional factors are not static but evolving, which is in line with North's (1990) view in his seminal work *Institutions, Institutional Change and Economic Performance*.

However, Rong's approach is not without its limitations. Institutions are evolving, and thus, continually changing the choices available to individuals. Therefore, institutions or institutional changes are not only part of a continuous ongoing process but also a rather complex one. The characteristics of institutions, essential to an understanding of the nature of institutional circumstances (e.g. political, cultural, economic), have been identified in Rong's research. However, although a central facet of Rong's argument is that institutions are evolving phenomena, how and why this evolution takes place has not been fully explained. Moreover, the role of informal institutions has also not been fully investigated. It is often argued that changes in institutional circumstances are largely influenced by the embedded informal institutions in society (North, 1990; Orru, 1997). Formal institutions, such as policies or regulations may change rapidly as the result of political or economic decisions, whereas informal institutions, that are embodied in tradition, convention and codes of behaviour, are 'much more impervious to deliberate policies' (North, 1990, p.6). This is because they evolved and grew alongside history, and more importantly, were crucial for researchers to review and explain the path of historical changes in the process (North, 1990; Hodgson, 1997).

Another major shortcoming is that Rong's (2004) study neglects the social embeddedness of individuals. Social embeddedness is important because the behaviour of individuals is a reflection of the society or economic actions in which they are engaged. North (1990) argues that the perceptions of individuals depend on both the information that they receive and the way they process that information. Simply speaking, individuals perceive and interpret their environments, make choices and then take action. Biggart (1997) claims that institutions tend to be socially constructed, thus, clusters or the emergence of a cluster can be view as the product of individuals' 'subjective realities, rather than as objective, material artifacts' (Biggart, 1997, p.21).

Therefore, the task of this thesis is not only to identify the institutional factors involved in the process of cluster formation, which includes to investigating in depth the changes in institutional factors and assessing the implications of such changes, but also to explore the embeddedness of the individual in the larger institutional environment. Subsequently, it is important to understand how individuals make sense of their institutional environment, and how the generation of a shared understanding created by the institutional environment shapes individual actions. Such issues provide the basis for the establishment of a platform for cluster formation.

### **3.6 Social embeddedness**

Given that institutions tend to be socially constructed, cluster formation can be seen as the product of individuals with a series of personal perceptions and interpretations of the environment in which they are engaged. As no individuals are isolated from their environment, the concept of ‘social embeddedness’ can be used in this study to advance the understanding of cluster formation.

Karl Polanyi (1944), as the originator of ‘embeddedness’, emphasises a cultural approach to economics and argues that economics are embedded and entwined in economic and non-economic institutions. Initially, Polanyi’s work did not receive much recognition by mainstream economists, but was adopted more widely in other areas of the social sciences, such as sociology and anthropology. The term ‘embeddedness’, did not receive much attention when first introduced by Polanyi and was not applied by many researchers until Granovetter’s (1985) famous work *‘Economic action and social structure: The problems of embeddedness’* was published.

According to Granovetter (1985), economic activities are embedded in the social structure, and social relations and social networks are the core of the social structure. Thus, embeddedness can be viewed as an ongoing contextualisation of economic

activities in social relations and social networks (Granovetter, 1985). The ongoing contextualisation process reflects and emphasises the interrelationship and interdependence among different institutions/institutional factors. Moreover, the concept of ‘embeddedness’ precludes the atomisation of human behaviour, which is implicit in both undersocialised (neoclassical economics) and oversocialised (Parsonian sociology) conceptions (Granovetter, 1985; Kalantaridis and Bika, 2006). ‘Embeddedness’ is defined by many researchers as the nature, depth, and extent of an individual’s ties into the local environment (Whittington, 1992; Uzzi, 1997; Dacin *et al.*, 1999; Jack and Anderson, 2002). The concept of embeddedness can help us to have a better understanding of the individuals, who exist, behave and interact with certain environments, based on Granovetter’s (1985) argument that individuals are embedded in an ongoing system of social relations and they do not behave outside of their social context.

The concept of embeddedness has been realised and used by many researchers as an analytical or theoretical concept in understanding industrial districts. It can be seen in Marshall’s research, that a common social background in a region is an important factor for developing and maintaining industrial districts. Although, the word embeddedness was not mentioned in Marshall’s work, similar concepts to ‘embeddedness’ can be identified, since Marshall emphasised the social and cultural background of a region and its influences on the formation of industrial districts. Porter (1998a) also mentioned in his seminal work ‘The Competitive Advantage of Nations’ that there are obvious relationships between clustering and the specific geographic environment. Thus, it can be argued that the clustering phenomenon is more than just about geographical proximity or concentration, and that there must be something else. Becattini (1990), one of the major contributors to the research area of industrial districts, takes forward Marshall’s research and extends his research from purely economic effects of agglomeration to a broader perspective, which also strongly emphasises the role of the social, cultural, and institutional foundations of local industrial growth. Becattini (1990) defines an industrial districts as a

‘.....socio-territorial entity which is characterised by the active presence of both a community of people and a population of firms in one naturally and historically bounded area. In the districts, unlike in other environments, such as the manufacturing towns, community and firms tend to merge’ (ibid, p. 38). In light of this, the most important symbol is its local networks, i.e., the formal cooperative relations among different entities within the area and also their relatively stable relations built on long term communications, which was discussed in section 3.2 and 3.3.

The potential benefits of social embeddedness for existing and new businesses and entrepreneurs can be classified into three aspects: first, enterprises that exist in trust-based social networks, are more willing to cooperate and share risks. This reduces the emergence of individual opportunistic behaviour, that may cause potential disturbances to the competitive balance. Second, the relatively stable relationship among firms/entrepreneurs could help to reduce the emergence of retaliatory behaviour. Third, if there are mutual benefits among firms/entrepreneurs, it will be easier to take consistent and co-ordinated action needed to achieve common goals. Therefore, firms/entrepreneurs in a particular area do not merely consider their economic benefits. Their performance is deeply embedded in their social backgrounds (social relations and social networks), that simultaneously influence the behaviour of the entrepreneurs and in turn are influenced by the entrepreneurs as well.

The nature of social interaction tends to be facilitated and governed by the institutional framework and its constituent elements, in particular the informal ones. This research will identify these institutional factors in the Chinese context, pointing out that networks are established on the basis of these institutions. It will also pay particular attention to the informal networks and institutions that play an important role in facilitating communication of individuals with each other and engaging in ways that facilitate the emergence of clusters.

The concept of embeddedness, allied with the concept of institutions, facilitates the

interaction and interrelationship of established SMEs/entrepreneurs alongside those aspiring to become entrepreneurs and SME owners. It is important to re-emphasise that the engagement in this process and the membership of a cluster is directed at the level of the individual. Operating in the particular local environment means that the individual will be cognizant of the nature of the particular environment, including the historical background, social values, cultures, customs, families and networks. This perspective provides the opportunity to assess the reasons for engagement with a cluster and the basis to explain and understand the drivers and processes in cluster formation. However, although the ongoing contextualisation generated by the continuous interaction between individuals and their environment has been highlighted (Granovetter, 1985), the linkage between how individuals behave in certain ways (i.e., the process of their interaction) and how this relates to the formation of clusters still have not been presented. The theory of 'sensemaking' (Weick, 1995) can contribute to filling this gap. The concept of sensemaking will now be presented.

### **3.7 Sensemaking**

It is claimed by Scott (1995) that no organisation can be properly understood without considering its wider institutional context. Sensemaking is the feedstock of institutionalisation, since 'it is the institutionalising of social constructions into the way things are done, and transmission of these products, that links ideas about sensemaking with those of institutional theories' (Weick, 1995, p.36). Lounsbury and Glynn (2001) point out that individuals are 'socialised (indoctrinated) into expected sensemaking activities and that firm behavior is shaped by broad cognitive, normative, and regulatory forces that derived from and are enforced by powerful actors such as mass media, governmental agencies, professionals, and interest groups' (Weick, *et al.*, 2005, p.417), that reflect the individual's key role in their social context.

Sensemaking is about the way people perceive and interpret. More specifically, it is



the process by which people organise to make sense of certain inputs and enact this sense back into the world to make that world more orderly (Weick, *et al.*, 2005, p.410). In other words, the enacted world is not just an input to an individual but also an output of that individual. In this sense, individuals do not merely perceive their world (institutional environment), but as a result of their perception, their behaviours or actions help to shape the world around them (Lam and Ritchie, 2006).

It must be emphasised that sensemaking is about the interplay of action and interpretation, therefore when action is the central focus, the interpretation is the core phenomenon, but not choice (Laroche, 1995, p.66; Lant 2002; Weick, 1993, pp.644-646; Weick *et al.*, 2005, p.409). Also, when adopting the idea of sensemaking, it is essential to appreciate the small details (small actions, emotions, languages and its meanings, etc.). According to Weick *et al.* (2005), 'smallness does not equate with insignificance' and small actions 'can have large consequences' (*ibid*, p.410).

### **3.8 Conceptualising the framework**

The conceptual framework will argue that integrating the concepts of institutionalisation, social embeddedness and sensemaking provides an appropriate approach to explaining the formation of SME clusters. The previous chapter argued that geographical proximity, emphasised in both economic and political approaches to clustering, is a necessary, although not sufficient condition for forming clusters. Thus, geographical proximity alone will not with any certainty lead to cluster formation, even as the means for achieving competitive advantage and sharing technological innovation. Moreover, a stable cluster will normally have obvious regional or localised characteristics, which will depend on the importance and degree of dependence of economic activities on local relations (Storper, 1997). This means that the formation of a cluster in one area that seeks to imitate that in another area might not be successful. This success is not only influenced by the formal and objective realities, but is dependent to an even greater extent on the informal institutions and

how individuals perceive and interpret the institutions they engage with.

However, as argued in the Literature Review chapter, most cluster studies focus on the three ‘classical’ aspects, i.e. ‘geographical concentration’, ‘relationships’ and ‘mutual benefit’ when related to cluster formation, but neglect two other important elements, i.e. individuals and the environment they interact with.

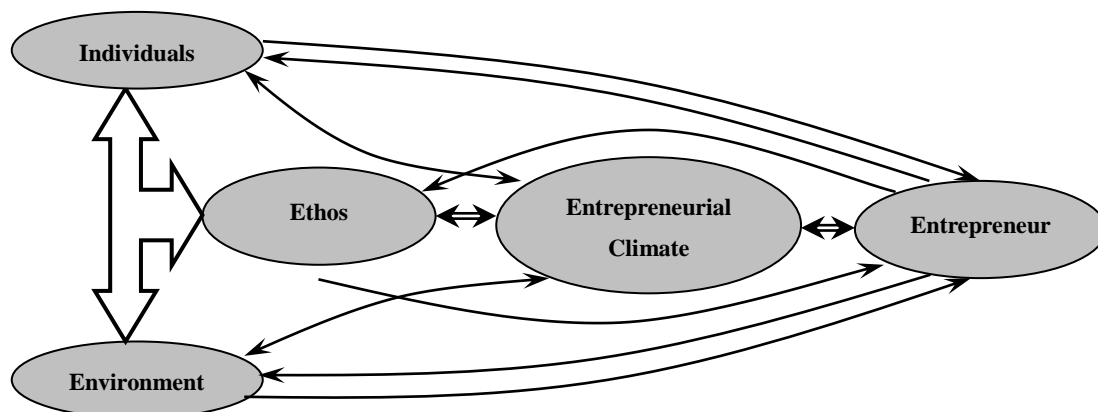
Individuals include different actors who are related directly or indirectly to the cluster creation, such as entrepreneurs, policy makers and families, and entrepreneurs are the leading actors among these people in the cluster formation. Cooper and Dunkelberg (1987, p.12) ask the question ‘how does it happen that some people become entrepreneurs, while most people do not’. They claim that ‘there must be something distinctive about the background or make-up of entrepreneurs and research should be able to illuminate these characteristics?’ By the same token, the question might be asked, ‘How does it happen that some people choose to start their business in one certain area or join the group then form a cluster, while other people in other areas do not?’

Granovetter (1985, p. 506) argues that individuals do not act like atomised actors who follow social norms and customs mechanically. He emphasises the importance of individuals’ embeddedness in their social relations and their social interactions. Therefore, ‘if the social situation of individuals is fully analysed, their behaviour looks less like automatic application of ‘cultural’ rules and more like a reasonable response to their present situation.’ (Lam and Ritchie, 2006, p.4)

Individuals cultivate and share a common understanding with each other under certain environmental situations. Conversely, they may also be influenced by the environmental conditions themselves, such as social, economic and political factors. The interaction between people and their environment generates one kind of ethos. (See Figure 3.1: Interrelationship Diagram). Sabel and Zeitlin (1985) define ‘ethos’ as

something that is ‘reconciled and gave immediate human content to the claims of competition and ambition on the one hand and community and co-operation on the other’, and the particular form of embeddedness that occurs in districts and clusters consequently has a real effect on how business is done (Wilson & Popp, 2003, p.12). Ethos here could be considered as ‘entrepreneurial climate’. The emergence and gathering of entrepreneurs and other actors in cluster creation takes place in this kind of ‘entrepreneurial climate’. Based on this concept, the unit of analysis may be positioned from the growth or the competitive advantages generated by the clusters, to the growth of the cluster or groups of firms all centered around the entrepreneurial initiatives of a single entrepreneur or entrepreneurial team (Rosa, 1998; Rosa and Scott, 1999). Furthermore, as this is an ongoing rather than a static process, each element will also interact with one another to shape and reshape the whole atmosphere. The interrelationship is illustrated in Figure 3.1.

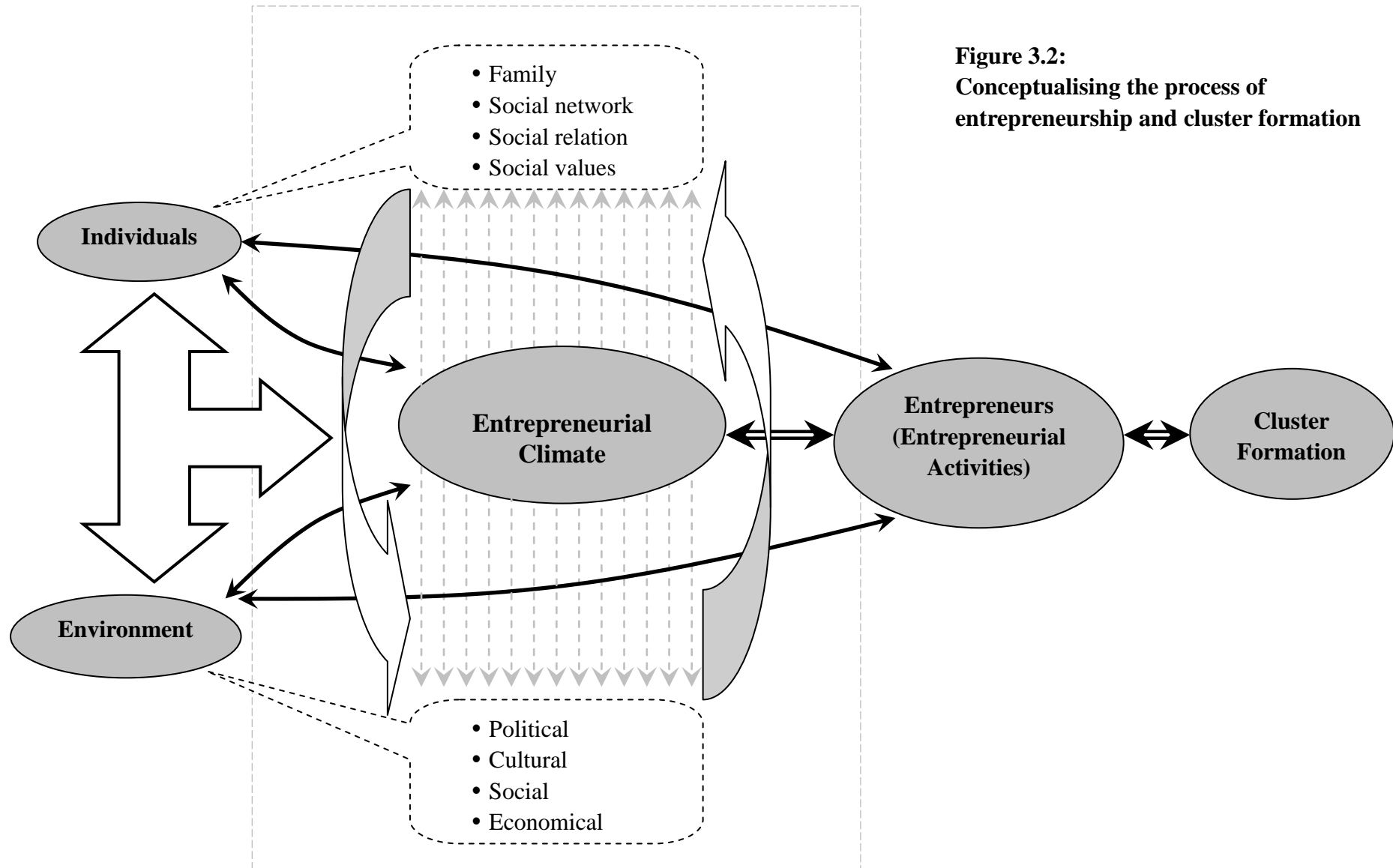
**Figure 3.1: Interrelationship Diagram**



The ‘entrepreneurial climate’ generated by the interaction of the individual and the environment is an essential element for cluster formation. In other words, the generation process of ‘Ethos’ or ‘Entrepreneurial Climate’ can be understood as the process of embedding (or embeddedness), identified as the ‘nature, depth and extent of an individual’s ties into the environment’ (Jack and Anderson, 2002). This process

is also the key for maintaining and developing the cluster, thus helping to extend its life cycle. However, no matter how long the lifecycle will be, the longevity of a cluster will largely depend on the actors (individuals) and their interaction with the environment. It must be emphasised that this research will only focus on the initial stage of cluster development, i.e. cluster formation (critical mass and takeoff). Within this particular period, the research will not only look at attributes of the actors and investigate what makes them different from other people in other places who are not inclined to form a cluster, but will also examine the complementarity of their environmental situation and their interaction with each other, which is conducive to the formation of a cluster.

The evaluation and analysis of previous research presented earlier in this chapter supports the evolution of the interrelationship diagram depicted in Figure 3.1 to that represented in Figure 3.2. This strengthens the importance of the conceptualisation process associated with embeddedness. Individuals, in this context, respond to and undertake roles in relation to other elements of their environment. They engage with family members, both the immediate and more widely defined family, engage in associated social networks, develop social relations, and acquire social values. The totality of the environment with which they continuously engage contains political, cultural, social and economic factors and influences (i.e. institutionalisation). The ethos generated by the interaction between individuals and their environment, representing a more 'entrepreneurial climate', is cultivated through the interplay of the different elements of 'individual' and 'environment'. The nature of the 'entrepreneurial climate' in which the entrepreneurs live and more particularly the process of embeddedness experienced, will determine the nature of the individual in relation to their entrepreneurial aspirations and consequently the likelihood that clusters will be established. The individuals are being fostered to recognise the importance of being rooted in the local community (i.e. their sense of belonging), willingness to create new ventures, behaving entrepreneurially, willingness to gather together, which then naturally leads to cluster formation.



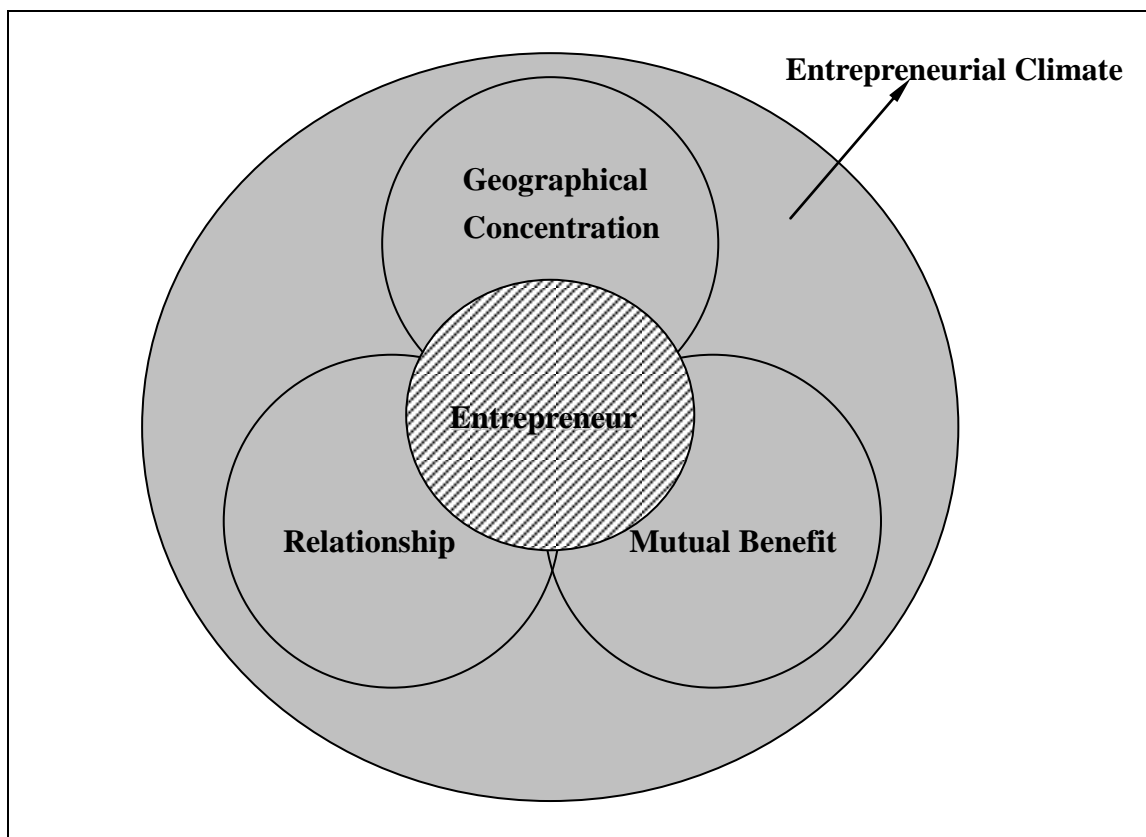
**Figure 3.2:**  
Conceptualising the process of  
entrepreneurship and cluster formation

It needs to be emphasised that the whole process is an ongoing, constantly changing adaptive dynamic system. The terms employed in the conceptual representation are indicative of the common features or values and are representative rather than specific. Equally, all of the elements are interrelated to differing degrees, with flows of influence in every direction. Redding and Witt (2007), recognising this dynamic and complex process, point out that the 'relations between things change over time and finding stable patterns does not mean that they are stable forever; and yet stable patterns may be traced, with enough staying power to explain a society's business system at present and to help judge its direction of emergence' (ibid, p.21). In essence this reflects the approach adopted in developing the conceptual framework and the subsequent research to explore the influencing factors in more depth.

To put it simply, different clusters are formed for different reasons. However, for those countries wishing to 'build' clusters, there are also two other elements worth including apart from 'the classical three', namely individuals and the entrepreneurial climate. 'Individuals' refers mainly to entrepreneurs themselves, whereas 'the entrepreneurial climate' refers to a wider context where the interaction of different elements takes place. Moreover, this context is likely to vary between different nations, regions and local areas, reflecting their extant economic, political, social and demographic conditions and may also be subject to variation with the passage of time. Evolving from the features of Figure 3.1 and 3.2, the present figure (Figure 3.3) identifies the major components that may contribute towards the generation of a cluster. In addition to the backcloth of the 'entrepreneurial climate', 'geographical concentration' as discussed earlier is important, as are the identification of 'mutual benefits' and the development of some form of 'relationship'. At the centre of these collections of elements are the actors. Here, actors are the individual entrepreneurs, or

more appropriately a group of individual entrepreneurs, who perceive, analyse and respond to the set of cues generated by the entrepreneurial climate and the three other elements, whilst also interacting with them, then taking the decision either to form a cluster with others or not as the case may be. These five elements comprise the primary elements in the Cluster creation framework (Figure 3.3), representing the core of the present research. Because these elements are interrelated, they all need to be considered simultaneously as a whole.

**Figure 3.3: Cluster creation elements framework**



Moreover, developing the extant definitions of cluster in combination with the argument of this chapter may help to redefine a cluster for the purpose of this present study as ‘a group of independent and interconnected firms and entrepreneurs in a defined geographical area, producing similar or related products, faced with common

challenges and opportunities, cooperating not only on contractual terms, but also on trust and pledge, and shared common understanding within a particular 'entrepreneurial climate'.

### **3.9 Summary**

The aim of this chapter has been to establish the conceptual framework relating to the formation of clusters. Taking forward the relevant studies, that have been critically reviewed in Chapter Two, this chapter has argued that a more integrated perspective should be utilised to enhance the understanding of cluster formation, particularly emphasising the value of the social perspective. This chapter also argued that the role of individuals cannot be taken for granted in the study of clusters. As the dominant agents who form and facilitate clusters, it is argued that an individual's behaviour is embedded in the social context he/she is engaged in. The importance of social relations and networks in a social context has been highlighted. Thus, the discussion in this chapter starts from reviewing social relations and networks, including networks, Chinese network systems, *guanxi*, trust and Chinese philosophy, to present a rather comprehensive foundation for understanding the key social characteristics, especially in the Chinese context.

Although previous research has endorsed the value of social characteristics in the study of clusters, family and family business as one of the most distinctive features of Chinese society, this has not been rigorously investigated in order to understand cluster formation. It is argued in this study that it is extremely important to understand the family concept. This is not only because the concept offers a set of rules and regulations for local agents, but also because its meanings have been instilled in every



aspect of social and economic life. Thus, family and family business have been regarded as one of the main perspectives necessary to understand cluster formation in China. This Chapter follows this perspective and has supported it with a discussion of Chinese culture.

In addition to cultural factors, there are also other factors that need to be considered in relation to the process of cluster formation. Taking into account the different factors (i.e. cultural, political, economical and political factors), an institutional perspective is proposed. The contribution of institutional studies is their emphasis on the interrelationship between different factors. They also view the institutionalisation as an evolving phenomenon. However their weakness is that they have not fully explained how and why the interrelationship took place, and also have not thoroughly explained the nature, depth and extent of individuals' ties to their local environment. The concept of social embeddedness has been adopted to fill this gap.

However, although combining institutional factors and social embeddedness theory emphasises the ongoing interactions between individuals and their institutional environment, the ways in which and the process by which individuals perceive and interpret their environment has not been explicitly uncovered. Hence the social embeddedness concept was unable to present a straightforward linkage between how individuals perceive and behave to how clusters are formed. Due to this weakness, the concept of sensemaking has been used as a complementary tool, to complete the conceptual framework of this study.

In conclusion, a conceptual framework, which based upon the theories of institutionalisation, social embeddedness, and sensemaking, has been developed to

extend and deepen understanding of cluster formation in this study. In the next chapter, methodological issues will be fully discussed and presented.

## **Chapter Four: Research Methodology**

### **4.1 Introduction**

Strauss and Corbin (1998) claim that research methodology represents a way of thinking about and studying social reality. Methodology is important since it provides a 'sense of vision', indicating where the researcher wishes to go with the research (Strauss and Corbin, 1998, p.8). Research methods, on the other hand (i.e., procedures and techniques for collecting and analysing data), are the means to 'bring that vision into reality' (Strauss and Corbin, 1998, p.8).

The broad methodology employed within this study is associated with phenomenological and qualitative research approaches. Qualitative research has gained in popularity over the years in different disciplines (e.g. Business and Management, Social Studies, Education, Psychology, Health, Architecture, etc.) and a variety of different perspectives and approaches have been developed and refined (see for example, Gilgun, Daly and Handel, 1992; Denzin and Lincoln, 1994; Westbrook, 1994; Morse and Field, 1995; Strauss and Corbin, 1998). According to Silverman (1998, p.3), qualitative research is best viewed 'not as a set of free-standing techniques but based on some analytically defined perspectives'. The strength of qualitative research methodologies is their ability to focus on actual practice in the field and investigate how organisations or individuals behave and routinely enact within the particular context (Silverman, 1998).

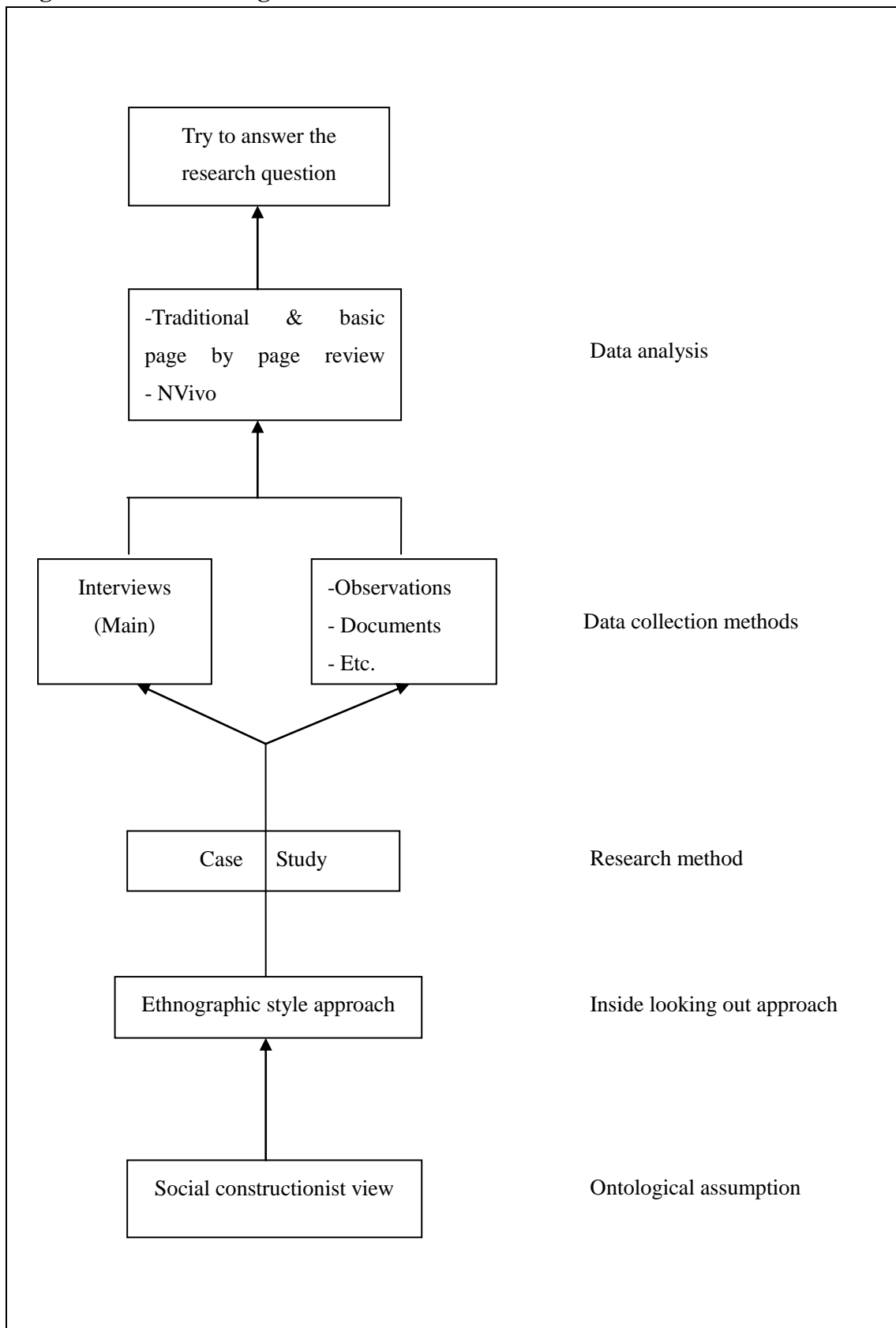
A methodological framework for this research was designed, with a view to demonstrating the consistency of the views and theories put forward in the Literature Review Chapter (Ch.2) and the Conceptual Framework Chapter (Ch.3). This should

also assist in explaining the approach employed in answering the research question and improve understanding of the formation of clusters in the Chinese context. Figure 4.1 presents the structure of the methodological framework used in this research.

Since it is based on a qualitative approach to research, the ontological assumption of this thesis is that of a social constructionist view, which argues that the world is socially constructed (Berger and Luckmann, 1967). Within the grounding of this social constructionist view, an ethnographic approach is adopted which looks at the cluster formation from an ‘inside looking out’ perspective (Schwartzman, 1993), i.e. seeking to understand individuals’ views from their particular perspectives. These perspectives are captured using the research method of a case study, employing semi-structured in depth interviews with key individuals, and utilising multi-stage fieldwork to uncover the vivid living experiences of the informants and how these develop and change. The whole process helps to accumulate data and lay the foundation for further analysis, insights and discussion. The ultimate target is to achieve the aim of this research.

The next section will explain the nature of social constructionist view and the appropriateness of this methodology to the present research context and aims.

**Figure 4.1: Methodological framework**



## **4.2 Social constructionist view**

Originally introduced by Berger and Luckmann (1967), social constructionism has progressed significantly since its inception, generating a considerable number of theoretical and empirical contributions reflecting the innovative perspective involved (Gusfield 1981; Schneider and Kitsuse, 1984; Best 1989; Holstein and Miller, 1993; Hannigan, 1997). The methodology has also gained greater currency and acceptability in different research fields, for example, entrepreneurship studies (Bouchikhi, 1993; Johannisson, 1995; Chell, 2000; Fletcher, 2006), science and technology, media studies, and environmental studies (Hannigan, 1997). The common feature in each of these applications is that using a social constructionist methodology provides a clear focus on ‘how people assign meaning to their world’ (Best, 1989, p.252).

Social constructionism has become a central theme in social science research. The central theme is that the world people experience and the people they themselves become, are first and foremost the product of social processes (Nightingale and Cromby, 1999). Society itself is therefore the root of all experiences and the prime influencer. In other words, the relationships people have and the nature of the people themselves are primarily constituted by ‘the social reproduction and transformation of structures of meaning, conventions, morals and discursive practice’ (Nightingale and Cromby, 1999, p.4). This reflects one of the features of the social constructionist view, that is, the importance of language. Language is not only recognised as the dominant carrier of meanings, but also the medium that carries the raw material generated by people from their social activities and experiences.

The social constructionist view was adopted in the present research since this was viewed as the most appropriate methodology with the greatest potential to enhance

insights, explanations and understanding of cluster formation in China. Preliminary evidence, thoughts and perspectives on cluster formation and the factors influencing the process and structures suggested the importance of factors such as social interaction, conventions and morals. Compared to mainstream cluster research in Western or developed countries, cluster research in developing countries such as China takes place within a different background with specific contextual features. Such variations are evident when comparing geographical location, historical development and culture. These variations imply that the things people know (or think that they know) might be different and the way people perceive, make sense of and interpret their context will also differ. Similarly, the things that people would regard as evidence to support their thoughts may also differ depending on context. Nightingale and Cromby (1999) emphasise the importance of being 'real' about social constructionism, ensuring that we are fully aware of the fact that variations exist in the ways of talking about the world, because 'the subjectivities of the actual, living people that are constituted in and from those ways of speaking will vary, along with the cultures that produced and sustain them' (ibid, p.4). Moreover, people's knowledge and actions can never be viewed separately (Burr, 1995). The ways in which activities are carried out would normally influence the way people obtain and frame the answer after posing the question. Different 'truths' may arise from different actions and purposes. Thus, knowledge, viewed from a social constructionist perspective, is linked to, and also emerges as a product of activity and purpose, which is intertwined with social actions (Burr, 1995; Nightingale and Cromby, 1999). Whilst recognising that there may be many methodological implications, the application of the social constructionist view in this research was considered appropriate and suitable. The social constructionist view was regarded as particularly useful in addressing the aims and context of this research, whilst at the same time

laying the foundation for the ethnographic approach, discussed in the next section.

### **4.3 Ethnographic approach**

The adoption of an ethnographic approach requires the acceptance of a particular perspective that recognises the idea that ‘The world is not already there, waiting for us to reflect it’ (Cooper and Burrell, 1988, p.100). In other words, meanings are not already formulated and readily available out there but are actively constructed by people through ongoing interaction and negotiation.

From an ethnographic perspective, the ongoing process of perceiving, interpreting and representing reality involves several steps in the research process. Cazal and Inns (1998) summarise these steps into three groups. The first of these is gaining access to the perceptions, behaviours and meanings provided by participants within designated events in a specific context. The second step is analysing and imposing some form of structure on the materials generated and captured, i.e. bringing together the perceptions, behaviours and feelings of participants and arranging them into a certain kind of order or structure. Implicit in this selection and ordering is the need to identify and prioritise the available data to determine which represent key elements and which constitute peripheral elements in terms of their contribution to understanding the particular situation or phenomenon. The third step identified by Cazal and Inns is conveying and disseminating those experiences and meanings to the wider research communities. From an ethnographic perspective, these three steps in the research process imply a transfer of meaning between different people: from the participants in an event or a phenomenon; to the researcher, who captures and interprets the words and language of the participants’ discourse; and to the eventual readers who read the



written-up report of the research (Cazal and Inns, 1998). The effective communication of the original meaning across the three stages in the chain is critical, otherwise there will be inconsistency of meaning and understanding across the different stages (Sartre, 1972; Rapport, 1994; Cazal and Inns, 1998). According to the ethnographic approach, in order to understand different ways of life or 'the behavior of humans and their groups' views presented must reflect 'the point of view of those being studied' (Bryman, 1988, p.46). Obviously, in the processes within and the progression through these steps, the researcher is not only the key person who goes into the field to learn about the world 'from the inside out' (Schwartzman, 1993, p.4), but also the key person to link the other two groups into the research process. This is in line with the social constructionist view. Therefore, researchers themselves, acting as 'instruments' (Rew, Bechtel and Sapp, 1993) in the data collection and analysis process, are not simply 'reporters' of the facts, but rather 'craft workers' who create identifiable works (Watson, 1994).

Linking the ethnographic and social constructionist methodologies and approaches to the present study shows the potential contribution they provide. The purpose of this study is to explore the reasons behind SME cluster creation in China. An important dimension to improving our understanding of this phenomenon relates to how individuals make sense of cluster creation in a specific social and environmental context. Such perspectives, meanings or attitudes are likely to be influenced by a variety of personal, institutional and contextual factors. An ethnographic approach, supported by a social constructionist methodology, was chosen because it was thought that this approach would provide greater insights and explanatory powers when capturing, organising and analysing such data and provide a distinctive paradigm to enhance understanding of the cluster formation process. Within this methodological

umbrella a set of complementary research methods will be employed as explained and justified in the following section.

#### **4.4 Research methods**

This thesis utilised a case study approach as the basic platform. The case study and the involvement of the case participants were constructed from semi-structured in-depth interviews, observation and documentary evidence, such as records. Such methods seek to uncover the depth and richness of the living experiences of the informants within the clusters in China (Yin, 1984).

Robson (1993, p.40) defines the case study as the ‘development of detailed, intensive knowledge about a single ‘case’, or a small number of related ‘cases’’. According to Morris and Wood (1991), the case study strategy will be of particular interest to the researcher if he/she wishes to gain a rich understanding of the context of the research and the processes being enacted. The case study approach provides substantial depth of understanding of the research problem, and also frequently provides many clues and insights for further investigation (McCuddy, 1995), in particular when ‘how’ and ‘why’ questions are being posed (Yin, 1993). Hence the case study method is most appropriate when the aim of the study addresses a contemporary phenomenon occurring within real life, which complies with Yin’s criteria for selecting the appropriate method (Yin, 1993).

According to some authors, (such as Yin, 1993; Stake, 1995), several sources of evidence can be used in case studies, for example, interviews, observations, archives and documents (e.g. articles in newspapers/magazines, letters, agendas, memos and

administrative documents). The use of several sources of evidence adds to the validity of the data through corroboration. This study draws primarily upon interview sources, i.e. data are collected through semi-structured in-depth interviews, which provides the researcher with the opportunity to 'probe' answers, where interviewers want the interviewees to explain, or build on their responses (Saunders, *et al.*, 2000). Archival and documentary sources are also used when evidence from interviews needs to be corroborated, or vice versa.

A multi-stage fieldwork programme was developed, with multi-level data collection and analysis being conducted over a 3 year period (2006 - 2009) to achieve the research aim and objectives. Most of the key informants were interviewed several times over this three year period, and others were generally interviewed once or twice. The form of interviews varied from the more formal to the informal, depending on the balance between the observed cultural norms in China and the style of the mediator effecting the introduction to the informants. The duration of the interviews varied significantly from 30 minutes to several hours depending on the conversation flow relating to the substance of the interviews themselves and the on-site situation of the interviewees at that time (i.e. their attitude: towards cooperation or not, their willingness to talk or not, whether they had enough time to talk or not, and if there were any emergencies to deal with at work on that day).

#### **4.5 Fieldwork**

The fieldwork was completed in multiple stages. A preliminary pilot study was conducted in the initial stage (MPhil stage) to test and validate the proposed data collection and analysis methods. This helped to inform the data collection for the later

stages (PhD stage). The informants at the first stage of the study were drawn from those engaged in the development of SME clusters, including practitioners and government officials in SME cluster creation in China (Zhejiang Province and Shanghai). The focus of later stages of the fieldwork was on re-interviewing the informants from stage one, building up a trusting and mutual understanding relationship, and also seeking the possibility to gain access to new informants.

#### **4.5.1 The fieldwork process**

##### **-- Fieldwork: stage one**

The sample size in stage one consisted of 11 interviewees in Zhejiang Province (7 business owners, 3 government agencies, 1 academic), and another 3 interviewees in Shanghai (all three of them business owners). The researcher gained access to the rest of the interviewees through one interviewee in Shanghai (hereafter SH1), and the focus of the fieldwork in this research is in Zhejiang Province. The fieldwork was undertaken mainly in Wenzhou and Shaoxing cities in Zhejiang Province. The status of the interviewees is summarised in Table 4.1:

**Table 4.1: Status of Interviewees – stage one**

<b>Interviewees:</b>	<b>Set up the business</b>
SH1	Alone
SH2	With brother
SH3	With friends
W1	With brother
W2	With father
W3	With friend
W6	Alone

W8	Alone
W9	With friends
SX1	With father and brother
SX2	With wife

Interviewees:	Type of industry	Date of starting business	Years in business
SH1	Wholesale and retailing (auto part)	1990	20 years
SH2	Manufacturing (W1's technical innovation centre)	2004	6 years
SH3	Manufacturing (RB's sub)	2003(set up year)	7 years
W1 (HK)	Manufacturing (HK head office)	1986	24 years
W2	Real estate	1986	24 years
W3	Manufacturing	1987	23 years
W4	Official (CC)	N/A	/
W5	Official (IR)	N/A	/
W6	Academic	N/A	/
W7	Official	N/A	/
W8	Wholesale and retailing (Auto parts)	1995	15 years
W9 (RB)	Manufacturing (Bearings)	1984	26 years
SX1 (XD)	Manufacturing (Wiring harnesses)	1987	23 years
SX2	Manufacturing (Springs)	1990	20 years

As mentioned above, the field research was mainly based in Wenzhou and Shaoxing in ZheJiang Province and Shanghai, which are shown in the Map 4.1, Map 4.2 and Map 4.3.

**Map 4.1: Map of China**



**Map 4.2: Map of Zhejiang Province**



**Map 4.3: Map of Zhejiang Province and Shanghai**



Wenzhou City is located in the south-east of Zhejiang Province, intersecting the two economic zones of the Yangtze River and the Pearl River Deltas. It is a coastal city, and is the economic, cultural and transport centre of South Zhejiang. The total geographic area is 11,783 square kilometers and the population is more than seven million. (Wenzhou Official Website, 2007).

Shaoxing is located in the south of the Yangtze River Delta, in the central-northern part of Zhejiang Province, between Hangzhou and Ningbo. It occupies an area of 8,256 square kilometers and has a population of 4,340,000. Within this, the downtown area is 362 square kilometers and has a population of 640,000. This is one of the key developed and open cities of the south part of the Yangtze River, and, according to the

Shaoxing Official Website (2007), is one of the 40 best cities providing what is believed to be a very supportive environment for investment, in particular for the physical infrastructure.

According to the data from the government websites of Wenzhou and Shaoxing, the private economy accounts for more than 90% of the two cities' economic aggregate activity. These two cities both have economic development features, i.e. particular industries. Based on the private sector economy, with visible regional features in its industrial composition, Wenzhou has formed 13 well-known industries and has developed a number of economically strong towns, such as: China's Biggest City of Low-Voltage Electrical Equipment 'Liushi Town', the National Major Production Base of Car Accessories 'Tangxia Town', and the National First Producer of Trademarks 'Jinxiang Town', among others (Wenzhou Official Website, 2007). Shaoxing has formed 35 blocks of specialty economies on a significant scale, such as the textile, printing and dyeing industries of Shaoxing County, the socks, shirt, pearl and hardware industries of Zhuji City, the umbrella, chemical, mechanical and electrical industries of Shangyu City, the necktie industry of Shengzhou City, the medicine and axletree industries of Xinchang County, and the furniture industry of Yuecheng District. (Shaoxing Official Website, 2007).

These economically strong, key regional towns are accelerating the progress of modernisation and urbanisation of the two cities and of the whole ZheJiang Province in China. This is the primary reason for choosing these two cities to undertake the research fieldwork, because these two are the most representative cities in Zhejiang Province with vibrant entrepreneurial cultures and environments, thus providing the researcher with opportunities to gain access and do the interviews in the field.



**- Fieldwork: second and later stages:**

The second and later stages of the fieldwork were carried out from the summer of 2007 to the summer of 2009. The former interviewees were revisited and the key interviewees were interviewed again in order to gather and generate more data. Five new participants were introduced by the stage one interviewees and subsequently joined the project (See Table 4. 2 for details). Data collection from these stages helped to shape the main body of the three case studies incorporated in this research, while reshaping and refining the conceptual framework. All on-site data collection was completed by the summer of 2009. Since then, the researcher has maintained contact with those informants and updated their information through emails and telephone calls when necessary.

**Table 4.2: Status of Interviewees – stage two and after**

**Business founders**

<b>Interviewees:</b>	<b>Set up the business</b>
YY1	With friend & brother
YY2	Alone
SX3	With wife
SX4	With husband
SX5	With Friend

**Re-interviewing: Summer (2007- 2009)**

<b>Wenzhou</b>	<b>Shaoxing</b>	<b>Shanghai</b>
W9	SX1	Sh1
W1	SX2	
W3		
New firms join in 2007 September		
	<b>Shaoxing</b>	<b>Yuyao</b>

	SX3	YY1
	SX4	YY2
	SX5	
SH1 introduce YY1 and YY2 to the researcher SX1 introduce SX3, SX4, SX5 to the researcher		

**Table 4.2: Status of Interviewees – stage two and after (continued)**

Interviewees:	Type of industry	Date of starting business	Years in business	No. of employees
YY 1	Manufacturing (Lighting and transformer )	1991	18 years	500
YY2	Manufacturing (Electric switches & plastic parts)	1991	18 years	280

Interviewees:	Type of industry	Date of starting business	Years in business
SX3 (Used to be university lecturer, then started a business)	Textile (Wholesale and retailing)	Around 1992	>10 years
SX4	Textile (Manufacturing)	Don't know exactly	> 10 years
SX5	Wholesale (Automobile)	Don't know exactly	>20 years

#### **4.5.2 Access to participants**

In terms of the research aim and objectives, the evidence suggested that there is a lack of sufficient data on the selected areas in China and it was difficult to gain the necessary access to informants in China whilst the researcher was based abroad in the UK. Hence, it proved vital for the researcher to collect the data at first-hand on site in

order to be able to fully describe the process of cluster formation in China.

### **- Selection of informants**

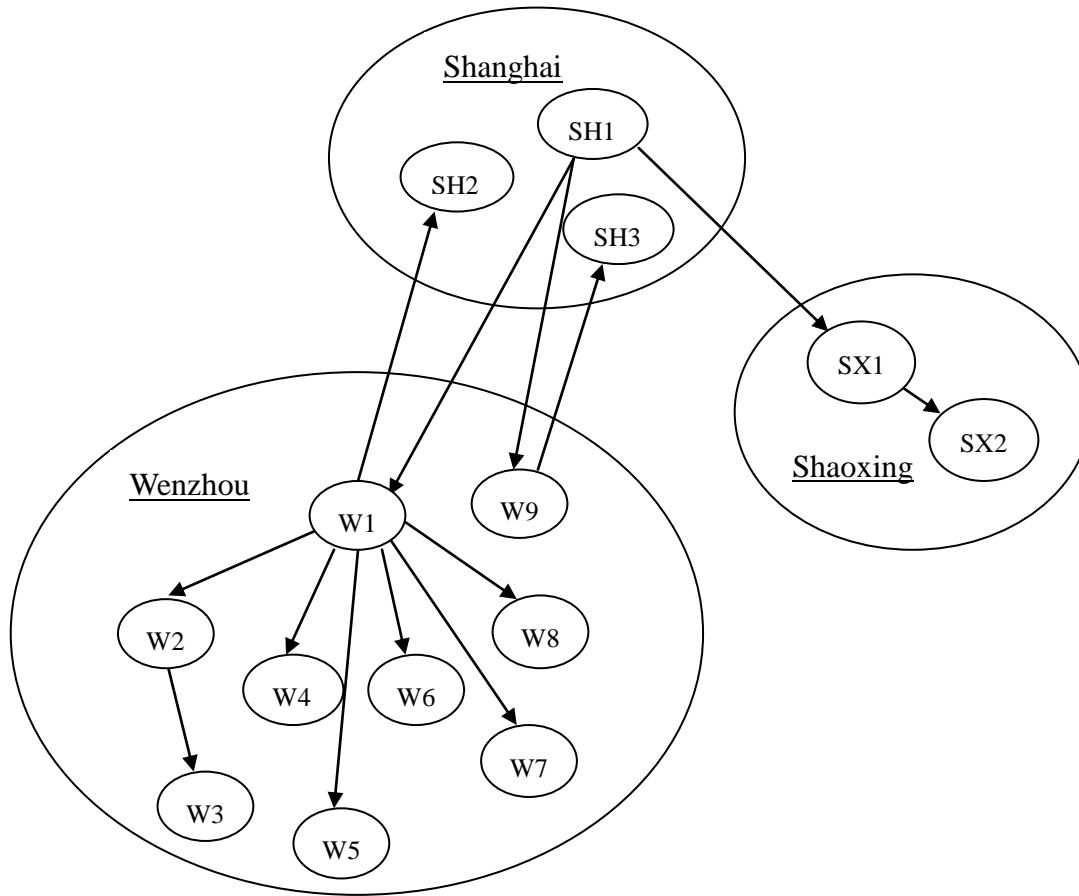
According to Mullings (1999), whether a researcher can achieve access to his/her informants is highly dependent on how the researcher approaches them. The best approach, based on the experience of the pilot study, was to gain access to the target subjects through personal contacts. Reflecting on personal experience suggests that people, especially Chinese, are not willing to let other people know too much about themselves unless they know who they are talking to very well. Therefore, in order to achieve the aim of this project, access to the target subjects was initially achieved through family, extended family and personal networks. Issues concerning the representativeness of sample selection, familiarity with the subject and role of the researcher are recognised and are discussed further in Section 4.6 (Problems in the fieldwork). This experience further informed and reinforced the argument that researchers inevitably play a key role in social science research.

The sample size of informants required is not easy to determine. In the initial stage, the target was to reach as many people as possible in the selected areas until the information collected proved solid enough to generate sufficient data to gain an understanding of the associated networks of actors and the process of cluster formation. The intention was to gain access to a good spread of informants to gain insights into the more common characteristics, motivations and processes whilst also capturing the richness and diversity in individual cases. The motive was not to achieve a representative sample, since this would not be feasible, but rather one that provided insights from a variety of perspectives.

The three key informants W1, W9 and SX1 in this study were all introduced by SH1. Before entering the field, these three key informants were contacted by telephone to confirm the visit, explain the objectives and ask if they could introduce more related actors willing to be involved in the research. All three of these key informants were willing to help, as their companies were rather well-known in their local area, and they also had various links with local people and local firms. Figure 4.2 shows the access process in the first stage, with a further description of their relations in Table 4.3. Informants in stage one, therefore, involved actors with different backgrounds, such as government officials, who helped to generate the overall situation within the local economy and local industries; entrepreneurs or managers who had built up or managed their firms having gone through the different stages of firm development within the developing local economy; local academics who offered training to entrepreneurs and managers in their local area; and other actors related to the key entrepreneurs or their firms, such as their family members, relatives, friends, or their employees, who had witnessed the development of the entrepreneurs or their firms. All of these people around the three key informants form a miniature version of their social and economic networks, which helped to shape the initial form of the case studies in this research.

In the second stage, the focus shifted from including all types of actors in the field to only including the entrepreneurs and those directly related to them. Access to new informants was expanded through the network of existing participants in stage one (See Figure 4.3 and Table 4.4), which further enriched the fieldwork data and helped to generate the main body of the three case studies in this thesis. The details and results will be discussed in Chapter Five and Chapter Six.

**Figure 4.2: Fieldwork access process: stage one**

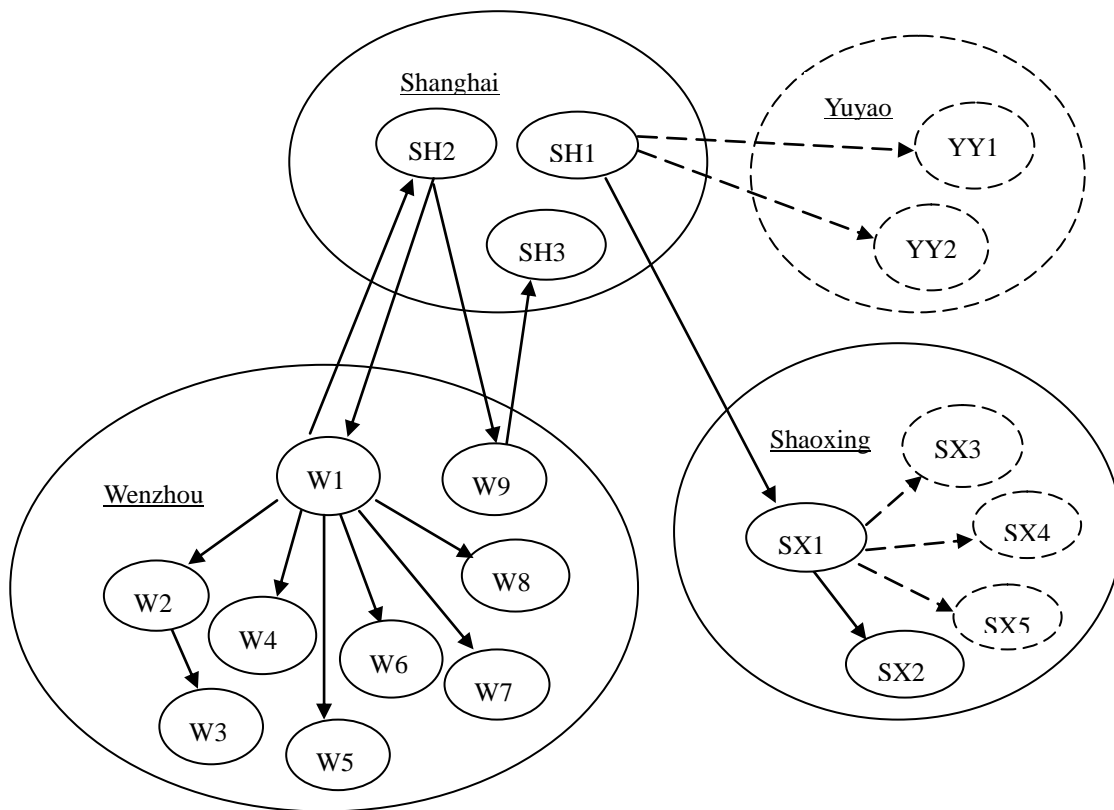


→ The direction of arrowhead means who introduced who to the researcher.

**Table 4.3: Relationship between interviewees**

Interviewees:	Relationship:
SH1 vs W1, W9, SX1 vs SH2, SH3	Friend and business partnership Friends' subsidiary
W1 vs W2, W4 vs W3 vs W5 vs W6 vs W7 vs W8 vs SH2	School friend Competitor Relative Student and Teacher Acquaintance Friend and Business partnership Head office & subsidiary
W2 vs W3	Business partnership
W9 vs SH3	Head office & subsidiary
SX1 vs SX2	Neighbour and friend

**Figure 4.3: Updated fieldwork access process in the second and subsequent stages**



It is claimed by Markusen (1994) that a two-hour interview needs ten hours of additional work, which includes initiation, preparation, transcription and analysis. According to studies of research interviewing, ‘simply to buy a tape recorder, invest in a suit and tie or a smart dress, write some letter, prepare a semi-structured questionnaire’ (Cochrane, 1998) are not sufficiently good preparation to establish the researcher as a ‘temporary insider’ (Mullings, 1999) in the field. In order to build up a rapport and win trust and understanding from the participants, research into the background of the selected areas was carried out prior to the interviews. This included research into their local history, recent economic development, traditional customs or even some local anecdotes in order to be as well prepared as possible for the interview.

**Table 4.4: Relationship between interviewees (second and subsequent stages)**

<b>Interviewees:</b>	<b>Relationship:</b>
SH1 vs YY1	Friends
vs YY2	Friend and business partnership
YY1 vs YY2	Aacquaintances Supply products to the same industry Located in the same area
YY2 vs W1	Know each other's firm because of SH1
YY2 vs SX1	Know each other's firm because of SH1
<b>Interviewees:</b>	<b>Relationship:</b>
SX1 vs SX3, SX4	Classmates in 'manager training courses'
SX5	Father's friend
SX2 vs SX3, SX4	Classmates in 'manager training courses'

Most informants approached were willing to be interviewed, but compared to formal interviews, informants seemed to be more talkative and perform more naturally in informal meetings. Thus, informal meetings, such as having meals, tea or coffee together or other social events (such as the celebration of the setting up of the firms, school friends meeting at a party, CEO training courses) were used as important ways to collect information and also to approach potential participants. This is a reflection of the Chinese way of communication, discussed in the conceptual framework section.

#### **4.5.3 Arranging the interview process/recording and analysing data**

The ethnographic research approach would suggest that it is important to pick up on

clues that shed light on the interviewees' personal characteristics. Most of the interviews took place at the interviewee's office or home. This provided useful information about the interviewees, such as their clothes and accessories, their families, their body language, and hints of their hobbies or interests, all of which helped to set the interview in context. Such personal information is likely to be linked to the development of the business and to cluster formation. Notes were recorded following the interviews. This information has formed a crucial part of the data collected from the fieldwork.

The majority of the data was collected through formal and informal interviews. Most interviews with entrepreneurs were started from a factory visit. Some of these visits were accompanied and introduced by the entrepreneurs themselves, who would later be interviewed. In some firms (particularly well-developed ones), the factory visits were guided by specific employees, who worked as a 'tourist guide' for the firm to introduce their products and development situation. This not only provided a brief insight into the situation of the firms, but also offered both interviewer and interviewee the opportunity of a warming up period before the interview took place. In some cases, the interview was taped during the course of the factory visit. In other cases this was impractical because interviewees did not immediately give permission. The situation normally changed in the second and third visit, as some actors finally agreed to being taped in the interview. However, a few still refused. In some cases this appeared to be related to the intense competition in the local area and in other cases this was for personal reasons. Therefore, it was important to let the informants know that the views and information they provided would be kept confidential from other interviewees. A code name was used instead of the real name of the respondents. Notes were taken during all interviews, irrespective of whether the interviews could



be tape recorded or not. The interviews that were tape recorded were transcribed and analysed with the support of both the traditional page by page review approach and 'NVivo' in the initial stage.

### **- Rationale for data collection and analysis**

It soon became apparent that 'cluster' is not a commonly used word in real business life. Initial attempts to use it in some of the discussions with informants proved to be a failure. Most informants had never heard of the term before and had no idea what it meant. Some of the informants made sense of the meaning of this term by themselves or simply from the expression of the interviewer. In most cases, the term 'cluster' was not used in the fieldwork process. This was in order not to mislead and restrict the participants and to keep sufficient openness and flexibility to collect as much data as possible.

Data analysis follows the model mentioned in the literature review chapter (Ch.2) and conceptual framework chapter (Ch.3) (See Figure 2.1: Cluster creation elements framework). The five elements on which it was based were: (1) Institutional context/entrepreneurial climate; (2) location (geographical); (3) individual; (4) relationship and (5) mutual benefit.

Data analysis is not a separate and distinct stage that is carried out subsequently to data collection, but rather an ongoing process throughout the research. This is consistent with the methodology of this research, i.e. social constructionism. In the initial stage, NVivo was adopted in order to simplify the data analysis process. However, due to the expansion of the accumulated transcripts and information, 'NVivo' was not considered appropriate. Whilst NVivo was useful for the generation

of key themes, it also resulted in a loss of the essence of reviewing and analyzing transcripts. Manor-Binyamini (2010, p.1999) argued that researchers should understand the conceptual and context of the data rather than focusing on 'dictionary meanings' of key themes in the process of data analysis. Therefore, in order to ensure validity and capture the richness of the data, whilst at the same time helping the researcher to trace the meanings, relationships and implications of the conversations with informants', the NVivo approach was replaced by the most traditional and basic approach, i.e. read the transcripts page by page and as many times as the researcher can.

The collection and analysis of data is a long, complex, and labour-intensive process. Fieldwork material gained from the early stage of data collection and analysis helped to inform the development of the conceptual framework, and also to identify the emerging themes and issues for further research in the later stages. During the process of data analysis, rather than imposing a fixed, pre-determined structure, the researcher has taken account of all the potential themes that emerged from the ongoing research experience, then carefully utilised or categorised them, seeking to implement further discussions in the later stages and gain an advanced understanding of the research topic. This process has also helped this research to gain new insights that have lead to the literature being revisited, and the conceptual framework being reshaped. Table 4.5 lists the key themes of the questions that the researcher asked during the fieldwork process. These were based on the framework (Figure 3.2) proposed in Chapter 3 (Conceptual Framework).

**Table 4.5: Targeted questions in data collection process:**

<p><b><u>1. Location:</u></b></p>	<p>- The origin of the company (RB,HK, XD): city</p> <ul style="list-style-type: none"> <li>Briefly describe the background of the city (population, geographical space, natural resources, local culture, transportation, education level, etc.)</li> <li>Why choose this city to start business?</li> <li>What do they gain from the city?</li> <li>What makes the city different?</li> </ul> <p>- New location: Shanghai (e.g. RB's sub, HK's technology and innovation centre, etc.)</p> <ul style="list-style-type: none"> <li>Why move to Shanghai?</li> </ul>
<p><b><u>2.Institutional context/entrepreneurial climate:</u></b></p>	<p>- Government behaviour: central government &amp; local government policies, their influence.</p> <ul style="list-style-type: none"> <li>From planned economy to market economy</li> <li>Related/supportive policy</li> <li>Source of finance (loan, taxes, etc.)</li> <li>Chamber of Commerce</li> <li>Other support</li> </ul> <p>- Local Atmosphere</p> <ul style="list-style-type: none"> <li>Local cultures and traditional customs</li> <li>Market opportunity</li> <li>Role model, mentor and competitors (advocate doing business, explain why)</li> </ul>
<p><b><u>3. Individual/actors:</u></b></p>	<p>- The founder of each case (brief introduction + his/her knowledge and skills)</p> <p>- Family and friends (founder and his network)</p> <ul style="list-style-type: none"> <li>Source of finance</li> <li>Human resources</li> </ul> <p>- Motives and Intention</p>
<p><b><u>4. Relationship</u></b></p>	<p>- Social networks (Inter/intra)</p> <ul style="list-style-type: none"> <li>Source of finance</li> <li>Human resources</li> <li>Role model, mentor and competitors</li> </ul>
<p><b><u>5. Mutual benefit:</u></b></p>	<p>- Physically secure (business reward, job secure)</p> <p>- Psychologically secure (business psychology, social status and face)</p> <p>- Risks</p>

#### **4.6 Problems in the fieldwork**

On the whole, the fieldwork in China proved successful, but there were still some problems that emerged during the research process. It is important to be aware of these problems in order to be able to reconsider and adjust the procedures and skills used in the field. The social constructionism approach and the ethnographic view emphasise that researchers should be at the centre of the research process (Strauss & Corbin, 1998; Cazal & Inns, 1998). This means that the ideas of researchers should not only be presented in the conceptual framework, but also in the methodological framework. It is therefore worth highlighting the problems encountered in the research, as these problems played an undeniable role in helping to shape the research ideas and improve the research skills of the researcher.

The first and most important target on entering the field is to get data. However, data access problems appeared even prior to undertaking the fieldwork. Compared to Shanghai, which is a big city, the two other main areas selected were newly developed, having previously been traditional rural areas. Due to the weak infrastructure and to low or absent financial disclosure, it was extremely difficult to get detailed data and information to approach potential local enterprises or entrepreneurs.

The accuracy and transparency of some available published data is questionable. The data and information released by different departments or institutions were not always consistent. Moreover, there was always a time lag in producing the published data, Mukherji (2001). This delay may be due to the complex bureaucratic procedures which have to be progressed ‘layer by layer’, from local to central government. Therefore, the first challenge was to find accessible, meaningful, reliable background information on the selected areas and potential participants.

Secondly, access to the potential participants via email, letter, and telephone did not prove workable in the pilot study stage. Emails and letters did not produce any response from the companies contacted. The cross country research (from the UK to China) and international postage proved both time consuming and costly, which could be one possible reason. Contacts via telephone were also refused with different answers, such as, 'too busy', 'no time', 'will contact you when we are available', or in some cases people even simply hung up with no response. Therefore, this 'cold-calling' approach was abandoned and instead personal networks were used. This proved more successful. The whole process for gaining access to the participants is unsurprising in the Chinese context and reflects the assertion in the conceptual framework chapter, that 'who you know' sometimes is more practical than 'what you know' in China.

Thirdly, most informants were more encouraged to talk in informal interviews than in formal ones. Some of the informants, in particular business owners of small enterprises, were not comfortable with the style of formal interview. Most of them, in particular in the initial stages, were unwilling to allow the interview to be tape-recorded when permission was sought before the interview. According to Strauss and Corbin (1998), researchers should know how to approach and communicate with informants without putting them on the defensive or pushing them to act in expected ways, and interviewers need to adjust the interview on the basis of emerging issues. With this consideration in mind, notes were taken when the tape recorder could not be used.

For the above reasons, a conscious decision was made to shift the initial focus from

investigating the financial issues of the family business to investigating the networks and social relations among the informants. This decision was made partly because of the difficulties of getting access to the necessary financial data discussed above and partly because the data collection pointed to the importance of personal networks and relationships and it was thought that such networks would also be important in terms of the formation of clusters. The shift made in the process of the fieldwork thus helped in sharpening research questions and developing research skills. It also drove the research to rely heavily on first hand on-site data and information collection. As a result of this, it became crucial to represent this data accurately. Therefore, strategies for data collection were adjusted from purely adopting the tape-recording method to both tape-recording and note-taking. The result of data collection shows that they complimented each other and worked quite well. Of course, to avoid misleading the readers and to convey data on how informants 'see things', and more importantly on how informants 'do things' (Silverman, 1998), attention is paid by the researcher in the data presentation to ensuring the truth and accuracy of the interview journeys. Furthermore, as discussed in Section 4.4, the interview data was supported by other available documentation to improve the validity.

#### **4.7 Conclusion**

In relation to the research aim and objectives, the main purpose of this chapter was to construct a sensible methodological framework and a practical research design, i.e. to explore the potential answers to the research question. A social constructionist view and an ethnographic approach are adopted as the methodological grounding for this study. The research methods used comprised case studies based on semi-structured interviews as a tool to move the research thinking from a sense of vision to real life

events. Multi-stage fieldwork was carried out on the basis of the above to collect data to identify the reasons behind cluster formation and how people make sense of the clustering phenomena through their own personal view, their experience and their activities. The next two chapters, Chapter Five, Case Studies and Chapter Six, Findings and Discussion are the result of the long journey through formal and informal interviews, secondary data and documents, via analysis. The next challenge to be faced is how to handle the 'heavy glop of material' (Miles & Huberman, 1994, p.8), which needed to be extracted and shaped into a real and coherent story. Hoggart *et al.* (2002) argue that there is no 'telling it like it is', but what will direct the reader are the interpretation, selection and attempts of the researcher (Hoggart *et al.*, 2002, p.238). Therefore, as an interpreter, the role of the researcher is to make a choice regarding which materials should be included and construct those materials into stories to show readers what potentially leads to the formation of clusters and how people make sense of cluster formation in the Chinese context. As it is impossible to present an all-inclusive picture of the informants' lives in the field, the intention in the later chapters is to show partial aspects of their lives, i.e., views, experiences and feelings, which are drawn from the research questions and conceptual framework.

## **Chapter Five: Case Studies**

### **5.1 Introduction: The classification of the cases**

The informants were divided into 3 groups, entitled RB, HK and XD. Each grouping represents the composition for a case study. The rationale for the allocation of each informant into a particular group is primarily based on two factors, (1) their main geographic location and (2) their established relationships (mainly business relationships) with each other. Although these two parameters lead to consistent allocations into groups this is not always the situation. For example, SH2 is a subsidiary of W1 and although it is located in Shanghai, and not Wenzhou, it has still been incorporated in the HK group due to their evident close relationship. Likewise, SH3 is a subsidiary of W9 and has therefore been included in the RB group. Further explanation of the basis for grouping each informant into particular groups is articulated further in the case analysis.

Each case starts with an explanation of how the researcher gained access to the key informants and actors within the network. This may represent an important parameter in determining the nature of the relationship between the informant and researcher during the interview and the consequent willingness to share more detailed and potentially sensitive information concerning the relationship with others in the group. The more detailed presentation and analysis of the data are structured on the basis of the five cluster formation elements (please see Figure 3.3) explained and developed previously in the Literature Review and the Conceptual Framework chapters. The five elements comprise: Location, Institutional context, Individual/Actors, Relationship and Mutual benefit.



## **5.2 Case Study one: RB network**

### **5.2.1 Background**

The RB Group was set up by W9 and his friend in 1991. The company has its head office in Wenzhou and operates 8 manufacturing sites in different geographical areas within China. The company manufactures bearings which are a universal product with a wide range of engineering applications, used extensively in the motor, auto and motorcycle industries. The fixed assets of the RB Group in 2004 were valued at US\$ 134,000,000 and, the company's sales revenue reached US\$ 261,000,000. RB is therefore a substantial business and one of the key enterprises in ZheJiang Province, and a leading member of the ZheJiang Bearing Association.

W9, the main founder of the RB Group, set up his business in 1984 in Wenzhou at the age of 28. The introduction to W9 as an informant was facilitated by SH1. The two have had an established co-operative business relationship since the 1990s. As a result of the successful cooperation, they have become close friends although currently they have fewer business connections. Their close friendship was instrumental in ensuring that the researcher experienced no problems in gaining access to W9 and his company for the interview.

The first encounter with W9 was in a tea house (茶坊)<sup>5</sup> in the city centre of Shanghai during the period of the Chinese National Festival. He indicated that he and his wife would fly back to their home in Wenzhou after the interview in the late evening. His wife accompanied him to the tea house for the interview. After W9 introduced her to me, she went to another table and was reading magazines during the interview.

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<sup>5</sup> Tea house (茶坊) is a very common place in China, where people can have different kinds of tea, coffee, snacks etc. The function of Tea house in China is just like that of a Café in the UK. It is a popular place for businessmen to meet and discuss business, get to know new people and to network, etc.

The term ‘cluster’ was initially used by the researcher to describe the research, but this was not understood by the interviewee. Thereafter the term SME business research was used instead of cluster to describe the research. Subsequently, it was explained to interviewees, where necessary, that the terms network and cluster would be used interchangeably as appropriate (Please see Methodology Chapter for detail). At the start of the interview, W9 was asked to relate stories on why he decided to start up a business, how he managed to achieve this, and what motivates him to keep on running the business. The interview proved to be wide-ranging and in addition to business issues the discussion also covered his beliefs, the personal goals he wishes to achieve and his family.

The RB company, is effectively the main company with several subsidiaries distributed across China which can be viewed as a special case. Its head office in Wenzhou is located directly next to the low-voltage electric cluster in which the HK group is based. The informant W9 did not consider his company to be a member of a cluster, either due to the lack of understanding of the term cluster in this context or the absence of any meaningful direct ongoing relationship with other members in the group. Part of the explanation of this position may relate to the belief by RB that they built up the whole supply chain themselves and in so doing created a ‘quasi cluster.’ In a subsequent interview W9 referred to this as the ‘big factory’ using its Shanghai manufacturing unit as an illustration of this term ‘big factories’. Since the Shanghai manufacturing site had only been recently built and was still developing, W9 spent most of his time in Shanghai. This was also fortuitous since W9 was able to introduce the researcher to informant SH3, who is the manager of the RB’s subsidiary in Shanghai.

## **5.2.2 Location:**

### ***5.2.2.1 The origin of RB: Wenzhou***

Wenzhou, located in the southeast of Zhejiang Province, is the birthplace of the RB Group. Situated at the intersection of the two economic zones of the Yangtze River and the Pearl River with coastline of 355 kilometers, Wenzhou is the economic, cultural and transport centre of south Zhejiang Province. The total geographical area of Wenzhou is 11,784 square kilometers, among which the urban area is 1,082 square kilometers, and the remainder is sea. By the end of 2007, the total population of Wenzhou was 7.558 million (Wenzhou Official Website, 2007).

Since the reform and open door policy, Wenzhou has experienced rapid economic growth. According to statistics provided by the Wenzhou Official website, Wenzhou's GDP increased from 1.32 billion RMB yuan to 183.4 billion RMB yuan from 1978 to 2006, an annual growth rate of 15.1%. The GDP in 2007 was 215.7 billion RMB yuan. The gross financial revenue of Wenzhou increased from 135 million RMB yuan to 24.1 billion RMB yuan from 1978 to 2006, an annual growth rate of 20.3%, and reached 29.3 billion yuan in 2007. (ibid, 2007).

W9, the founder of the RB Group, was born and brought up in Wenzhou. Although he has expanded his business across the country, he still referred his firm as a Wenzhou firm and maintained the RB Group's Head Office in Wenzhou. W9 considered Wenzhou to be his roots, and also the starting point of his success. When asked, '*where did you start up your business, and why did you choose there?*', he explained that he chose Wenzhou not only because he was born there, but also because Wenzhou is a special place:

W9: *Why chose Wenzhou to start business? One reason...it is because you can only set up factory or start up a business in Wenzhou, in other places, you could not. This was a very clear situation. Wenzhou was different from other places.*

YW: **Do you mean the local government at that time was more willing to accept and support business start-ups, although the whole big national environment was not...?**

W9: *How to say, it was not really like this. I would say... the survival and development of a firm is related to a lot of different reasons and conditions...*

W9 emphasised that what he would say was just his personal view, different people might have their own view and think differently. Then he continued his speak:

*We stand at the bottom of the country (grassroots?), from my own experience, there were two conditions for starting a business. First: the strength/power of government management... that is to say...was rather weak in this place... they do not always keep an eye on you, and do not care too much about you. This is one thing. Second, the financial situation in this place was rather chaotic. In view of these two chaotic situations, you have the possibility to build up your business. Although at that time, the country talked about the open-door policy... allow this...allow that...allow private people to (start business) .....Why did people in other places not start a business, whereas Wenzhou people did?*

*Because in Wenzhou, there was a large population, but little land. Moreover, there was a lack of industry. There were a lot of people, you know, who had plenty of*

*spare time, they kept on thinking and tried to find a way out for themselves, so when the restrictions became a little bit looser and the country began to allow...you know, to do develop private businesses...people began to do this, to do that, e.g. they bought a vehicle to use for transportation, etc. Thus we say, if restrictions only begin to loosen a little bit in one place, people in this area would get far ahead of others. When the government was strict, people were waiting and ready to take action, some of them ran businesses secretly, and when the country permitted, they began to do it massively. Well, the government also thought that, you know, there were so many people, and they were not allowed to do w that... the market and the society would be a mass... If they had 'Nothing to eat' this would cause trouble, so the government open one eye and close the other... this is one aspect.*

The financial environment, was also given as a reason for W9 for starting a business in Wenzhou, will be discussed in section 5.2.5.1.1

The above account has shown W9's personal perspective on the relationship between choice of location and doing business. It explains the impact of the geography of Wenzhou on the development of businesses. Wenzhou has a shortage of cultivated land, but an abundance of water resources and mountainous land<sup>6</sup>. The cultivated land was clearly insufficient to feed the population. Therefore, in order to survive, local people began to find ways out for themselves. Setting up firms was a good choice. Wenzhou's weakness, i.e. lack of cultivated land, has turned out to be a strength, and has 'produced' many entrepreneurs.

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<sup>6</sup>The total geographical area of Wenzhou is 11,784 square kilometers, among which, the urban area is 1,082 square kilometers, and the rest is sea and mountainous land of over 200 thousand hectares. The total amount of water resources is 14.113 billion cubic meters

### 5.2.2.2 Shanghai: RB's new-sub

Unlike most of the interviewees, W9 does not think he is in a cluster, in fact he does not want to think he is in a cluster. Instead, he has chosen to build up his own cluster, and Shanghai is the location of his new subsidiary. The reason why the founder chose to build a 'cluster' in Shanghai is very similar to W1 as will be seen in the second case study<sup>7</sup>. W9 talked about these considerations when asked by the researcher "*why choose Shanghai, but not other place?*"

W9: *Why we chose Shanghai. Well, to be honest, labour in Shanghai is not cheap, but why do it nevertheless? The main purpose for us to choose Shanghai is to expand our international business. Most of the big, multinational firms are concentrated in Shanghai. If we have a big industrial park in Shanghai, suppose we want to invite them to visit our place, it would be much easier...there are plenty of opportunities. We also thought...the closer we were to those leading international companies, the more communication opportunities we would have, and the quicker our company would develop and progress. As regards exports, we are close to Shanghai Yangshan harbour<sup>8</sup>, which is very convenient.*

*Why choose this exact location to build up our firm? Well, we built up the firm next to the Tai River, you know, Jiangsu Province, Anhui Province are next to the Tai River, so as Zhejiang Province and Shanghai, which just formed the Yangtze River Delta economic zone. Our factories are built in this circle within this economic zone. We have a lot of clients in these places, they are closer, it is more convenient.*

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<sup>7</sup> W1, another key informant from Wenzhou, please see case study two: HK network for detail. (W1's company is located in the low-volt electronic appliance cluster, producing similar kinds of products. But he has now kept the manufacturing base in Wenzhou, and moved the R&D centre to Shanghai High Tech area.).

<sup>8</sup>The new harbour in Shanghai opened in 2006. It is the biggest harbour in China now.

**YW: Does that mean the transportation costs will be lower?**

*W9: Yes...We take our Shanghai industrial park as the centre, it basically takes about 4 hours to drive from our furthest factory to Shanghai. From the Suzhou manufacturing site to Shanghai, that's even closer, it only takes one hour.*

The above account has shown a strong link between the location and expansion of the company, which facilitates development of the business. This echoes literature that points to the importance of the geographical location as one of the key elements in the formation of clusters. However, according to W9's account, it can be inferred that issues related to 'location' are only able to be carefully considered and planned when the firm has developed to a certain stage. Firms at different stages of development consider different 'location' issues. Business founders of small and medium sized firms, have more 'restrictions' on choosing 'location', according to the development stage, scale and capacity of their businesses.

### **5.2.3 Institutional context/entrepreneurial climate:**

#### ***5.2.3.1 Government behaviour: central government & local government policies***

In December 1978, six years before W9 set up RB, China began its economic reform and implementation of an open-door policy. The aim of China's macro-economic policy is to maintain steady economic growth, to avoid major economic fluctuations and to enhance people's living standards. Since the introduction of the open-door policy, the Chinese economic system has moved from a centrally planned system towards a market oriented one. At the end of the 1990s, private business was formally

acknowledged as an integral part of the economy in China's Constitution. From that time, barriers to the development of private firms have gradually been removed by the government, enabling private firms to develop rapidly and become the pillar of China's economy.

According to statistics provided by China's National Development and Reform Committee in 2006, SMEs represented 99.3 per cent of the registered firms in China and accounted for 55.6 per cent of Chinese Gross Domestic Product (GDP), 62.3 per cent of exports, 46.2 per cent of tax revenue and 75 per cent of employment opportunities across China. In response to the need to support and promote SME development in China, both central and regional governments have promulgated several laws and regulations to improve the support, management, and protection of SMEs.<sup>9</sup>

Like most of the informants, W9 witnessed and experienced the different stages of economic development in China and applied the appropriate policies of the time to develop his business. The Wenzhou government report identified several distinct stages in the development of Wenzhou's economy. The first stage was the initial stage of reformation and opening in China (1979-1980). 'The Wenzhou economy started with family businesses and developed a diversified economy without restraints and had settled the question about economic total amount, and then formed the mode of 'small commodities, big markets' (Wenzhou Official Website, 2007). W9 was working in the construction industry in his early 20s during this period of time. Like all of the informants, W9 expressed the importance of this stage and emphasised its

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<sup>9</sup> In June 2002, Central Government promulgates the Law of Small and Medium Sized Enterprises, which provides clearer lines of legal responsibility in the sector.



influence on his later business, since the Chinese economic development was instigated at this stage. The second stage occurred after the mid 1980s, 'The Wenzhou economy linked the capital, talents and technology and guided family business towards stock cooperation and developed a stock cooperation economy, which has produced the effect of 'small capital, big radiation' (ibid). The majority of interviewees built up their firms in this stage, W9 being one of them. W9 said: *'It was very difficult when we began our business, we had almost nothing, and we used all our savings, we also borrowed some money from others to start our business, it was not easy, but we could not miss the chance'*. W9's words reflect the similar situation and thoughts of the other informants in that period. The third stage occurred after 1992, inspired by the spirit of Mr. Deng Xiaoping's statements during his famous southern trip and the 14<sup>th</sup> National People's Congress, the second wave of pioneering work that focused on expanding the economy was carried out. The situation can be described as 'small region, big development' (ibid). Most of the interviewees mentioned the changes for their firms during this stage. W9 began to get financial support from the government and started to invest large amounts of money on product innovation, network and market exploration after 1992. According to W9, this year was the turning point for his firm, which helped RB to accelerate its growth.

### **5.2.3.2 Local atmosphere**

#### **-Market opportunity**

Wenzhou has experienced many changes since the late 70s and early 80s. Because of the Reform and Open-door policy, barriers to starting private businesses have been dismantled. The whole market situation in Wenzhou was quite disorderly, and the quality of Wenzhou products varied. W9 started his business in this environment.

W9: *We started our business in 1984. We produced plastics at first, and supplied them to a factory in Shanghai. However, this did not last for long, because the company in Shanghai soon closed down. We lost all our investment, which was about seven to eight thousand yuan. In 1986, we began to produce electric pianos, to which we devoted money, time and energy. But in 1989, the situation became tough, and the electric piano market fell into recession, so we decided to switch our business to other products. After doing research for six months, we decided to make bearings.*

**YW: Why did you choose to make bearings? What gave you the idea to produce bearings?**

W9: *Oh, about bearings. Well, we had produced several different products before we made bearings, such as electric pianos, etc. The market for electronic pianos was not very big, and they therefore could not be our product in the long term. We spent a long time considering that what kind of products should be our product. First, we wanted it to be good quality and sell at a good price, because the better the quality is, the higher the price would be. This was our expectation and also our requirement. Second, we wanted there to be a real market need, and to find a product that would be used in daily life. And third, we wanted the product to have long longevity. We did some research at that time and found that the volume of bearing exports was very large compared to the volume of imports. The proportion rate was about 3:1 at that time, which meant when China exported 3 sets of bearing, and we can only got 1 set back, or even less than 1 set. That's why we choose to make bearings, because it was in line with our long*

*term target. On the other hand, a bearing is also a standard part, basically, it would not change a lot in the next one or two decades or even longer, and this fulfilled our criteria i.e. good quality good price.*

When W9 was asked how they did the research, and whether there were other people around them, such as friends, relatives, or neighbours, who also produced bearings at that time that might have inspired them to produce bearings as well, W9 indicated that the decision to make bearings was based on their market research and not on following others.

*W9: No one produced bearings in our local area. Even in the whole Wenzhou area, there were only about one or two companies producing bearings at that time... very few... not many people did that. We also discussed our ideas with other people, such as relatives, friends, etc. They gave us a lot of suggestions. Some of them thought this idea was quite feasible, and could be put into practice. Based on all of these, we finally made our decision and chose to produce bearings.*

W9 also mentioned his partner Zhan's view:

*He got the feeling that, although the quality of bearings and the bearing market was not very good, it had great potential for further development.*

According to W9, before RB decided to choose bearings as their main produced, RB had made several different products as well. They set up their business when the free market had been opened up, and they chose to change their products when the market for their product was in decline, and a new market opportunity opened up. W9 also

mentioned ‘after doing research’ many times during the conversation, which reflected their attention to the market, and their strong motives and intentions to do their business and make it better. Moreover, discussion and consultations with friends and relatives reflects the influence of family and social relations, which help business founders in shaping and catalyzing the existing market opportunity.

#### **5.2.4 Individuals/Actors:**

##### **5.2.4.1 *The founder of RB***

W9, the main founder of RB Group, set up his business with three of his friends in 1984 at the age of 28. Before W9 set up his business, he had been working in the construction industry for about 10 years in various jobs, such as a mason, carpenter, and electrician, while his three partners were working in state owned enterprises at that time. W9 and his partners had already known each other for many years, according to W9:

*W9: Before we started our business in 1984, we had known each other for several years....I knew Zhan particularly well, I had already known him for almost 10 years at that time.*

**YW: So you two are old friends?**

*W9: Yes, we have known each other since we were teenages, we were mates. I knew him when he was 16 years old, at that time, I was 18...em...Yes, in 1984, I was 28 years old, he was about 26 years old. The other two were around the same age, almost all of us was in our late 20s and early 30s.*

After working for others for many years, W9 and his partners decided to change their life and chose to start their own business and work for themselves. This is discussed further in section 5.2.4.3.

#### ***5.2.4.2 Family and friends***

##### **5.2.4.2.1 Source of finance**

According to studies of SME businesses, the main source of finance, in particular of start-up funds, is from business founders' relatives. However, discussions with W9 revealed a different means to access funding. Funding came mainly from capital borrowed from external sources, i.e. from the '*Gao Li Dai*' (高利贷, in other words from a high interest loan from an underground bank. According to W9, borrowing money from family members was not a good option. This was firstly because the standard of living of his family members was not good enough, hence the amount of money they could offer was not large. Secondly, borrowing money from family and friends was not a good option because he would then owe them a favour, in Chinese '*ren qing*' (人情. Thus W9 chose to borrow the majority of his start-up funds from external sources, although he did borrow small amount money from his family members and relatives, and invested almost all of his personal saving when he set up RB. Please see section 5.2.5.1.1 for detail and further discussion.

##### **5.2.4.2.2 Human resources**

The discussion with W9 clearly identified that family members or relatives were not the key actors in setting up RB. This reflects the strict rule on human resource

recruitment restrictions established by the founders of RB, that family members, relatives or even acquaintances were not allowed to work in RB. They decided to target the general public in their recruitment. The discussion about human resources did not focus on the business founder's family support in setting up the business, but rather placed emphasis on public recruitment. In fact, RB rarely talked about his family or relatives during the whole process of the interview. However, support from family members or relatives in human resources did exist in RB's case in terms of direct and indirect personal support. Evidence of such support was provided by W9's wife following the interview who confirmed the contribution of family members in human resource terms when W9 was just setting up his business (RB).

W9's wife referred to the contribution that she and other relatives made as follows: *'At the beginning stage of RB, when they were extremely busy, we<sup>10</sup> often gave them a hand.'*

From this information, it may be possible to infer that family members or relatives as one part of the business's human resources normally offer informal and short-term support when the business is in need. (Please see section 5.2.5.1.2 for detail information and further discussion.)

#### **5.2.4.3 Motives and intentions**

This section will examine the motivations and intentions of W9. As he had clearly expressed the view that he did not belong to any cluster, motives or intentions in relation to clusters were not pursued or discussed during the interviews. However, W9

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<sup>10</sup> Here 'we' include W9's wife, and their relatives.

did talk about his motives and intentions associated with starting a business, including entrepreneurial reasons.

YW: *Just as you said before, you and your friends gathered together, discussed, and then decided to start a firm? What caused you to make this decision? Why did you not remain in the construction industry?*

W9: *Well, from my point of view, if you have worked in an industry for a long time, you would be tired of it. I felt tired of working in the construction industry. I had worked in the construction industry for almost 10 years. There were things I really did not like.*

YW: *Which things?*

W9: *Well... when the house was completely built, the whole project was over, and then we had to find a new project to do. Always looking for this, looking for that...I felt, from my own perspective, when you finish one thing, then have to go out to find another, it was very frustrating and there was no continuity at all, which was one thing that made me want to leave that industry. At that time, when we talked about the construction industry in Zhejiang, or the whole nation's construction industry, there was heavy reliance on the government to provide the contracts and work. Actually, we did not have a lot of projects to do and there were always long gaps when we did not have any jobs. When you were available to work...but had nothing to do, you know...the feeling was so frustrating....and simply making a living was so difficult. It was not like nowadays, where everywhere is under construction, everywhere people are building new houses, etc. Therefore,*

*in this kind of uncertain situation at that time, I chose to start a business, which would provide more continuity.*

YW: *So do you mean, when you were involved in construction work , your work was very dependent on government decisions. If the government needed to build more houses, then you were employed, if not, you did not have work to do.*

W9: *Yes, that was the case.*

YW: *If, at that time, you could have built houses without government constraints, would you have started a similar company in the construction sector on your own?*

W9: *Yes, if I could, I would. After all, I was more familiar with that sector, but ...*

*We switched our focus to the manufacturing industry, and established a firm in that sector. Honestly, we did not know how good or how bad our firm would be, and we also did not know too much about how to run a business.*

From the above conversation, it is reasonable to identify that the most fundamental motives for W9 to start a business were associated with making a living. The term ‘continuity’ can in this context be inferred as seeking a ‘stable job, stable income’. As working in the construction industry could not secure W9’s livelihood, W9 dropped out and chose to start his own business in order to gain more control of his life and his economic situation.



Unlike W9, the other three co-founders were working in state owned enterprises (SOEs) before they set up the firm. The reason for them to want to start a business was mentioned by W9 during the interview.

*W9: My friends were working in SOEs before we gathered together to establish the firm<sup>11</sup>. Zhan had just got his degree from the Broadcasting and Television University<sup>12</sup> at that time. They were all considering their future careers. You know, there might be some things or some dreams, that would be difficult to achieve in state-owned-enterprises that you may have the chance realise through setting up your own firm. The model of firms we established would be very different from the model of state-owned enterprises. You could do a lot of things which were not possible in SOEs.*

W9's account may be used to infer that the opportunity for personal development for people working in the SOEs was relatively limited compared to those available from setting up one's own business. Therefore, in order to achieve further development opportunities and fulfil their dreams, W9's partners joined W9 in starting their own business.

A revealing insight into their preparedness to start a business was their admission that before taking the decision to start their own business, they did not have any knowledge about how to make their main product, a 'bearing'. None of them had any experience in manufacturing and by W9's own admission they had no relevant experience at all:

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<sup>11</sup> 'gather together', here means 'set up the firm'.

<sup>12</sup> Like 'Open University' in UK, offer opportunities for people who want to get further education.

W9: *Actually, we did not know how to make a bearing when we first started. We had no idea about it at all. At that time, we just felt that if others could make the product, why couldn't we? We did a lot of investigation before we start, although none of us had worked in that field before. We still thought it was a product worth investing in and producing.*

*We hoped we could produce better products that would then take the place of imported bearings. Our belief was that if others could do it, then so long as we worked hard, we could also do it. But when we actually began production, we realised that we had so many difficulties, e.g. how to choose the raw material, the planning of the production process, quality control, etc. We were not clear about any of these and we learned by doing, 'to feel the stone to cross the river'”<sup>13</sup>.*

Two key motives and intentions for establishing their own business may be inferred from this conversation. The first is the strong motive to gain greater regularity and security over employment, ensuring a better livelihood and control over their life. Secondly they had a sense of dissatisfaction with the current working environment and the constraints on personal development, particularly being employed by others. It is evident that they were prepared to take significant personal and career risks by establishing a business despite having no prior experience or knowledge of the product nor running and managing a business. All this issues will be further discussed in Chapter Six.

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<sup>13</sup> 'Feel the stone to cross the river' is a well-known saying said by Mr. Deng Xiaopin, who was the chairman, and proposer and implementer for 'open door policy'. Here means to figure things out as one goes; taking one step at a time.

## 5.2.5 Relationships

### 5.2.5.1 Social networks

#### 5.2.5.1.1 Source of finance

Most firms, in particular small and medium sized firms, have a high demand for funds during the initial stage of the start up process. The RB Group was just such a business at the outset. However, discussions with W9 revealed a different type of experience in getting access to the start-up capital needed<sup>14</sup>. Unlike most of the other informants in the other cluster, the main source of W9's funds was borrowed from external sources, rather than being generated from internal or family sources:

W9: *Most of our business start-up funds was borrowed from others.*

YW: **Any savings of your own?**

W9: *Yes, I invested almost all of my personal savings, which I saved when I was working in the construction industry, but it was only a small amount of money. The rest was mainly borrowed from external sources.*

YW: **What do you mean by external?**

W9: *Well, you know, Wenzhou, this place is quite different from others. From ancient times until now, there have always been underground private banks in Wenzhou. We use the term 'Gao Li Dai' ('高利贷' - 'high interest loan' / usury) ... we say ... if there were no money, no 'high interest loan' (高利贷) in this place ... you could not start up a business. If this place has money, but no 'high interest loan', you*

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<sup>14</sup> Also including funds for developing the first few years.

*could not start up a business either...*

*At that time, Wenzhou was not rich, rich places were large cities like Shanghai, or Shenzhen, etc. People there were richer, because their salaries were higher. However, they all saved their money in the bank, and ‘gave’ these funds to the nation<sup>15</sup>, but in Wenzhou, these underground private banks (‘地下钱庄’) have a lot of private financial resources. We borrowed the money from them, then started our business. Thus, if you want to start a business, you can only choose Wenzhou, this place.*

**YW: Did you borrow any money from relatives or friends?**

**W9: *Of course.***

However, when W9 was asked elsewhere in the interview whether his relatives or friends offered significant support in financial aspects during the start-up stage, W9 shook his head slightly and said:

**W9: *Relatives were the same, they also lend you the money with high interest rate, the same as ‘Gao Li Dai’ (高利贷, High interest loan offered by underground private banks) did. Some of the relatives, although they did not have money themselves, could help you to borrow money from others as well. Borrowing money from them was also troublesome. I did not want to owe them too many ‘ren qin’ (‘人情’, favours).***

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<sup>15</sup> Here ‘gave’ means ‘saved’, the sentence means saved their money in the bank.

The above account clearly demonstrates that the main start-up funds for W9's business were generated from external sources. W9 also indicated that borrowing money from relatives or friends was not an option he favoured, for which he gave two reasons. Firstly, he would have had to commit to '欠人情' (owe his relatives/friends favours), which would lead to '还人情债' (returning the favour). Secondly, the standard of living of his relatives and friends in Wenzhou was not very good. Most also need to make a living by themselves in difficult conditions, therefore, even if they could afford to lend the money, the amounts would not be very large. Their own economic situation would also make it unlikely for them to be able to take the risk of lending the business founder a large amount of money, given that the business was still embryonic, and its future was unknown. Therefore, borrowed money from 'Gao li Dai' became an option when there were no better alternatives.

However, when W9 was asked why they did not borrow money from banks when they set up, W9 expressed the view that getting loans from banks at that time was even more difficult.

*W9: If I could have borrowed the money from the bank at that time, I would have done that definitely.*

*The most difficult time for our firm was from 1984 to 1992. We received no financial support from the government during that period at all. The mentality of the local government at that time was more in favour of pursuing a policy of 'short, steady and speedy' projects' (i.e., short term investment giving quick payback, steady growth and generating quick high-profile results). However, for companies like ours, that needed to produce high quality products, we were not*

*able to meet their requirement for 'short, steady and speedy' projects. They<sup>16</sup> only came around to see...well... what's going on in our firm. People who worked in bank came here, looked around, and then left. That was it, no attention was paid.*

*The development of our firm was heavily reliant on the 'leasing companies' who bought equipment needed then loaned them to you to use. They charged you high interest rates, which made it feel like another 'form' of government 'Gao li Dai'<sup>17</sup> (“高利贷”high interest loan). At that time, we just went out to see what kind of equipment we needed, told them, they would buy the equipment and then lend them to us, just like that.*

The above accounts of RB's set up, echoes the point discussed in the literature, indicating the difficulties for the business founder to obtain bank loans, especially in the early stages, although this was probably when they had the greatest need for such funds.

According to W9, it took at least eight to nine years to change the RB Group's financial situation:

*W9: The turning point for our firm occurred in 1993. In 1992 and 93, Wenzhou set out the target “Quality to set up the city”. The reputation of Wenzhou products was not good at that time. When the city began to set quality as its target, you know, the government needed to find some companies that produced good quality*

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<sup>16</sup> Here 'they' means government officials.

<sup>17</sup> Because those leasing firms are state-owned enterprises.

*products. From that time, the government began to offer support to our firm.*

*Well, for us, the support was reflected in the local government officials bringing some people to our firm to visit our factory. Those people who worked for various departments at different levels nationally (including national (central government), provincial or local. If they said anything like 'this factory is not bad', well, the local government would begin to pay attention, and feel good about it. Then, the bank, you know, would feel this enterprise was relatively good, and become more willing to lend you money. Why do I say that, because at that time, if you wanted to apply for loan from the banks, it was not easy, and it would also depend on the relationship between you and the banks.*

*Well, if local government felt the scale of your company was small and not big enough, leaders from central government might exclude it from their eyes, they would also talk to the bank... well... 'this firm is good', that would make it easier for us to get loan...*

*The banks would also look at things like, whether this firm has attracted the attention of the government or not...just like nowadays, sometimes, the officials visit some place, then say something praiseworthy about some firms....if they are listed firms, the value of their stock would even rise because of this. You know, the theory is the same.*

*Because of this new policy and target setting, the government became more supportive to us at that time. When we needed money for technological innovation, they would give us a priority consideration. When we got the loans from government, we did not need to pay for the interest, it was really good for*

*our firm.*

The above account demonstrates the difficulties for business founders, especially new, small businesses, to obtain bank loans. Bank loans were there, but not easy to access. It is obvious that government policy plays an important role in guiding how Chinese banks issue loans to firms. On the other hand, gaining access to the bank loan is also related to factors such as the size, development stage and performance of firms. The nature and strength of the relationship between firms and banks was highly relevant too. This generally accords with the evidence presented in the literature review concerning the role of banks and government support. However the use of family and social relationships as a primary source of financing differs from the experience elsewhere in the sense that friends and family were unable and possibly unwilling to raise sufficient capital or risk this on new ventures.

#### 5.2.5.1.2 Human resources

W9 as founder and owner-manager of the RB group of businesses was reluctant to endorse the importance of the relationship between the business founder and his family, kinship or friends during the business start-up stage, expressing the view that the link was not very strong. Unlike the majority of informants in this and other cases, W9 has shown a preference for non-family employees and has already started to recruit people from the general public in preference to relatives ever since he founded the RB group:

YW: *Who worked for you at that time, I mean at the beginning stage of your business. Where were they from, how did you find them?*



W9: ‘....recruited them from the public....’

YW: **Recruited from the public, from the very beginning?**

W9: *Yes, we recruited people from the general public, and we believe we should recruit people from the wider public. Our firm pays particular attention to the human resources aspects, and the core concept of our firm is ‘people’. We began to recruit people from the general public with the recruitment of our first group of employees. In the early stages, we only recruited people from our local county, which is a rather small area. After that, the recruiting area has been expanded step by step, from the local county to the wider local area, then to the whole province, and now, to the whole country. Our first group of employees was recruited through a formal recruitment process. At that time, what we meant by a formal process was posting the recruitment poster on a wall in the schools... (W9 grinned when he said this).*

The main difference between the RB Group and other informants is that RB has had very clear policies, regulations and practices concerning the recruitment and hiring of human resource ever since it was established. The company emphasises that any person who has a family relationship lasting up to three generations with any RB employee will not be eligible for recruitment. Also, anyone who is a friend or acquaintance of any RB employee will not be eligible for recruitment. Moreover, every candidate for employment is required to attend RB’s internal examinations and assessments to test their working ability, character, skills, etc, and the final selection will be based on an integrated assessment of the candidate’s aggregate performance

across the range of tests.

The RB Group's strict regulations on human resources and recruitment make it very distinctive from the other firms in Wenzhou City, and elsewhere among the companies investigated as part of the empirical study. W9 explained the reasoning behind this further when asked why he chooses not to use relatives or friends as most of the other small firms do. He was also asked why the company decided to develop such policies so early in its establishment.

*W9: The idea of not using relatives and friends could be traced back to the very early stages prior to setting up the business initially. We (W9 and his partners) had a discussion about this before the decision was taken. To be honest, I was only a passive participant in that discussion. The main idea was raised by my partner, Mr. Zhan. He introduced many ideas from advanced countries, like United States, UK, etc. He suggested the reason why they developed so well is because they were fairer in the way that utilised people in their own countries. Thus, before we set up RB, we came to an agreement that the people we would use must be chosen from the public, and that our company should be managed by transparent and clear rules and practices. This is the origin of our enterprise's belief that we 'regard people as the root of the business and their effective management is best achieved with clear rules.'*

*Frankly speaking, family members or our own friends, might be very good, you value them very much, but when the firm develops into certain stages, their abilities might not be good enough, if you wanted to change their position. This would generate large negative influences, so we decide not to use family*

*members, relatives or friends, just keep it simple. We can, in any event, then create a fairer and more competitive atmosphere for people with ability recruited from the wider public.*

The observation was made that W9 liked to use more indirect statements or less harsh words to express his opinion. Hence, a more precise interpretation of his statement ‘change their position’ is likely to include not only the change in position or role in the hierarchy but also firing or dismissal. Similarly, the meaning that may be inferred from ‘negative influences’ may be the sense of dissatisfaction on the part of their relatives and/or other staff following adverse changes or lost promotion opportunities. The fear is that such harmful comments from these people might easily be communicated to others in the overlapping social networks, causing damage to the founder’s reputation. The expression ‘*keep it simple*’ reflects the desire to avoid such problems in advance, otherwise, there may well be an endless stream of such problems.<sup>18</sup>

YW: **When Zhan proposed this concept, what was the other people’s reaction? Did they totally agree or did they have their own opinion? What did you think about this concept?**

W9: *Personally, I think that Zhan’s point does make sense, it is also right.<sup>19</sup> Why do I think it is right? When I was working in the construction industry, or more*

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<sup>18</sup> The expression ways of W9 represent his characteristic and the speaking skills as a manager in China, i.e. cautious not to offend anyone.

<sup>19</sup> From the present researcher’s perspective, W9’s answer, ‘it is also right’ contains several potential meanings. It can be inferred that W9 might has his own opinion, which might not think and realised the problems for recruiting family members or friends at that time. But he has been persuaded by Zhan’s proposal, and thought Zhan’s point also make sense. In another word, if Zhan did not propose the idea of not using relatives and friends, W9 might use his relatives and take it for granted.

*precisely, working in a family business, oh~~ my feeling was... [Slightly shaking his head]. When I worked with my relatives, I got the feeling that the ones who have the real ability were not my relatives but others in the business. Ah...I realised then that it might be better to use public resources<sup>20</sup> when running a business. Em...what should I say...use people from the wider public should be the right choice.*

*In the early stages, there was no conflict between our relatives and ourselves because of this rule of not recruiting them. Why? It was because our relatives did not want to work for us. At that time, our firm was so small, and could not be thought of as a proper firm. Who would want to come and work for us then? No one. But later, when our firm had developed and reached a certain scale, our relatives frequently came us. We felt so embarrassed and awkward, but we never broke the rule. After a long time, our relatives began to understand, and then the situation got better.*

W9 seemed determined that no matter how good his relatives and acquaintances were or how well qualified the people introduced by his relatives, he would definitely follow the rule. This is because:

*W9: If you accepted one person introduced by one of your relatives, you would not be able to refuse the rest. Suppose I hire the person introduced by my uncle, who I feel very satisfied with, when my aunt comes and introduces someone else, can I refuse her? No. She, would feel unhappy. Can I tell her that the person she introduced is not up to my standards? I can't. She will think I do not value her*

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<sup>20</sup> Here means people recruited from public.

*judgment, which would offend her even more.*

*That is why, no matter how qualified or the person is or is not, we decided not to hire any relatives, friends or people introduced by them. We obey the rule strictly. This might make our relatives feel unhappy at first, but we treat everyone of them the same. We do not want to hurt anybody, and we would not wish to spoil the harmony (‘和气’) between us and our relatives and friends. It would not be very nice to be talked about by others<sup>21</sup>. If you say yes to this person, but say no to another, people would grumble about you and criticise you to death....*

The explanations provided by W9 have shown that as a business founder, to hire or not to hire people from his own family and social network is not only a personal dilemma, but also in his view a ‘no-win game.’ Therefore, in order not to make the situation more complicated, he considers it the best option not to hire any of them. He believes that this approach will allow him to avoid losing face and maintain harmonious relations with members of his family and social network in the short to medium term. It would also avoid making other employees feel they are being unfairly treated, which may damage staff morale. The most important advantage of this policy of not hiring any relatives will keep away the possibly endless problems<sup>22</sup> associated with family members and friends seeking to promote themselves and other friends within the business.

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<sup>21</sup> ‘Others’ should be people in their social network

<sup>22</sup> Endless problem could contain, for example, relatives might not work as hard as other employees or, he is incapable, but you cannot criticise him as others, even if you want to criticise him, you cannot do that in front of other employees, otherwise, he will lose his ‘face’, as his relatives, you’d better not to do that. Second, if your relative has been rewarded by his hard working and capability, other employees might still tend to relate this to the relationship between him and business founders, and feel unfair, then influence that emotion and morale. Third, the relatives working in your company should know company well, for example, how the business is going, and the financial situations, etc, which business founders might not want their relatives know too much, etc.

However, the interview did uncover an apparent contradiction to W9's strict rule on not hiring relatives and friends in their firm. W9 mentioned that his eldest son has already been working in the RB Group for more than one year, although not based in the same city as W9 himself. Similarly, his youngest son, who had just graduated from university the previous year (i.e. 2007), was now learning a third foreign language in Shanghai. This was in preparation for joining RB's international marketing department, to help his father (W9) to explore RB's international markets. From this, it can be inferred that W9 sees this as a perfectly natural thing to do, hiring his closest family members, i.e., his sons, given that the business belongs to W9, and in turn will eventually belong to his sons. W9 was not aware of this apparent inconsistency and viewed the recruitment and hiring regulations of the RB Group as applying only to others in the wider family and social network, and never restricting himself or his sons.

Another similar inconsistency arose when W9 mentioned that the RB Group had begun to expand their business into the wholesale and retail sectors within the industry. The person who had been given the main responsibility for this development was his brother-in-law. Interestingly, as the following extract demonstrates, W9 seemed prepared to delegate considerable power and responsibility to his brother-in-law to develop the business.

*W9: I have passed on almost the entire project to my brother-in-law. I am so busy recently and do not have enough time to look after that business. Let him take care of that business. It will not make me too worried. I do not need to follow the progress all the time, as he will contact me if anything happens. If I am not available, he can also ring his sister (W9's wife).*

Drawing from this account of W9, it can be inferred that, although the business founder may not wish to hire relatives directly to work in the core businesses, when they have other diversified business opportunities, they tend to use their relatives or a person who is familiar to them. Business founders may not have the time or the desire to keep their eyes on all of their businesses every moment of time. The trust generated by their relations enables the business founder to engage family members in such managerial positions. The benefit to the business founder of using relatives/friends in this situation is not only that it may save their own time and energy, but also that it enables them to ‘do the relatives a favour’. The most important factor in the W9 example is that the businesses are separate, and although they cooperate and support each other they do not ‘*work together in the same firm*’. This raises the possibility of the agglomeration of related firms in one specific geographical area, which may then in turn give rise to the formation of clusters. This issue will be developed further in the subsequent Discussion Chapter.

#### **5.2.6 Mutual benefit:**

The information provided by W9 at various stages in the interview confirm his opinion that mutual benefits as a basis clustering was largely non-existent in his business. When asked if there was a lot of communication and cooperation between RB and other bearing manufacturers, W9 responded that:

W9: *No, we do not have many communicate with each other in the current situation in China.*

YW: *Why? It is often said by a lot of people that...for example when firms are small, even if they are competitors, they still communicate a lot, cooperate to get one project then divide the work between each other, then both sides will benefit. Do you mean the situation is different for big firms?*

W9: *Just as we said before, in the situation of a shortage of funding, China's development is still relatively good. However, during this process, we also paid a high 'cost'. The cost is manifested in the 'distrust' between people, the degree of trust between people has become less and less. For example, some people don't have money, but take your products and tell you they will give you the money tomorrow. But when tomorrow comes, they will say the day after tomorrow, the day after the day after tomorrow. After a period of time, no communication from them at all. Why do they do that? These people, the funds they have got are very limited, but they do not plan carefully on how to use it. When their money runs out, they can only steal from others...*

*As a result of this distrust between most businesses, it will still take some time for firms to cooperate fully again and to gain mutual benefits.*

YW: *In what kind of circumstances, do you think there will be more cooperation between firms?*

W9: *From my own perspective, I think those who currently cooperate in the industry, although there are not many of them, are built upon personal friendship. Most firms will fight each other tooth and nail. Well, if I can't 'beat' you, ok, I surrender, as I have no choice. If I can not get the order, or can not afford to*



*compete on price and suffer losses, then I will do the OEM (Other Equipment Manufacturer) role for you, or even accept merger and acquisition by other companies. This kind of situation happens in more than just those friendship situations.*

*The competition is very intense in the industry. According to this trend, some weak firms might feel unable to afford to remain in the industry, then, they would naturally tend to seek a solution and discuss this issue calmly. Then we can have opportunities for win-win situation, and begin to trust each other. But currently, the time has not yet arrived, and is still a long way off.*

The above account emphasises that the realisation of mutual benefit and cooperation is largely based on the foundation of trust. With W9's disappointing experience, he has chosen to build up his own cluster, to avoid the problem of having to build up trust. This also gives him greater control of his business.

A number of issues associated with mutual benefits were not specifically mentioned or discussed by W9. Issues such as physical security (e.g. business rewards, job security), psychological security (e.g. business psychology, social status and face) were not discussed extensively by W9.

#### **5.2.6.1 Risk**

In this section, risk in the entrepreneurial process is examined. Similarly to most of the informants, W9 did not think much about the risk he would face when he chose to start a business, and no backup plan in the case of failure had been thought through in

advance.

YW: **Have you considered any risks, e.g. if your business fails, what would you do?**

**Do you have a backup plan?**

W9: *Well, we used to think very simply, what we believed was if only we invested the money, we would definitely earn money. But when we actually began to run the business, that was not the case. However, once you've already begun to run the business, you already have a tiger by the tail<sup>23</sup>, and there was no going back. Thus, apart from working hard and carrying on working we could do nothing more. There were some people who gave up in the middle<sup>24</sup>, then failed, plenty of them.*

YW: **Did you give yourself a time limitation, for example, run the business for 5 years to see whether it is ok or not. If it does not work well, try to do something else or join another business, have you got any thinking like this?**

W9: *I did not consider this in such detail. No. If we followed this approach to running a business, it would not be possible to run a business. I think we started our business and operated it under a certain kind of simplicity and ignorance. Sometimes I think... maybe this kind of simplicity and ignorance help so many private firms to succeed. If we considered every thing clearly, and then start up and run a private enterprise, it would be too difficult to do. You can not do anything, if you fear the wolf in front and the tiger behind (‘前怕狼后怕虎’,*

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<sup>23</sup> have a tiger by the tail 骑虎难下, here means ‘you are already committed’ or ‘you are already well down the line’.

<sup>24</sup> Here means many people gave up and close the business when they met problems in the process of entrepreneurship.

*Chinese Saying, means 'hesitate in doing something').*

It is possible to infer that the business founder was aware of the risks of starting up a business, but did not take these too seriously. The business founder did experience the pressure and risk during the process of running the business, therefore, using the expression “to have a tiger by the tail” is very appropriate. The potential meaning underlying this saying including the push and pull factors for starting and running a business, i.e. the business has already begun, money and time have been invested. If the business founder chose to close it, this investment would be lost. On the other hand, running a business is not only an issue for the business founder personally, but also relates to the employees. If the business founder chose to close the business, it will have an effect on the employees and other related people. According to W9:

*Although there were risks of running a business, we had tot insist on doing it. We'd already borrowed a lot of money from others, if we lost the money, closed the business, and given up, it would not only hurt ourselves, but hurt many more other people. For those people, who were related to us, who supported us, what can they do? What should I say to them?*

Moreover, to close a business would also damage the business founder's reputation and social status, because giving up doing something is seen as a 'losing face' in the Chinese Context.

RB, another company from Wenzhou will be viewed in the next case.

### 5.3 Case study two: HK network

#### - Background

The HK Group was set up by W1 and his brothers in 1991. The company has its head office in Wenzhou and its technology and innovation centre in Shanghai. The main product of the company is electrical equipment for the automotive industry. This includes, for example cigarette lighters, resistors, electronic horns and electrical control systems. These products are widely used in the automotive industries. The HK Group now has 500 employees, and in 2006, its annual sales revenue was around 3 billion RMB<sup>25</sup>.

W1, one of the main founders of the HK Group, set up his business in 1986 in Wenzhou whilst he was in his early 20s. He is now mainly based in the technology and innovation centre in Shanghai, but goes back to Wenzhou every few days depending on needs of the business and also to see his family. W1 was introduced to the researcher by SH1, and W1 had been SH1's business partner since 2002. As a result of their close business relations and friendship, W1 was more than happy to do the interview.

W1 provided introductions to more business people from Wenzhou, accompanying the researcher during the whole journey during one of his visits to Wenzhou. The reasons for his willingness to provide this level of help in the research can be inferred and summarised into three points: first, to visit his old friends; secondly, to facilitate the interviews and to, make interviewees feel more relaxed and safe in doing the interviews, and thirdly, to update his information on the companies he introduced to

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<sup>25</sup> RMB, Renminbi, Currency Unit used in China.

the researcher.

Other than W9, all the rest of the interviewees in Wenzhou were introduced by W1, the relationship is illustrated in Figure 4.1 (please see Ch.4 Research Methodology)

The interview took place in W1's office in the Wenzhou head office. The Wenzhou head office consisted of one main building and three large workshops. The main building looked new and had recently been refurbished. The name of the RB Group was printed on the top of the building. W1's office was on the top floor of the building.

Immediately prior to the interview, W1 was in a meeting with three of his employees in his private meeting room within his office. W1's office is very large, well equipped with furniture, and has a very large Chinese Calligraphy on the office wall behind his chair. The meeting quickly finished and the interview then began.

### **5.3.1 Location:**

#### ***5.3.1.1 Expansion business to large cities***

HK is located in the low-volt electronic appliance cluster in Wenzhou, and is very close to W9's company, RB. At the beginning of the interview, the dialogue related to the location decision in Wenzhou along similar lines to that with RB, but after a while, discussion turned to their business expansion to large cities.

In 2004, according to W1, the founder of HK, he moved the technology and innovation centre to Shanghai High Tech Area, retaining the Wenzhou office as the

company's headquarters and manufacturing base. W4 described his decision to move to Shanghai as follows.

*W4: There are several reasons to move our R&D centre to Shanghai. First, we are much closer to our purchasers and if there are any technical problems we just go there directly, and don't need to spend too much time on the road. It is more convenient than Wenzhou. Why we chose to locate in this high tech area? It is a mature high-tech park. The whole atmosphere is good, the support policies, the building and other facilities are good. Here, we also have a lot of large multinational companies such as IBM, Sony, etc. We wanted our employees to be exposed to their good working attitudes. Being located here also helped us raise our profile, other people might not know us, but they know our neighbours.*

Similarly to W1, other informants in the case such as W3 and W8, also mentioned that there is a trend for Wenzhou companies to move their R&D centre to Shanghai. According to W8: *The competition of traditional industries is more and more intense, more and more private firms have to change their mode, go through change programmes, and look for new ways to do business. I was told that one of my friends collectively bought more than 20 buildings with business colleagues in the Pu Dong area of Shanghai, planning to use the offices there as the R&D centre, just like W1.*

W2 expressed different ideas about moving the business to other cities: *There is not enough space for our company to further develop in Wenzhou. There is a shortage of premises. Wenzhou does not have many and now there are even less. So the question was where we could get land. So many reasons, land restrictions, market trends, etc...*

Other issues related to more business opportunities and greater potential were also expressed by W1, W3, W3, W6, W7, and W8 during the discussion on the location decision.

Other issues related to the education of the next generation were also mentioned by the business founders, such as the following account:

W1: *Now, I spend most of my time in Shanghai. I am planning to let my child move to Shanghai and attend middle school here, if she would like to. Our nearby area is quite convenient, and there are good schools, universities, hospitals, etc. There are also many places I can take her to when I am free. The education quality in large cities is much better than in small cities. More chances to see different things, more open-minded.*

According to the above account, business founders choose to move their business to large cities for a variety of reasons. The reasons could be summarised into the following points.

- Close to their buyers and customers, which both facilitates transportation and travel and also helps with technical problem solving.
- More business opportunities (both import and export).
- Better business atmosphere: policy support for clusters, better infrastructure, highly skilled neighbouring companies.
- Better reputation.
- Private and family life: better education for children, convenient location (for everything), more leisure facilities, greater prosperity.

It can be inferred that companies that relocate and expand their businesses to other cities can be classified into three types. (1) Type 1: Those that choose to open subsidiary companies in other cities to lower their costs, in particular raw material costs, but keep their main manufacturing bases in Wenzhou. (2) Type 2: Companies that move their headquarters to large cities to upgrade and develop further. (3) Type 3: Many companies choose to move other places because of restrictions, such as the lack of resources such as land and energy, and increasing production costs. Of these three types of enterprises, the first type formed the majority in Wenzhou, possibly in the whole of Zhejiang Province, which is good for the development of Wenzhou. Those companies that retain their manufacturing base in Wenzhou but move their headquarters to large cities bring benefits to the development of Wenzhou's industry. W1, W2, W3, W9 belong to this type. The other two types, that move to pursue development opportunities, might bring some advantages to Zhejiang province. They are in the minority. Enterprises that move away from Wenzhou benefit from wider external communications and also release more development space for remaining firms. (Moving to large cities is a trend. This might be another form of cluster formation after 2000, which was largely different from those formed in the 1980s or the 1990s.)

### **5.3.2. Institutional context/entrepreneurial climate:**

#### ***5.3.2.1 Government behaviour: Central government & local government policies***

Wenzhou is a small city, with limited land, but a large population. It has been one of China's coastal defense outposts since China's liberation, because of its strategically important geographic location.<sup>26</sup> During the first thirty years since China's liberation

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<sup>26</sup> Wenzhou, next to Fujian Province, opposite Taiwan across the sea.



in 1949, the country's total fixed industrial investment in Wenzhou was only 595 million yuan (Hu et al., 2005, p.37). After the Reform and Open door policy in 1979, Wenzhou's rapid economic development has begun to attract attention and has been visited by many people (e.g. officials, investors or other general public).

Between 1983 and 1986, more than 600,000 people visited Wenzhou to observe economic development there. W4 recalled that: *'Central Government was very surprised about this. So in 1988, they issued a special paper, an Emergency Notification to temporarily halt visits to Wenzhou, and to ask the local government to cancel the visits and inspections from 1988 till 1989 spring, in order not to affect the working processes in Wenzhou, and let Wenzhou concentrate on promoting its economic reform and development.'*

According to W4, *after 1992, after Deng Xiaoping's Southern tour speech, there was another wave of visits to Wenzhou. According to statistics from the Wenzhou government, the total number for people who visited Wenzhou to learn from Wenzhou's experience reached 5 million people from 1992 to 1994.*

What makes Wenzhou so different, and what attracts so many people to go to Wenzhou for a learning experience? W5 offered a very informative summary of the many 'firsts' for Wenzhou:

W5: *Wenzhou people dare to try. In Wenzhou, we have China's first rural professional market. One of the first cities that got the first batch of individual industrial and commercial permits. China's first rural credit cooperation that implemented interest rate reform. The first city in China to practice 'land subcontracting'. The*

*first local operation and management regulations for ‘Gua hu jing ying’ (挂户经营, i.e. affiliate household business to collective business). China’s first private bank after liberation. China’s first local laws and regulations on private sectors. China’s first local laws and regulations on joint-stock cooperative enterprises. China’s first pawnshop after liberation. The first city in China to set and implement local law and regulations on ‘quality standards in the City’. The first city in China to set up credit system, etc.<sup>27</sup>*

Many informants considered these to be a process that could not be avoided and an experience they must inevitably go through. W1’s comments also tended to support those of W5.

*W1: In 1984, when we had just started our own business, there were more than 100 million peasants that went for a ‘gou xiao’<sup>28</sup> (购销) in our local area. At that time, every household ran a business...family workshops, there were more than 100,000. ‘Gou xiao yuan’ (购销员) that had just begun to develop in this kind of situation. They explored markets from north to south, to promote and sell Wenzhou products to people around the China. They brought information back to Wenzhou, just like ‘bridges’, and played an important role in developing the rural commodity economy. However, household businesses and ‘purchase and sell’ activities did not get wide support. At that time, although most of the household businesses were selling products outside, most of them could not offer corporate seals, introduction letters, paper contracts or bank accounts. Because of these, Wenzhou people created the form of ‘Gua hu jing*

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<sup>27</sup> Also including: China’s first joint-stock cooperative enterprises; China’s first joint-stock cooperative urban credit cooperatives; China’s first local laws and regulations regarding private sector.

<sup>28</sup> ‘Gou xiao’ (购销), means ‘purchase’ and ‘sell’. ‘Gou Xiao Yuan’ (购销员), i.e., a job position which need to work as purchaser, and sales. Not always been in Wenzhou, need to go outside to other cities.

*ying’ (挂户经营), “Gou xiao yuan’ and household businesses were affiliated to collective enterprises, doing business in the form of village and township enterprises, etc. This was created by peasants.*

*W6: In the mid 80s, ‘Gua hu jing ying’ (挂户经营) enterprises were the main form in rural areas. Therefore, in 1987 summer, the Wenzhou government drew up regulations for “Gua hu jing ying” (挂户经营) enterprises. This was the first local operation and management provision, to help the development of these enterprises.*

#### **- Chamber of Commerce (CoC)**

The history of the Wenzhou Chamber of Commerce can be traced back more than 100 years ago to the end of Qing Dynasty. Around 1901, in order to ‘protect trade and business, create more business opportunities and open business channels’, Wenzhou businessmen set up the first unified regional business association in Wenzhou. After the liberation, the Federation of Wenzhou Industry and Commerce was set up in 1955. Then, in order to adapt to the Reform and Opening Up, in September 1990, the General Chamber of Commerce in Wenzhou was approved and set up. (Wenzhou Chamber of Commerce, official website, 2008). Up until 2007, there were more than 170 Wenzhou CoCs all over China. Wenzhou CoCs can also be seen worldwide, in countries such as the United States, France, Italy, Spain, Holland, Japan and Brazil.

Most of the informants mentioned Wenzhou CoCs or related associations or had attended events and business trips organised by Wenzhou Chamber of Commerce. Among them, W1, W3 and W7 are members of Wenzhou CoC. According to W1, W3, W7, CoC plays a supportive role to help business owners to expand their networks,

and arrange national or global business trips to develop new business and for them to experience different business environments. It is also a place where business owners can go when they meet problems, or a place where they can ‘*have a cup of tea, chat with others, meet old friends and relax*’ according to W1.

### **5.3.3 Individuals/ Actors:**

#### **5.3.3.1 *The founder of HK***

W1 was born in Wenzhou. He is the second son in his family, and also has an older brother and a younger brother. In 1986, W1 started a business with his two brothers. He was then was in his early 20s.

Before he started the business with his brothers, he had been learning about business from his relatives for a few years.

W1: *After I graduated from high school, I joined my uncle to learn about business. He had some apprentices at time (带徒弟), my elder brother was there as well, and that's why I joined them. My brother was working as a “Gou Xiao Yuan” (‘购销员’), going out to take orders, purchase material and sell our products. I went out with my brother and my uncle few times.*

*I also worked as ‘Gou Xiao Yuan’ (购销员) for a period of time. But later, I decided to focus on the technical aspects. You see, I am more interested in this aspect. We had my brother anyway for things like procurement and sales, etc.,. I was enough for one person in the family to understand this aspect.*

It can be inferred from the above account that W1 and his brother had intended to master different skills for business before starting their own. W1's younger brother was studying at University while W1 and his elder brother were working. After their younger brother had graduated, W1 and his elder brother left their uncle's business, and set up their own. According to W1, the three brothers take different roles in the business, this job allocation has not changed greatly up until now. W1 is responsible for technology and quality, W1's elder brother is responsible for the domestic market, while their younger brother is responsible for HK's overseas markets.

#### **5.3.3.2 Family**

According to the informants in this case, family and friends were the main resources and key actors for the business founders in their start up and development stages.

Table 5.1 shows the founders of the businesses in this Case Study. W1, W2 and W3 set up the firm with their family members. Although W6 and W8 did not set up their business with family members or relatives, according to the interview there were still intricate relationships among them and their families.

**Table 5.1: Business founders (HK Case)**

<b>Interviewees:</b>	<b>Set up the business</b>
W1	With brothers
W2	With father
W3	With friend
W6	Alone
W8	Alone

#### 5.3.3.2.1 Source of finance

Issues related to sources of finance will be discussed in this section. Almost all of the informants borrowed money from their families, relatives, or friends.

W1: *The majority of our start up funds were borrowed from others. Most of the money was from home (‘家里人’) , relatives and friends. Our parents lent us a lot. In fact, we also invested our savings, but only a small amount.*

W2: *My father was the main founder of our firm. At that time, I was still working in another company, and had not resigned yet. In the first year, I worked for others during the day time, and worked for our own business in the evening and at weekends. The start up funds were mainly from our home (parents’) savings. I did not take out a lot of money at that time<sup>29</sup>. I did not take a salary from my father at the beginning.*

Unlike W1 and W2, W6’s experience of getting access to the start up funding was not easy and smooth.

W6: *In order to start our business, we tried every possible way to borrow money. You see, it was not easy to borrow money from external sources<sup>30</sup> at that time. So, we could only go to our relatives’ and friends’ places to ask for help. We had asked all of our family, relatives and friends and finally, we got 20,000 yuan. However, our first income was only 30 yuan. We had no other choice, in order to survive, we had to ask others for money.*

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<sup>29</sup> Means he did not invest a lot of money in the business.

<sup>30</sup> Means impossible to borrow money from banks.

When asked whether they were charged a high interest rate by friends or relatives?

W6 replied:

*This kind of phenomenon did exist, but we were quite lucky, most of our relatives did not specifically mention such a thing. We really appreciated their support, therefore, when we paid them back, we normally added some more money to thank them. But if your relatives helped you borrow money from others, that interest rate would be higher, normally, the rate was 0.3%.*

W3 set up his business with his friend. The main source of finance was from his personal savings that he had accumulated from his previous work in a local state owned enterprise:

*W3: I had been working in the same industry for others since 1976, when I started my own business in 1987, and I had already had some savings. So the start up funds were all my own money. I didn't ask my family members or relatives for money, because they were not rich and I tried not to bother them.*

*Anyway, I had my savings. My wife also had her job. I discussed the idea with her, and then we decided to invest our saving in our business and use my wife's salary live off.*

*If we had any other choice, we preferred not borrow money from our relatives. Although their standard of living was not very good either, they still offered us support when we had cash flow problems. We did not like to owe them money, so*

*when we received our payment, we would repay them immediately. This way, we had their trust, therefore they were more willing to offer help and lend us money. But, unless we had no other option, we would not go them...normally... we would not open our month.*

The relationship between family, sources of finance and business founders has been discussed in the above account. It can be noted that, although finance for the business founders came mainly from their families, these sources were varied. Personal savings and savings from parents and spouses were mentioned by most of the business founders as their main source of start up capital. All of the informants had borrowed money from their relatives at some time, in the main when they met financial difficulties. Words such as ‘family’, ‘family members’, ‘relatives’, ‘friends’ were always used together or interchangeably, reflecting informants’ classification of the meaning of family and their family values.

#### 5.3.3.2.2 Human resources

Issues related to human resources will be discussed in this section.

*W1: When we first started our business, all our family members worked together. We were owners but also workers. My elder brother and I went out, buying, selling and contacting other people at the beginning. When my younger brother graduated, he then joined us. Normally, our parents were based at our home workshop, waiting for the order to come in. My father was mainly responsible for the production and technical things and my mother was mainly in charge of accounting and also helped out in production. It was very simple. Relatives*



*would come to help if we could not handle the production. We also did the same for them.*

*W3: We had 7 people in the company at the beginning. As well as myself and a friend, we also had our relatives and one of my apprentices (the one who came inform an SOE with W3) worked with us.*

W6's situation was quite similar to W3, when he first started his business. he had five members of staff, include W6, W6's brother and cousin, and their friends.

W8 set up the firm by himself. In the first few years, he did not employ any people. His wife was the only people who supported him when he could not handle his workload.

From the above account, it can be identified that almost all of the informants chose to work with or use family members and relatives in their business, thus it can be inferred that using family members and relatives is a natural choice for business founders in the early stages. Unlike W9 (RB Case), words like 'trust', 'trustworthy' were not mentioned at all. The researcher assumes that 'trust' is a natural thing embedded in people's mind, and thus they do not need to mention it specifically.

However, unlike the natural 'trust' between business founders and their family members and relatives, another word 'apprentice' was mentioned a number of times when issues related to family were discussed. W5 and W6 also mentioned this in the interviews. The role of 'apprentices' in family businesses has a specific meaning, because apprentices normally stay in their 'Shi Fu (师傅, teacher/master)'s house

and live with their Shi Fu's family. They are in effect, members of the family even if not actually blood relatives.<sup>31</sup>

### **5.3.3.3 Motives and Intentions**

In this section, how informants talked about their motives and intentions will be discussed. .

W1: *When I was learning about business in my uncle's workshop, I felt really interested in doing business. I knew I would not stay there forever; I wanted to start my own. I still remember the first time I went to Shanghai with my brother, I was so impressed. At that time, my brother said to me, if you want to have a better life, work hard, otherwise you will never escape from of our small village. Although we worked for our uncle at that time, we had our dreams already.*

W2: *There is more to life than making money, but if you cannot make money; all the others things are in vain.*

W3: *I had to give up my study and went out to work for others when I was 15, because my father was ill at that time, and could not work at all. I am the eldest child in my family. I had to work to support the whole family. However, working here and there I could not make enough money. I saw that some of my relatives opened workshops to process semi-finished products for others, and their incomes were better than mine. I thought starting a business might be a way out for me. If they*

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<sup>31</sup> "Be Shi Fu for a day, Regard as Father forever". Normally, when the 'Shi Fu' accepts the apprentice, 'Shi Fu' will act on the behalf of the parents, teach meanwhile look after the apprentice. Many people will treat their apprentice as 'half-son'; some of them will even marry their daughters to their apprentice, in order to keep the skills and knowledge in the family.

*can do it, I can also do it.*

Like W9 (RB Case), the informants in the HK Case Study also expressed their strong intention to make a living and have a better life when talking about the reason for starting their own business. However other informants, such as W8, had very different motives to the above informants.

*W8: I did not go out to look for jobs when I graduated from university. I didn't want to work for others. I wanted to try something different. My parents were very worried about me at that time, they thought I was wasting my time and taking risks with my life. But I just don't want to follow in their footsteps: find a job, make a living... No matter how hard you work, your income is always limited, you can't control it.*

*During that period, other than visiting my friends and going to relatives' factory to offer a hand, I stayed at home every day, reading newspapers, watching the news, looking for business opportunities. Coincidentally, I met W1 at my friend's house one day. He mentioned that he wanted to sell their product to foreign countries, and looked for appropriate people to do that work. I saw my opportunity, because my major in university was English for Business. That's what I was good at. Therefore, I opened an international trading company and started to do businesses.*

W8's conversation is very informative. It reflects W8's intention to have greater control of his life, and a choice 'not to work for others'. In order to get a better income, he wanted to start a business. He aimed to try to avoid the stereotypical

lifestyle, and chose not to repeat his parents' experience. More importantly, his words reflect the importance of social relations for getting opportunities and catalysing business start-ups. Please see Chapter six for further discussion.

### **5.3.4. Relationships**

#### **5.3.4.1 Social networks**

##### **5.3.4.1.1 Source of finance**

Issues related to sources of finance have already been discussed in section 3.21 by most of the informants. As the terms, 'families', 'relatives' and 'friends' were frequently used interchangeably by most of the informants, the individual meanings will not be discussed again here, other than to note that there is a large overlap between family networks and social network in the Chinese Context.

The way for W8 to get access to his source of finance was quite different from other informants.

W8: *My company is a trading company, and to this days, it is still a small business. I did not have any savings when I started this business, because I had just graduated from the university. The majority of my start-up funds came from W1. At that time, W1 was looking for someone who could use and speak English to help them to explore international markets. That happened to be my major at college. I was quite lucky, what they needed was a person. I did not need to worry about other things.*

YW: **How about the rest of your funds? Have you ever borrowed money from**

**others?**

W8: *Well, borrowing money was evitable. At the set up stage, as well as S1, my parents also offered me financial support. It was ok, because trading companies do not need large amounts of money at beginning. But when the company gets bigger, more cash is needed, and then we needed to borrow money from others. From banks, or sometimes from our relatives and friends, depending on the interest rates and whether it was convenient or not.*

YW: **How about the funds provided by W1?**

W8: *I paid him back immediately when I earned the amount of money. He had already offered me great help. I owed him and I could not be behind in payment.*

From the above account, it is clear that W8's start up capital was mainly from W1, his friend. Although, the amount was not large, he still felt he owed W1 a big favour. This relates to the 'Ren Qing' (人情) issue, also been mentioned by W9.

Other informants, such as W6, talked about another form of social financial resources, which can be accessed by business founders.

W6: *Normally, social relationships or social network was the most effective channel for private enterprises in Zhejiang province to raise funds. The most typical form is 'Cheng Hui' (呈会), a kind of civic form of fundraising. In some other cities, like Hangzhou, Shaoxing, etc, its name might be different. Some people call it 'Yao Hui' (摇会), 'Jiu Hui' (纠会), or 'Ren Qing Hui' (人情*

会). Their names might be different, but their functions are the same. They are a traditional folk custom in Zhejiang, where mutual financial support is offered to people who need it. The operation of 'Cheng Hui' (呈会) is based on the social networks based on trust.

*The early form of 'Cheng Hui' (呈会) was a kind of mutual support, borrowing and lending among people based on the small-scale peasant economy. It is based on 'Ren Qing' relationships (人情关系) and traditional ethical values and morals, 'Qin Yuan' (亲缘), 'Di Yuan' (地缘)<sup>32</sup>, etc. It evolved during the transition period from a planned economy to a market economy. Under the market economy, people use the ethical values more actively, but they also use the market mechanism to supplement it. They used the ethical values plus interest rates to increase participation.*

The above account suggests that social networks are an important source of financial support for business founders. 'Cheng Hui' (呈会), is a tradition specific to Zhejiang to raise funds based on social networks (also including family networks). 'Cheng Hui' (呈会) also be known as 'Ren Qing Hui' (人情会), the literal meaning of which is 'a gathering to do favours to others' in its literary meaning. W9 (See RB Case Study) also mentioned the word "Ren Qing" (人情). Thus 'Cheng Hui' (呈会) is both a way to unite people and offer mutual financial support, and also an economic system based on mutual support, which aims to maintain fair interest rates within the group.

According to W6, if everyone invests 50 yuan, it will called '50 Hui', if every member invests 100 yuan per person, it will be called 'Dan Bai Hui' ('单百会', i.e.,

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<sup>32</sup> '亲缘' means 'kinship, family relation'; '地缘' means 'location, birthplace, etc.'.

‘Signal 100 Hui’). For ‘Ren qing Hui’ (人情会), initiators normally face financial difficulties and therefore, he/she would invite his/her relatives, friends, and neighbours to gather together to set the ‘Hui’, in order to get support. Following the Reform and Open Door Policy, using social networks as intermediaries, the function of ‘Cheng Hui’ (呈会) has developed considerably. Initially, it provided small amounts of mutual financial support but has now grown into a significant financial resource to fund private enterprise. According to W6, “‘Cheng Hui’ has become a lubricant for the economic and social development of Zhejiang Province and a new form for accumulating capital.” The ‘Cheng Hui’ phenomenon will be further discussed in Findings and Discussion Chapter (Chapter 6).

#### 5.3.4.1.2 Human resources

Almost all the firms in HK case are family businesses, and reported employing family members, relatives and friends in the early stages. However, the vast majority of them expressed their intention to not use family members, relatives, friends, or even acquaintances when the firms had developed into certain stages.

W2: *We have seen too many unhappy stories, and disadvantages of family business, so although we are a family business, we decided not to use any family members, relatives, friends, or even acquaintance in our company. In our company, only my father and I are involved, no other people. If you ‘let your wife get involved in ‘politics’<sup>33</sup> (‘夫人从政’) or ‘let your relatives be involved in ‘politics’ (‘亲戚从政’), just wait and see, there will be too many troubles.*

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<sup>33</sup> Here means ‘involve in business management’.

W7: *We met problems when we had a 'family revolution', as it affected every member (family members and employees) and it was really difficult to implement. But we did not have any choice. This stage was necessary in order maintain the stability of other employees. Otherwise, we could not have kept good employees.*

W8 had a different experience:

W8: *The total number of employees I have now in my company is 37. None of them are my relatives or friends. My team is very young. Most of them graduated from university not long ago. The only family member who worked for me in the early stages is my wife. Now she is not involved in the business at all.....*

*However, it is not easy to recruit people, normally, the situation is...you know...we feel satisfied with others, but others do not feel satisfied with us, so they do not want to work for us. Or people want to work for the company, but we do not think they are suitable for the position we offer. Therefore, I choose to recruit young graduates and train them from beginning. As our team is rather small, employees are familiar with each other. The cooperation among them is good. And we appreciate them just as much as people appreciate their staff in family firms. 'Ren Cai' (人才, people with talent) should be cultivated.*

'Ren Cai' (人才) issues were mentioned by all the business founders. W1's conversation was typical of most of the other business founders' views regarding 'Ren Cai' issues in human resources.

W1: *Doing business in family firms has incomparable advantages, such as, strong cohesion, trust, hard working staff, entrepreneurial spirit, the ability to endure*



*hardship and the works are rather feasible. But when enterprises reach certain stages, and become bigger, human resources or 'ren cai' (人才) become important. You see, if there are qualified people in your family, it is ok, but in most cases or there are not. Family is Family, Wenzhou is Wenzhou, and human resources 'Ren Cai' (人才) are limited. If you do not open your door to the public, you would not be able to access a rich pool of human resources, and it is impossible to progress.*

*W2: Most enterprises begin to recruit people from the public in the later stages when they reach a certain scale. At the beginning, they were looking for skilled workers, retired engineers from big companies in large cities, then university graduates and now professional managers. Lack of 'Ren Cai' has been a problem for a long time. That's why they move to large cities, to improve access to 'Ren Cai'.*

Thus, it can be inferred from the above account that the 'Ren Cai' issue is not only an important aspect for business owner to consider from the human resource perspective, but also one of the reasons for them to move their firms to large cities.

#### **5.3.5. Mutual benefit:**

Issues related to mutual benefit were not discussed extensively by informants in this group.

Mutual benefits were not discussed directly, but they were observed by the researcher when W1 chatted with other informants before and after the interviews.

Some of them invited him to dinner together to discuss the business. Some of them briefly discussed business issues with W1 and asked for suggestions. Some of them mentioned a business opportunity and ask whether W1 wanted to join them. The academic, W6, offered the latest information on training for local entrepreneurs and provided some information from CoC.

Unlike W9, the mutual benefit from doing business were not discussed or mentioned directly, although it exists intangibly and unconsciously and plays a cohesive role. This was expressed by W1:

*“We are close to each other, convenient to visit each other. Sometimes, just a phone call can solve the problem. Do not need to go there all the time. I didn’t specifically think about gathering together to do the business with people who I familiar with. Our circle just like this, formed naturally, without intention.”*

#### **5.3.5.1 Role model and competitor**

Wenzhou is one of the most vibrant entrepreneurial cities in China. Local people, whether or not they are in business know almost all the famous entrepreneurs in the city.

Informants in the HK group know each other or have heard of each other through their business circles or social circles.

#### **- Role model**

The word ‘role model’ has hardly been mentioned directly by any of the informants.

During the conversation with them, they would normally mention names of famous entrepreneurs in Wenzhou or Zhejiang province, tell the researcher those famous stories, and compare themselves with them. Thus, it can be inferred that business founders see them as their role models, and aspire to achieve similar things or even greater achievements. Achievements of informants within the HK network were mentioned during the interview. (Potentially compare/compete with them).

- **Competitor**

W3 is W1's competitor, because some of their products overlap and are quite similar. Because of this research, W1 had an excuse/chance to visit W3 and his company.

*W1: Although we are acquaintances I would not normally go to his company, because I would feel uncomfortable. After all, we are also competitors. If you go there with nothing to, it is not very good. W2 just back to Wenzhou few days ago in order to discuss one joint project with W3, every one is here, so we can go there together for a look, and to 'get the scripture' (取取经 "Qu Qu jing").*

The above account has shown a subtle relationship between different business founders. They are friends, acquaintances, but they also keep their distance from one another. It can be inferred that the friendship, appreciation, competition and mutual learning are interweaved altogether, constituting a complex social network.

Moreover, the role of role model, mentors, and competitors could change according to what they do and what they achieve. They would also be related to their social/family network.

## **5.4 Case study three: XD network**

### **- Background**

XD was set up by SX1's father in 1987, with SX1 and her brother's support. (SX1's family formally changed the name of their business as XD Company in 1994). The company is located in Shaoxing Zhejiang Province. The main product of the company is automotive wiring harnesses, and its customers are mainly from Japan and North American. In 2007, SX had 260 employees, and its annual sales has reached 1 billion RMB yuan.

SX1, as the one of the founders, and also the legal representative of XD Group, started the business with her family in 1987. SX1 was introduced by SH1, because SH1 has been a very good friend of SX1's father more than 20 years.

### **5.4.1 Location:**

#### ***5.4.1.1 The Location of the XD: Shaoxing***

The XD Company is located in Shaoxing. As introduced before, Shaoxing is located in the south of the Yangtze River Delta, in the central-northern part of Zhejiang Province between Hangzhou and Ningbo. It occupies an area of 8,256 square kilometers and has a population of 4,340,000. Within this, the downtown area is 362 square kilometers and has a population of 640,000. It is one of key developed and open cities of the south of the Yangtze River, and, according to the Shaoxing Official Website, 2007, one of 40 best cities with a very supportive environment for investment, notably for the physical infrastructure. (Shaoxing Official Website, 2007)

Situated in the central and northern part of Zhejiang province, Shangxing is only 230 kilometers from Shanghai to the south, 60 kilometers from Hangzhou to the east, and 128 kilometers from Ningbo to the West. Shaoxing's downtown is only 30 kilometers away from his closest International Airport in Hangzhou. (Shaoxing Official Website, 2008)

Shaoxing is also one of the leading economic cities in Zhejiang Province. According to the Shaoxing official website, the GDP of Shaoxing was 2003 is 108.84 billion yuan (RMB), which increased 15% over the year 2002. Its gross financial income reached 10.73 billion yuan in 2003. The private economy accounted for about 95% of Shaoxing's economic aggregate performance.

Similar to Wenzhou, Shaoxing has formed 35 blocks of specialty economies with certain scales, such as textiles, the printing and dyeing industries of Shaoxing County, the socks, shirt, pearl and hardware industries of Zhuji City, the umbrella, chemical, mechanical and electrical industries of Shangyu City, the necktie industry of Shengzhou City, the medicine and axletree industries of Xinchang County, and the furniture industry of Yuecheng District (Shaoxing Official Website, 2007).

#### ***5.4.1.2 Location of XD company.***

In 1987, SX1's father left his job in a township factory and started to do business at home in a small village in the rural area of Shaoxing. Prior to 1994, the business of SX1's family was purely a family business. The workshops and offices were located between the ground floor and the third floor at their home. The fourth floor was the function room, which was used as canteen, meeting room, and activity rooms. The

fifth and sixth floors were the living area for SX1 families and some of their employees. In 1994, the business formally changed its name into XD Company and moved their plant from SX's home to a proper manufacturing plant. SX1 explained that the XD Company's second and most recent move was in the year 2006. Because of the rapid business development in year 2007, they were planning to again expand their business and had already started to build up new plant at the time of the interview in March 2008.

SX1 did not talk in detail about the first move from the family home to their first proper manufacturing plant. SX1's talked mainly about the second move of the XD Company.

SX1: *We began to build our new plant in year 2003, but we did not move in until the year 2006. I felt the pressure when we considered building up our new plant, because my elder brother did not agree initially. In his view, the company was his and he did not want to take out the money [to build up a factory] for others. But his objection was not accepted.*

YW: **By whom? Your father?**

SX1: *Yes, by my father. The building project did not progress smoothly because of some problems with the construction team. That's why we delayed our plan and moved into our current plant in 2006.*

*About choice of location, well, we considered two places at that time. One was a big industrial park in another district. The land price was 148,000 yuan an*

acre at that time, but now has increased to 500,000 yuan an acre. The other option was our local area. At that time, the Party secretary, had come to our company several times, not for other things, but just in the hope we would stay in our local area. He offered us preferential policy support if we did not move. Our Party secretary used to be the director of our local policy station. He helped us a lot, often offered a lift when other people came to our company for a visit, and really took care of us, therefore we would have felt very sorry if we were to move to another place.

Another aspect was that, we had about 50 employees at that time, and they were all local people. If we had moved to the large industrial park in other place, it might have caused problems. My father said, we would go to where we could build our new plant as soon as possible.

Our local government took us seriously. They came for coordinating<sup>34</sup> many times in order to keep us. Therefore we chose to stay here. To be honest, we have always been here, our attachment to the local area and people here is very deep. If we moved to a new place, others would not take you seriously, at least, would not take you as seriously as here. The support and assistance we get from the local officials are important and helpful to our business.

Sometimes, when I recall the days when we chose our new company location, I just feel I was not fortunate. Not forward-thinking and did not consider carefully, as I did not take into account the increasing value for the land price. SX2's company is next to ours, sometimes, we still joke with each other about this.

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<sup>34</sup> Here means to persuade SX1 to stay in the local.

The above accounts have shown the reasons why SX1 chose the location to build up XD's new plant. Choosing the location is dependent on many different factors. Although SX1 still regrets not considering the land price issues in choosing company location, she could not escape from the 'ren qing' (人情) influences. As in SX1's case, 'ren qing' (人情) seems to be the most important factor that affected their decision directly. Because of the local support and assistance from local officials, SX1 felt 'so sorry' to upset them if they moved. Moreover, the move to the new place would have meant to run the risk of losing their 'skilled and familiar' workers employed from the local area. This would have increased the costs of organising shuttle buses, transportation allowances for employees, etc. Thus, it can be inferred from SX1's account that social networks and social values influence people's decision making. This will be further discussed in Chapter 6.

## **5.4.2 Institutional context/entrepreneurial climate:**

### **5.4.2.1 Government behaviour:**

Specific policies or policies changes were not mentioned by SX1, but from the conversation with her, it can be inferred that government support is largely based on the performance of the company. It is far easier to get support from the government for companies with a good reputation or high performing companies, whereas, the small or the start-up business could not get support, because of their own limitations and conditions, such as: small size, no big profit gains. Just like SX1 said: "*Policies are just like this. If the company is good, they will always be around you, otherwise, they would not....*"<sup>35</sup>

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<sup>35</sup> 'Government and Policy are used interchangeably in the conversation by the informants.



#### **5.4.2.2 Local atmosphere**

Shaoxing is a vibrant entrepreneurial city, similarly to Wenzhou, however it has different features to that of Wenzhou. According to SX1:

*SX1: There are only few young people who want to start a business by themselves in their early twenties. Young people here are not active, and are unwilling to endure hardship, unlike the people in Wenzhou. People in Wenzhou go out and join society quite early, some even start to do business when they first graduate from high school. Otherwise they would think they were useless in other people's eyes. Most of the people I met from Wenzhou do not care too much about getting a university degree, they prefer to learn from real life, and live experiences. They think these are more important than other things.*

*The environment here is different. In our local area, many people still rely on their parents, in particular for financial support. Others are waiting inherit the business from their parents. We could not compete with Wenzhou in this aspect.*

This issue was also mentioned by RB in his interview.

#### **5.4.3 Individuals/Actors:**

##### **5.4.3.1 The founder of XD**

The main founder of the XD Company is SX1's father. SX1's father had served in the army for several years. According to SX1, her father had learnt a lot of skills during those years in the army, such as driving, fixing automotives and other electrical equipment. After finishing his service in the army, SX1's father returned to his home

town, Shaoxing, and worked in a township factory for several years. In 1987, he left the township factory where he used to work, and started his own business.

SX1 was born in Shaoxing. She is the second child in her family, and also has an elder brother and younger sister. In 1987, when SX1's family had just started their business, SX1's elder brother left his job and joined XD. At that time, SX1 and her younger sister were still at high school, and they helped their family in the business after they returned from the school.

#### **5.4.3.2 Family**

##### **5.4.3.2.1 Source of finance**

XD Company is a family business. According to SX1, the main source of finance was from their family savings.

*SX1: Before we started our business in 1987 my father worked in a township factory for several years and along with our savings from growing vegetables in the mountains, we put this money altogether, and bought a second hand punching machine. In the early years, everything was hand made by using files.*

*We got a lot of support from our relatives, especially from our youngest uncle. He was working at local supply and marketing agency ('供销社'), which was quite a good place to work at that time. His standard of living was relatively good. When we needed to travel for a business trip but had no money, he would lend us the money, sometimes, 50 yuan a time, and we would paid him back when we got back home.*

*We preferred not to ask our relatives if we could borrow money unless our business needed money urgently. The standard of living of most of our relatives was not very good at that time. Most of them had no money to offer, although we wanted to borrow, and they would have been willing to lend. We hoped our business would develop steadily, and normally we would reinvest the profit we made from our business back into the business.*

Similarly to most of the business founders in the preceding interviews, the main source of start-up capital for the XD Company was from SX1's family savings although the amount was not large. Financial support from relatives offered great help when needed urgently in the business. However, because of the low standard of living of most of SX1's relatives, borrowing money from relatives was thought to be a last resort for SX1. They preferred to use their own money instead of asking others.

#### 5.4.3.2.2 Human resources

In this section, the relationship between family and human resources will be discussed. According to SX1, the staff for the XD company came mainly from their family members and relatives.

*SX1: Before 1990, all the family members worked together in our business, my parents, my elder brother, my younger sister and me.*

*Life was tough in the early years when we first began to do business. We were poor and often did not have enough food to eat. We were virtually fed on carrots*

*and sweet potatoes. Normally, we worked when we got orders, if not, we went to the mountains to grow peanuts and vegetables.*

*The year 1990 was our turning point, because at that point we began to supply our product to a large company in Shanghai. So in 1990 we recruited five people, three of them were our relatives, and the other two were from the next village. Now our relatives have married and moved to other places, and they are not working with us any more, but the other 2 are still working with us. In those years when they were with us, they all lived in our home, just like our sisters.*

*In 1991 and 1992, the salary was 50 yuan per month.*

*At that time, my elder brother has already been married for a few years. He earned a salary, which was 120 yuan per month. You know when somebody got married and had a wife, if you did not give him salary, his wife would complain a lot. At that time, I was still at home I ate, lived and worked at home, I was not married yet, therefore I didn't take a salary from until the end of 1992. Neither did my sister.*

**- Family issues:**

SX1, like most of the informants in other cases, was of the opinion that family issues would arise during the different development stage of family firms:

SX1: *As regards employment of family and relatives, when the enterprise is small, it is*

*ok, no big problem. When the company becomes big, if you treat your relatives the same as normal employees, and your relatives also behaved as normal employees, there would be no big problems either. But if they did not, things would not be as easy as before.*

SX1 liked her employees and got along very well with them. However, she expressed the opinion that ‘*it is always difficult to deal with issues to do with relatives*’. This was explained during the interview. For example: She had different ideas on the choice of plant and company expansion to a family member. She found problems during the process of the plant construction with her brother in law, who used to work in the construction industry. Thus, she discussed the issue with her elder brother, because her elder brother was the person who was in charge of the plant construction. Her elder brother did not seem to be very happy about this, and blamed their brother-in-law did the ‘*secret report*’ to his sister. SX1’s brother no longer wanted to be responsible for that project, and thus, SX1 was forced to take responsibility for the project. She went to see the designer, discussed and solved the problems alone.

#### **5.4.3.3 Motives and Intentions**

SX1 explained why she and her family started to do the business.

SX1: *Why we started to do business? Well, it was forced on us by the environment and poor living conditions. At that time, my father and elder brother worked in a township factory. It was still in collective ownership at that time, farmers and peasants would get food allocated, but people working in factories did not to get a food allocation. Our life was tough and poor. We owed (‘dao gua’ 倒挂,) 200 yuan to the production team. You know what, my mother’s biggest wish was at that time, was to pay back the money we owed to the production team. Because*

*we were the ‘Dao Gua Hu’ (‘倒挂户’, in other words the family that owed money to the collective) were be looked down on in the village.*

It can be inferred that SX1’s family started to do the business because of poor standard of living. Starting a business was the best option for them to change their life. The fact that they owed money to the production team<sup>36</sup>, resulted in them ‘being looked down’ by others in the village, which affected the family both financially and psychologically, especially in village, in such a small society. This damaged the reputation (‘face’) of the family, an issue referred to by many informants.

#### **5.4.4 Relationships**

##### **5.4.4.1 Social networks**

According to SX1, social networks played an important role in the XD Company’s start up and early development stages.

The social networks at the start-up stage of XD Company were mainly based on SX1’s father’s network. According to SX1:

*SX1: My father used to work in the township factory before we started our business.*

*He is a very nice person, he loves to study and is willing to help others, thus he was trusted a lot by other people. At that time, one of our acquaintances told my father that he had got a big order and asked whether he would like to take on part of it. So we bought our first punch, processed by using files, and our business began.*

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<sup>36</sup> Production team was belonging to collective ownership at that time.

*My father also visited his old contacts (old guanxi 老关系) to get more business opportunities. One of them was working in a village-owned cooperative as sales. We introduced our products (connectors) to him. He thought our products were good, they were hand made and also good quality, and he thus agreed to help us to promote the products. We also got a lot of help from other people, without them, XD would not be where it is today.*

#### 5.4.4.1.1 Sources of finance

According to the preceding accounts said by SX1, XD Company's start up funds were largely generated from internal funds, which include family savings, and some financial support from their relatives. SX1 also mentioned finance from external sources.

*SX1: Our first investment was in 1988, from a bank loan officer (信贷员), to buy equipment. It was really not easy to borrow money from banks in those days. The bank director was not willing to offer the loan to us, but my father's sincerity touched the loan officer. Because of the loan officer's help, we finally got our first loan of 5000 yuan. Even now, we still feel so thankful and appreciative to that bank loan officer, and still keep in contact with each other. Now his son works in the bank, and we are friends and still have regular contacts. When we need to enquire or deal with any issues with the bank, we would contact him for suggestions.*

*After that, we developed through reinvesting our profits into the production,*

*rolling development.*

*In the early years, we bought second hand equipment from others, adjusted the equipment by ourselves, my father knew how to fix and adjust it.*

*Year 1992 was our first leap forwards. After a two year trial, we got the authorization from our buyer, and become the only supplier for a large MNC.*

*In 1995, and 1996, we borrowed 30,000 yuan from the bank. The bank was willing to lend us money, because at that time, we had begun to supply our products to the well-known multinational company in Shanghai. You see, for small rural companies like ours, it was not easy to become a supplier to well-known companies. Although our company was not big, our products were good. Banks knew this. Therefore, applying for loans was not as difficult as before.*

From the above account, it can be inferred that external funding was difficult to get for SMEs, in particular in their initial development stages. The ability to get loans mainly depended on the performance of the company, the better the performance or the reputation of the company, the easier it was to get a bank loan. This echoed what SX1 said in section 5.4.2.1, and was also similar to the experience of RB. It will be further discussed in Finding and discussion chapter (Chapter 6).

#### 5.4.4.1.2 Human resources

According to SX1, from 1987 to 2001, family, relatives, and friends were the main



human resources for the XD Company. In 2003, there were almost 50 employees in the XD Company, all recruited from their local area according to SX1. SX1 pointed out that employees were one of the main factors that they considered when they decided on the location of their new plant.

SX1: *We moved to our current new plant here in 2006. Our new plant here is not too far away from our old factory. Thus all of our employees moved here with us at that time.*

*Our company now has 170 employees, mainly producing wiring harnesses, an extremely labour-intense company. Now there is hardly enough space to store our spare parts. If we had begun to build our new plant from last year, we would not have this problem now....*

YW: **Why didn't you build up the new plant last year?**

SX1: *How do I say this... You see, the company does not just belong to me, and things need to be discussed with other people<sup>37</sup>. To further expand and build up a new plant at this time, the views of the family members were inconsistent at first. That's why the project was postponed to this year. Moreover, to further expand our business, also means recruiting more employees, which is also one of the things that needs to be considered. Nowadays the employees are different from people in our time, and management of them is more difficult.*

YW: **Who is responsible for recruitment?**

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<sup>37</sup> Here means SX1's family members: parents, brother and sister.

SX1: *This is mainly dealt with by me and another manager. My brother, my sister and I have different roles in the company. My elder brother is responsible for infrastructure, and is not involved in production and operation. My younger sister is in charge of accounting.*

*In production I promoted one deputy director. This was because attended a talk entrepreneurs, and realised the importance of delegating responsibility from that day. To promote employees is a good thing for the boss, and also a kind of honour for your employee. The more you trust others, the better work others do for you. As the technical and quality part cannot be separated, our deputy director has been authorised to in charge of both. He is a very good person, and our cooperation is very good.*

The above accounts have shown the inconsistency between SX1 and her family members when discussing their family businesses, which echoed what SX1 said in section 5.4.1.2 and section 5.4.3.2.2. Working and dealing with family members can be more difficult than dealing with normal employees. ‘Trust’ was mentioned again in this case, and needed to be further discussed in the next chapter.

#### 5.4.4.1.3 Role model/ mentor/ competitor

##### **- Role Model**

From the conversation with SX1, it came across clearly that SX1’s father is her role model. In other words, SX1’s father is the role model for their family. According to SX1, although her father did not have a good educational background, his character,

his hard working, his fairness and open-mindedness have been appreciated by many people not only the SX1's family, but also by their employees and neighbours.

SX1: *My father had a hard time in his childhood. Although he does not have much education, he is diligent, hard working, willing to learn and accept new things, unlike most other people of his generation who would stick to their old fashioned ideas forever. In rural areas, to let the daughter take charge of the whole business is thing that would never happen. Other people in our village could not understand at first, and thought there were 'no people in our family' ('家里没有人了')<sup>38</sup>. After several years, people have begun to understand, and thought my father's choice was right, and thought he was forward thinking and has a long term view.*

According to SX1's father, he made the decision and employed his three children in the business according to their character and strengths.

SX1's father: *I know my children very well. Who could be the director? I wanted my daughter or son, whichever one had the ability, to get the post. Although, SX1 is my second child, she is steady and careful compared to her elder brother. SX1's character is good and suitable for the post. Thus I felt comfortable with handing over the whole business to her. My eldest son is down to earth, but his temper is not very good. He is not very patient at times, and would not be able to persuade employees and convince them so he would find it difficult to be a good boss. So I put him in*

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<sup>38</sup> Because in early Chinese rural society, people's thinking was conservative and the status of men and women was different, normally people treat women as inferior to men. In most cases, family businesses were inherited and managed by the son, but not the daughter. Daughters would normally work in support roles (e.g. secretary, clerk etc but not manager), or even be not to be allowed to participate in the family business.

*charge of the infrastructure, construction and transportation, but did not get him directly involved in production and operations. My youngest daughter is still quite young, she has a lively personality and she is good at communicating with different people. Therefore she is now in charge of accounting, but also human resources. Normally, the three of them would go on business trips together. They could support each other. All of them are very good.*

**YW: Do they totally agree with your decision on whether to place them?**

*SX1's father: If they did not agree, they would tell me. Our family is democratic. If anyone is of a different opinion, we just discuss frankly together, rather than bottling our feelings up. So all of the family members, my children, we get along with each other quite well. If we were like other family business, we would have been disbanded long time ago.*

#### **5.4.5 Mutual benefit:**

Issues related to Mutual benefit will be discussed in this section. According to SX1:

*SX1: We know all People<sup>39</sup> within the industrial park, we often meet and communicate in different meetings, but we are just acquaintances.*

*SX2 is an old friend, he used to be our neighbour, and we know each other very well. As both of us produce mechanical spare parts, when we encounter any*

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<sup>39</sup> 'All People' here means 'bosses/managers' in the industrial park where they located.

*problems, whether in production, in technical aspects or management, we would come together for discussion...You see, we all see ourselves as solid and, hard-working but not high-profile, and at times we also feel annoyed and tired of running a business (SX1 laughed).*

*My friend's (SX2) company was set up and developed by SX2 and his wife. They did have any technical knowledge in the beginning...To set up and run a business is really a tough job, and we didn't want our children to go through this. There are many annoying things you have to deal with, labour laws, product quality, buyers and suppliers, etc. We hope our children will not take over the business. But this is probably the way it is going at the moment unless, things change later. While our companies are growing, how could we hand over the business to outsiders?*

SX2 and his wife were mentioned many times during the conversation with SX1. As well as discussing issues met in the business, they also go out together to attend training courses for entrepreneurs and local and personal events. SX2's company is just one step away from SX1's. The close relationship between SX1 and SX2 gave the researcher the chance to talk to SX2 and his wife. Both of them talked of cooperating with other companies when doing business, or and also had the feeling that networks with other businesses could help to lower the business risks and produce mutual benefits, although there are still issues not a hundred percent guaranteed. Just like what SX1 said: *"at least, you are not alone, you do not face problems alone. You know someone else also has similar kind of experiences. It might not able to help you solve the problems, but psychologically, it makes you feel much better, because you know you have somebody who to meet for a discussion or suggestion. And it is just like an*

*alliance.”*

## **5.5 Summary**

It was mentioned in Chapter Two (Literature Review) and Chapter Four (Research Methodology) that the focus of this research is mainly on the beginning stage of the cluster development, i.e. how and why clusters are formed (critical mass and take-off). The case studies in Chapter 5 have sought to investigate the personal attributes and experiences of the actors (mainly entrepreneurs) in the selected fields, to look at how they make sense of their entrepreneurial decisions and actions, and also to answer what makes them different from other people in other places who might not be inclined to form a cluster. This was examined in the light of the environment in which they operated, in order to determine the extent to which the environment was conducive to entrepreneurship and the formation of clusters.

The apparent lack of consensus in understanding the cluster concept, discussed in Chapter 2, Literature Review, appeared to increase the difficulty in identifying, selecting and analysing the so-called ‘cluster’ and the participants. Therefore, I proposed a model with 5 key elements for to define what can be viewed as a cluster and how the cluster is formed. I argued that, whilst the three key elements that were adopted by many researchers in the field of cluster research are useful, these ‘three’ elements alone could not be seen to equate to clusters. As discussed in Chapter 3. Conceptual Framework, in addition to Location (geographical concentration), Relationship and Mutual benefits, Individuals and Institutional Context also need to be considered as a whole to support the understanding of clusters.

These three Case Studies have different features. The HK Case was developed and based in a 'cluster' of its own industry, the XD case was based in and played a key role in a 'cluster', that was not related to its own industry, while the RB case, that developed next to HK's cluster, chose to build up its own 'clusters' in different regions of China. Based on the Case Studies and analysis in this Chapter, in the next chapter I intend to reflect on the empirical work in the light of the literature review and Conceptual Framework chapters to further discuss the existing and emerging elements of this research. The different implications of each case generated throughout the entrepreneurial process (or development and networking/gathering process) will be further investigated.

## **Chapter Six: Findings and Discussion**

### **6.1 Introduction**

Taking forward the analysis in the Case Studies Chapter, the findings of the fieldwork will be further discussed and analysed in this chapter. The chapter discusses implications from the findings in order to answer the central questions. The first question is whether existing theoretical concepts of cluster formation can be employed and fitted well into the Chinese context. The second question is what lessons can be learned in respect of individuals' entrepreneurial behaviour and the cluster formation process through the lens of the three empirical cases.

This Chapter will emphasise the active role individuals play in interacting with their environment and other participants in the entrepreneurial process, which then gives rise to the formation of the cluster.

Important themes to emerge from the case studies that were widely discussed by interviewees included 'source of finance', 'entrepreneurial learning', 'entrepreneurial opportunity', 'cooperation' and 'institution and interaction'. However, this does not mean that those accounts provide sufficient evidence of the cause for the formation of the cluster. It merely indicates that some themes were more often mentioned or widely talked about by the informants and that the researcher should pay attention to these themes. The following chapter is therefore structured according to these key themes, 'source of finance', 'entrepreneurial learning', 'entrepreneurial opportunity', 'cooperation' and 'institution' and 'interaction'. The final Section then discusses the implications for the findings in terms of answering the central questions.



## **6.2 Source of finance**

Entrepreneurs from both Wenzhou and Shaoxing all mentioned the importance of sources of finance for their business. Two main themes emerged relating to sources of finance. These were (1) start-up capital and (2) managing capital in running the business.

### **6.2.1 How to manage the capital for start-up**

Most of the informants used their capital very carefully in the early stages to minimise the start-up capital. Ways of minimising their costs that were frequently used included using family members to work in the business, hiring low cost labour, renting second or even third hand equipment, or buying and using equipment collectively, working from home or renting small offices at the home of others or premises of other companies. According to the informants, the typical form of enterprises in Zhejiang province was ‘shop at the front and workshop at the back (前店后坊)’. These enterprises were essentially home-based, in order to save or reduce the investment needed to build the plant and rent a sales office. W1, the business owner of HK, described it as ‘doing the rites in a snail shell (螺蛳壳里做道场)’.

None of the informants in Wenzhou or Shaoxing used banks or bank finance as the financial source to set up their firm. This was due to the weak financial infrastructure and under-development of the banking system in China in the 1980s and 1990s, when China had just begun to implement economic reform. In order to cope with this lack of infrastructure at that time, some informants chose to be a ‘red hat company’. The essence of a red hat company is that private individuals sign a contract with a state-owned-enterprise undertaking to entirely or partially run the business, bear the

business risks and take the profit, but the state retains ownership of the enterprise. This system is known as *Chenbao*. Choosing to be a ‘red hat company’ saved significantly on investment capital and made it easier for those wishing to start a business. This practice was described by YY1 as ‘Borrowing Chickens to have eggs’ (借鸡生蛋), meaning to make a profit or achieve your aims through using other people or things. However, the majority of the informants were not as ‘lucky’ as YY1. Most of them set up their firms from scratch. Their success in setting up firms can be attributed to the generous support informants received from their families and relatives. All the informants admitted to having their family members and relatives involved in the business start-up phase. It is a ‘natural choice’ because of the ‘trust’, according to many informants. Having family members working in the business also means it is ‘more easy to talk with when the business is short of money to pay their salary’ (SX1), or ‘work voluntarily when they are available or when business is difficult’ (W1). Business owners such as SX1 worked for her family firm with no salary being paid until she got married. W3 never asked for a salary in the early years when he joined the company founded by his father, and there were other cases of family members working without a salary. Thus, it can be inferred that having family members and relatives in the business is not only more flexible for doing the work, but more importantly helps to reduce the cost and save money when starting and running businesses.

### **6.2.2 How to manage the capital in running the business**

By managing the start-up capital, entrepreneurs are also finding ways to manage the capital required to continue running and developing their business. A number of ways were identified to manage the capital in running the business. It was mentioned

previously that most companies had family members and relatives working in the business or became red hat companies in order to reduce the cost for starting up the business and saving investment at this stage. Other strategies were used for managing capital at the different stages of the business. Most of the informants interviewed were in the manufacturing sector, which needs relatively high levels of investment to buy manufacturing plant and equipment. In order to minimise the cost, they used different ways to reduce the need for capital to set up and run the business. For example, W9 rented an old storehouse that had been left unused by a farmer, for which he did not pay rent, but offered the labour of himself and his partners with the daily farm work, particularly in the harvest season. The businesses of W1 and SX1 were all based at home in the form of ‘shop at the front and workshop at the back’, thus saving money for rent. They all worked for others before setting up their own company to accumulate the capital for starting and running a business. Informants described, several ways of managing the capital needed to run the business, informal ways included ‘*borrowing from relatives*’, ‘*Gao Li Dai*’ i.e. high interest loans and ‘*Hui*’ (W1, W9, W6, SX1, SX2 ). Formal ways such as ‘bank loans’ were mentioned by some informants (SX1, W9, YY1) but this did not seem to be a good option for them due to difficulties in accessing these loans.

In Zhejiang Province, *Hui*, a means whereby people offer mutual financial support when needed by *Hui* members is quite common. However some informants only mentioned this briefly, with only one exception, W6, an academic from Wenzhou. Normally *Hui* is raised by a host with his/her family members, relatives, friends, and acquaintances, etc. There are no formal contracts among the *Hui* members, but all people follow the unwritten rules based on their mutual trust, reputation, relationship and so on. Although *Hui* culture has its tradition in Zhejiang Province, following the

ten year long Chinese Cultural Revolution (1966-1976), the Chinese economy experienced wide-scale neglect and lagged behind other major international economies. The people in rural areas like Wenzhou and Shaoxing did not have any extra money to join '*Hui*' due to their low income and poverty. Therefore, despite the economic reforms that took place in the late 1980s, the '*Hui*' method was not an option for the informants either when they set up or continued running their business in the 1980s and 1990s.

All entrepreneurs interviewed had experience of borrowing money from their family members and relatives in the process of running a business. Although all informants viewed this as a 'favour' offered by their family members and relatives, the difference was that in Shaoxing most informants tended to return the favour by paying back the capital on time, whereas, in Wenzhou people not only paid back the capital on time, but also paid interest whether asked to or not. This may provide the reason why informants such as W9 thought there was no real difference between borrowing money from relatives and others because when entrepreneurs borrowed the capital from their relatives, they needed to pay back both the 'favour' (the debt for *Renqing*) and the capital with interest, but when they borrowed the capital from others, only the capital and interest were needed to clear the debts. Therefore, it offered a niche for '*Gao li Dai*' (i.e. high interest loan/ usury source) as an informal way for those informants who either preferred not to or were unable to get financial support from other sources to run their business. According to W9, friends and relatives would sometimes help informants to access *Gao Li Dai* or raise the amount of money similarly to *Hui*, when they were in need. In this way, entrepreneurs would not owe 'Renqing debt' or lose face among their families, friends and social networks.

Much literature views social networks as a source of finance (Biggart and Hamilton, 1997). However, this can be challenged based on the informants' accounts. Other than W8, all the other entrepreneurs used their own savings as the first choice to set up or run a business, then went for other options such as Gao Li Dai, bank loans, or Hui. Relatives and friends were normally the last resort when entrepreneurs failed to borrow the capital from any of the options above. This is quite unexpected and different from the findings of most Chinese studies on business generations. The features of Chinese family values and social network/relationships (guanxi), discussed in the Literature Review and Conceptual Framework chapters, are believed to shed some light on this finding which the nature and depth of the case method employed helped to generate the supporting evidence, as will now be explained.

Chinese business always bears its distinctive marks on family and social relationship (Redding, 1996; Redding and Witt, 2007), and the values and rules for the family and social relationships are fundamentally based upon the Confucian philosophy (Fang, 2006; Wright and Twitchett, 1962). Confucianism advocates that an individual cannot be viewed as independent, but rather as an integral part of a large network of people (one big 'family'). In a Confucian society such as China, social and economic activities are highly overlapping and very relationship-oriented. Thus maintaining relationships both personally and socially (e.g. to build up and maintain trust, keep and gain reputation) are vital concerns for all people in society, especially for entrepreneurs. On the surface, it seems to be a natural choice for entrepreneurs to borrow money from friends and relatives when in need. However, doing so has hidden implications since it places the informants' trustworthiness as an issue in the open, or in other words, exposes their 'face' and 'reputation' to their main social network. Entrepreneurs are therefore likely to think carefully before borrowing money from

friends and relatives. Table 6.1 lists the considerations and implications for the informants of borrowing money from different sources.

**Table 6.1: Considerations and Implications for borrowing money from different sources**

Borrowing money from relatives and friends	Borrow money from other source (bank, high interest loans, hui, etc.)
<p><b><u>Pay back the money on time</u></b></p> <p><i>To clear the debt:</i></p> <ul style="list-style-type: none"> <li>- Pay back the money.</li> <li>- Pay back the ‘favour’ to thank the person for lending the money.</li> </ul> <p><i>Implication:</i></p> <ul style="list-style-type: none"> <li>- Keep the reputation and trust relationship among the key social network although potentially run the risk of losing both.</li> </ul>	<p><b><u>Pay back the money on time</u></b></p> <p><i>To clear the debt:</i></p> <ul style="list-style-type: none"> <li>- Pay back the money.</li> </ul> <p><i>Implication:</i></p> <ul style="list-style-type: none"> <li>- Good credit record.</li> </ul>
<p><b><u>Fail to pay back the money on time.</u></b></p> <p><i>To clear the debt</i></p> <ul style="list-style-type: none"> <li>- Need to pay back the money as soon as possible.</li> <li>- Need to pay back the ‘favour’ to thank the person for lending the money.</li> <li>- Need to pay back the ‘favour’ for the delay of paying back the money.</li> </ul> <p><i>Implication:</i></p> <ul style="list-style-type: none"> <li>- Normally in this situation, more ‘Renqing’ (favour) debt is owed to the person who lends the money. To keep face and trust relationship, sometimes the borrower will voluntary add more interest or pay extra money (or buy gifts etc.) to the lender, apologising for paying back late. However, the ‘Renqing’ (favour) debt cannot be cleared only through financial compensation, but also</li> </ul>	<p><b><u>Fail to pay back the money on time.</u></b></p> <p><i>To clear the debt</i></p> <ul style="list-style-type: none"> <li>- Need to pay back the money with fine (e.g. default interest, etc.).</li> </ul> <p><i>Implication:</i></p> <ul style="list-style-type: none"> <li>- Credit being influence, but still have chance to be re-earned.</li> </ul>

<p>take other forms, which most often require the borrower to invest more time, energy, social capital and money to pay back the favour.</p>	
<p><b><u>Fail (or refuse) to pay back the money.</u></b></p> <p><i>To clear the debt:</i></p> <ul style="list-style-type: none"> <li>- Impossible</li> </ul> <p><i>Implication:</i></p> <ul style="list-style-type: none"> <li>- Bad record forever.</li> <li>- No future money borrowing from the lender.</li> <li>- Lose 'face' and personal reputation.</li> <li>- Destroy interpersonal trust in the social (guanxi) network, or more seriously to be excluded from the social circle, might lose support and help when in need in the future.</li> <li>- Might influence the credit for the borrower's close members of the family when they need financial support from the social network, or more seriously, shame the family in the social network.</li> </ul>	<p><b><u>Fail to pay back the money.</u></b></p> <p><i>To clear the debt</i></p> <ul style="list-style-type: none"> <li>- Pay back the money.</li> <li>- Pay the fine (e.g. default interest, etc.).</li> </ul> <p><i>Implication:</i></p> <ul style="list-style-type: none"> <li>- Bad credit.</li> <li>- Blacklisted from this bank, be customer to another bank.</li> </ul>
<p><b><u>Backup solution:</u></b></p> <ul style="list-style-type: none"> <li>- None</li> </ul>	<p><b><u>Backup solution:</u></b></p> <ul style="list-style-type: none"> <li>- Borrow money from relatives and friends to pay back the bank or other resources.</li> <li>- If other resources cannot get access, then go to relatives and friends for the source of finance.</li> </ul>

It can be seen from the comparison in Table 6.1 that borrowing money from other sources is better and more straightforward for entrepreneurs from a long-term perspective. As there are no personal relationships involved, entrepreneurs do not

need to pay 'Renqing' favour back to the lenders when they are in need. Moreover, 'Renqing' is not necessarily related only to financial issues (lend the money in return next time when the lenders require), but could relate to any other issues or means in which the lenders think the borrowers (informants) can help. If the borrowers (informants) refuse or fail to meet the requirement and not pay the favour back, this will affect the informants' reputation in their social network (normally in a negative way). Thus, even if informants have paid back the money, they still might not be able to get financial support from their relatives and friends in the future because of the bad record of not paying 'renqing'.

It can be argued that, although the social network can be viewed as a source of finance when entrepreneurs need capital, it is also an ongoing investment for entrepreneurs who want to get constant and future support (potentially more important), and thus cannot be overused without long term consideration. Not everyone will go for such sources immediately and not everyone can get access to them when in need. Therefore, financial sources from relatives and friends are normally used only as a backup solution or in an emergency.

In other words, borrowing money from relatives and friends has both financial and personal implications and thus influences the way entrepreneurs manage the capital to run their business. This finding echoes the result of other studies of entrepreneurial finance (e.g. Lam, 2010), and also supports the argument in the conceptual framework chapter, that social networks are not sources of capital that already exist, but rather ongoing communication and social interaction between individuals and others (other individuals and environments) that determine the availability of finance from social networks. In other words, although entrepreneurs need access to sources of capital and



capital is supplied by their networks, whether the capital is available or not is related not only to who the entrepreneur is and who the entrepreneur knows, but also to what the entrepreneur did previously and what the entrepreneur intends to do.

### **6.3 Entrepreneurial learning**

There has been considerable debate as to the extent of entrepreneurial learning, i.e. whether the knowledge or the skills of entrepreneurship are learned or inherent (Aldrich and Wiedenmayer, 1993, Jack and Anderson, 1999). There is one school of thought that focuses on the environment to which entrepreneurs are exposed. Proponents of this view argue that entrepreneurial knowledge and skills are learned by entrepreneurs. The other school of thought puts greater emphasis on the characteristics and personality of the entrepreneurs, arguing that the entrepreneurs' knowledge and skills are inherent. The findings of this study are inclined to support the first argument, that entrepreneurial knowledge and skills are learned. Two aspects of this will now be discussed: learning from the family and learning from outside of the family.

#### **6.3.1 Learning from the family**

Family is the basic unit of a society and it is also the first place for individuals to learn about the world. Most of the informants indicated that their knowledge of doing business was gained from their families and relatives because of the close relationships between them. Most of the informants in Wenzhou mentioned that they had family members or relatives who were running their own businesses or working in others. According to the informants' accounts, setting up a business or running a

business were very common topics among their family members and relatives when they gathered together. This included daily meals, visiting relatives, or situations when relatives were short of staff in their business and came to ask for help. Thus, most of them thought they were growing up in an environment where there was plenty of information about business, and had thus learned or been taught the basic business rules since their childhood.

Compared to informants from Wenzhou, informants from Shaoxing had less knowledge of doing business, because they did not have many relatives who were running businesses when they were a child. Most of their family members and relatives were farmers or workers who worked in village or township workshops. The common topics in their daily lives were normally about how their crops were or what they did in the factories or workshops. According to SX1, doing business was not mentioned by her father until their family could no longer live on their farming incomes. She started to know and learn the business skills and knowledge whilst working for their family business, which was set up by her father. The learning experience of SX2 was similar to that of SX1. Moreover, most of the informants from Shaoxing (also in Shanghai) mentioned that most people in their area aspired to work in a state-owned-enterprise, which was considered to be an 'iron bowl' (铁饭碗) for their lives, which means a guarantee of a steady income to feed the whole family. Therefore, it can be inferred that for informants from Shaoxing, doing business was not learned naturally until their family chose to start one. Doing business was not valued to the extent that it was by their counterparts in Wenzhou. Work for state-owned-firms was their best choice, and working for themselves was a second choice. This comparison of the informants underlines the fact that learning from the family (family education) is important in shaping people's view and knowledge about

entrepreneurship.

### **6.3.2 Learning from outside of the family**

According to the informants, there are two ways for them to gain entrepreneurial knowledge and skills. The first is through their social environment, and the other is from their experience of working for others.

#### ***6.3.2.1. Learning from the social environment***

The results of the empirical work showed that the social environment in which entrepreneurs grew up was an important influence in terms of gaining entrepreneurial knowledge and skills. There were plenty of opportunities to learn from buying and selling activities in informants' daily life both in Wenzhou and in Shaoxing. These included, for example, the Supply and Marketing Agency (供销社) in the village, the husband and wife shop next door, the hawkers who came around on a daily basis and the 'Gou Xiao Yuan' (购销员, people who buy and sell products) who worked actively on the market. The entrepreneurs interviewed for the research learned from people around them in their daily lives that doing business was not difficult, and they therefore developed the idea that 'if others could do business, why couldn't we?' Moreover, some of the informants from Wenzhou also mentioned one phenomenon that after the economic reform in 1980s, some of their folks, who had lived abroad, started to come back to their home town to invest and set up businesses. This was widely discussed among the people in the villages where informants lived and became big social news locally. The news of how these returnees from overseas built up and ran the business became an important source of information for informants to gain

entrepreneurial knowledge and skills. The above discussion points to the importance of the social environment in influencing and shaping individuals' entrepreneurial knowledge and skills.

#### ***6.3.2.2 Learning through working for others***

Apart from informants SX1 and W8, all the other entrepreneurs had had experience of working for others before starting their own business. As discussed in section 6.3.1, informants from Wenzhou tended to develop the knowledge of doing business during their childhood, whereas informants from Shaoxing were often exposed to this knowledge later in their lives. Working for others was often a good way for informants to taste the real flavour of doing businesses, to 'accumulate experience' (W3), 'earn the money to start your own business' (W1), and additionally, it often minimised the informants' risks because 'you are not using your own money, but that of others' (W6) to learn how to run a business'. According to W1, YY1, YY2 the experience they gained whilst working for others formed the foundation of their business knowledge and skills, which provided them with a platform for setting up their own business. Even when interviewees worked for their relatives, as was the case for W1, W9, YY2, this did not prevent them from leaving their relatives' business and starting their own. Their experience highlights the fact that working for others is an important process for people to learn about business. There was to some extent, a lack of 'loyalty' from the informants as employees even if their employers were their relatives. The 'disconnected' (not work for them anymore) and 'connected' (because of the kinship, social relations) relationship among the informants also gave rise to other forms of business relationships, such as acting as a subcontractor, supplier or agent for companies they had previously worked for. These new business

relations lead to the creation of clusters. This will be further discussed in sections 6.5 and 6.6.

Informants from Wenzhou enjoyed greater freedom than their counterparts from elsewhere, supported by a more open local government, that with ‘one eye open and one eye closed’. The main form of business in the Shaoxing and YuYao areas was collective village or town workshops. Collective or state-owned enterprises were the best option for people in those areas to earn a higher salary. In these areas the main alternative was farming. However, for most informants, it was not easy to find a job without using contacts or ‘guanxi’. SX4, YY2 were among the lucky people who found a job, one in a state owned textile company and the other in a town plastic processing factory. Both of them indicated that they had no idea about industry before they worked there. However they both eventually left the companies once they had reached a point where they thought they had nothing more to learn. They then started their own firms in the same industries and become the competitors of their previous employers. This, again, reinforces the importance of gaining experience working for others in setting up new businesses.

It can be inferred that when individuals have learned the skills they need, they are more inclined to set up their own business. However, the question arises of why some people start a business and others do not, although they have the knowledge and skills required. Thus, beneath what it is necessary to learn for starting a business, there are underlying reasons, i.e. why individuals want to learn and develop the skills to start a business. Many of the informants in this research indicated that they already had the intention of starting a business prior to taking a post in another company. They then carefully chose the industry and chose to acquire the knowledge and skills required.

This finding sheds light on the relationship between working for others and starting a business. It also points to another way to understand entrepreneurial learning.

It is important to highlight the important and active role played by individuals in the entrepreneurial learning process. Based on the above discussions, it can be argued that entrepreneurial knowledge and skills are intentionally or unintentionally perceived and interpreted by individuals. The ways individuals perceive and interpret things are different. Some informants learnt from working for others and then decided to create their own firms. Some informants carefully chose their work and industry to learn what they believed to be the useful skills. It is important to emphasise not only how people learned, but also why they chose to learn. Therefore, the following two questions arise: first, are there any shared understandings or shared meanings among those individuals who want to start a business under certain conditions? Second, how do the shared understandings and meanings of entrepreneurship shape the way individuals perceive, understand and interpret their environment, and learn from it? This will be further discussed in section 6.6.

#### **6.4 Entrepreneurial opportunities**

As mentioned above, informants explained that the entrepreneurial opportunities emerged in two ways: firstly, from their conversations and communication with their families and social relations, and secondly through their previous employment experience.

The majority of the informants indicated that their business ideas were generated from chatting with their family members and friends or acquaintances. These conversations

included talking about the progress of their business, discussing with someone else in their network who was going to start a business, and discussing business ideas. SX1's company, XD is one example. XD was founded because SX1's father was told by a friend of his, who was running a factory producing automotive wirings, that the business was very good and had a large market. He was told that automotive wirings were highly in demand in the automotive industry, were not difficult to process and profits were good. Impressed both by what his friend told him and by the obvious improvement in his friend's standard of living, SX1's father finally made the decision to quit his job at the factory and started his own automotive wiring business.

Spotting an opportunity and turning it into reality however are two different things. China began to implement economic reform in the late 1980s, making the transition from a controlled economy to a market economy, and began to lift the barriers to the development of the private sector. However it was still not easy for individuals to set up a private business at a practical level. According to the majority of the informants, the process of getting a 'business license (营业执照)' was complicated and time-consuming. W9, the founder of RB, recalled that *'Nowadays some people still complain about the time and process when they want to set up a firm, but in our time, the process was far more complicated. The document needed to be approved and signed by layers and layers of bureaucracy. You needed to go here and there to collect those signatures, pay this fee and that fee. All this time and effort were spent just to get that 'piece of paper' (i.e. the 'business license').'* Being aware of these issues, many informants chose to start their business from *Chenbao* (承包) state-owned enterprises (SOEs), a practice mentioned in the previous section. According to the informants, this helped them simplify the bureaucratic procedures for the application to start their own company, allowing them, *'with the red hat'* on (As discussed,

previously in Section 6.2.1, where private individuals take over the management of SOE, but still leave the company in state ownership) to maximise their advantages to enjoy favourable policies offered by the government for SOEs. YY1 was just one of them. Another way to have a private business is to buy a registered company with a business license from others. According to the informants, the difficulty in obtaining registration provided a business opportunity in itself at that time, which involved either working as agents to help private individuals obtain business registration or selling registered companies to others for a profit. The above discussion suggests that individuals play an important role in the way they perceive, and interpret policies they have to follow.

As discussed in Section 6.3.2.2, entrepreneurial opportunities could also come through the experience of working for others. The informants who had employment experience before they set up their own business all reported that they had developed a knowledge of doing business, realised the opportunities in the industries they were in, and then chose to start their own business. W1 and his brother were working in his uncle's company as apprentices before they set up their own company. After a few years of working in the workshop producing electronic components and then working as "*Gou Xiao Yuan*" (a post in purchasing and sales), which involved travelling around the country, they had learnt both the techniques for production and the skills for marketing and communication. As a result of this experience, they became aware of the profitability of the business, which had low production costs and were also aware that their knowledge of the market, and contacts with suppliers and customers, would make it easy for them to get orders. Hence, after their younger brother graduated from university, they left their uncle's company and started their own business. YY2, the business owner of a plastics company had a very similar



experience. The motivation for him to set up his own plastics business came from his time working in a factory producing plastic appliances. Whilst working there, he realised that the demand for plastic appliances in the market was very high, and noticed his boss frequently borrowed workers from other companies to meet the production needs. He thought it was an opportunity, and therefore decided to leave the factory and set up his own plastics company.

In summary, social relations and past employment experience were the two main factors that played an important role in helping informants to form and shape entrepreneurial opportunities, and also to help informants to realise their entrepreneurial opportunities.

## **6.5 Cooperation**

The analysis in the three previous sections has focused on the active role played by individuals in interacting with their environment to obtain, manage or generate the sources they need in the entrepreneurial process. However, these analyses still leave open the question of how cooperation develops that leads to the emergence of clusters. Will ticking the boxes of 'source of finance', 'entrepreneurial learning' and 'entrepreneurial opportunities' enable clusters to emerge? Answers are needed to the question of what actually encourages individuals to gather together, coordinate and work as a unit to form clusters. There are literatures that focus on aspects of cooperation that characterise successful clusters and districts (Humphrey and Schmitz, 1998; Nadvi, 1999; Schmitz, 1999; Parrilli, 2001). Therefore, in this section, discussion and findings in relation to cooperation will be presented and analysed.

From the accounts of the informants, it can be seen that business cooperation has existed among some of them for many years. In addition to the two subsidiaries (SH2, SH3) of W1 and W9, business cooperation among informants also existed among other informants.

W8, for example, worked with W1 as a business partner and helped W1 sell products to the overseas market. According to W8: *‘Without W1, there would not be the me of today. If W1 had not supported me at that time, I would have found it impossible to set up my firm...Since our firm was set up, our business had developed quite steadily. Our first markets were in China, then we extended into Japan, and now markets extend to America and Europe. The electronic goods produced by W1’s company were upgraded rapidly in recent years, better techniques and better quality...we feel more confident and now try our best to push the overseas market bit... We are happy to work with each other...He trusts me to do things, if I messed the things up, I would have no face to see him.’*

When W1 talked about the story of how he chose to work with W8, he mentioned that W8 is a friend of a friend: *‘I met W8 when we had dinner at my friend’s house. I mentioned during dinner that I was looking for someone who knows English to help me contact my foreign clients. My friend said W8 was just the person I was looking for. We [W8 and W1] had met several times before that dinner and [I] thought he was a good person. As he is also a friend of my friend, I let him do the work.’*

Another informant, W2, described his cooperation with W3: *‘My cooperation with W3 is cross-sectoral. We were busy working in our industries when we were young. Now both our businesses have developed to a certain level, and we feel that we can do*

*something together. Once at a friend's party W3 mentioned something about floating on the stock market...the flotation things. You see, I used to work in banking for years before starting my own business...I still have a lot of friends in the financial sector. Personally I felt very interested in this project, so I told W3 if he was serious about it I wanted to join in. He agreed, I then invested some money and the project is ongoing... The process of floatation is quite complicated. We have known each other for more than 20 years... we know each other's character well. Working with each other is quite straightforward. We do not need to talk in a roundabout way like with other people when doing business.'*

Based on the informants' accounts and the process of how the key informants introduced the researcher to the new informants during the interview, business cooperation was always in evidence. However, a second reading of the accounts from the interviews shows that the process by which the cooperation was realised related not only to the business. As well as the active role informants played in sensing and facilitating the cooperation, the importance of the informants' personal relationships with each other was clear. According to W1, W8, W2 and W3, personal relationships had already existed for years before they set up the business cooperation. Thus, it can be argued that, based on some of these cases, business cooperation or business relationships were set up as an outcome of personal relationships. Although, almost all the informants indicated during the interviews that they knew each other or had at least heard of each other, this does not mean that everyone could establish a cooperative relationship with each other, reinforcing the importance of personal relationship in business cooperation. It is also interesting that the interaction that led to the cooperation between the entrepreneurs normally took place in an informal way at social gatherings, such as having meals together, birthday parties and class

reunions.

Family members and relatives also play active roles in establishing cooperation. According to W1: *‘When my brother and I left our uncle’s company, although we had accumulated some experience and guanxi, most of our business came from our uncle. We shared some orders with him. When there were problems in production, or a shortage of workers, or cash flow problems, he would help us. We also did the same for him when he was in need. The electronic goods we produced at that time were very simple and almost the same. Using nowadays’ standards, we would be seen as competitors, but in fact, we weren’t. We actually worked for each other and supported each other... Our uncle retired 3 years ago and our cousin succeeded him. Now, our products are different, but they are still helping us processing some spare parts.’*

In W9’s case, he put his brother-in-law in charge of his new business expansion into retailing. Although he sets very clear rules in his company, which forbids the employment of family members or relatives in their business, when it comes to cooperation, he still chose a relative, who he could trust, because *‘you don’t need to keep eye on him’, ‘he will look after the business because it is also [part of] his’, ‘if he can’t reach me, he can ring his sister [W9’s wife], so problem solved’*.

From the accounts of the informants, the facilitation of cooperation can be summarised on the basis of five different relationships: cooperation due to the family relationship (father, mother, brother and sisters, etc.); cooperation due to relative/extended family relationship (e.g. non-blood relationship, in-laws, etc.); cooperation due to friendship or neighbourhood relationship (e.g. school mates, neighbours, etc.); cooperation due to business relationship and cooperation due to industrial relationship. It is argued that the first three kinds of relationships are

stronger in the Chinese context compared to the other two. This echoes the view of Fei (1992), discussed in the Conceptual Framework Chapter, that family-oriented relationships are the key foundation in Chinese society and the social relationships for Chinese people is are like ‘the ripples formed from a stone thrown into the lake’ (ibid, p.65). The closer ‘the spreading circle’ to the centre, the more significant ‘the spreading circle’ it is, and the more cooperative opportunities there will be. This again, reflects the importance of family and its extended social network in the Chinese context, because the business or industrial oriented cooperation exists in almost all countries, but family oriented cooperation is particularly prevalent in China.

Moreover, according to the accounts of the informants, three types of cooperation among entrepreneurs can be concluded. The first is vertical cooperation, which means entrepreneurs working in the same supply chain and subcontracting to support each other (e.g. W1 and W8; W9 and SH3, SH1, W1 and W9). The second is horizontal cooperation, which represents entrepreneurs producing the same or similar products and sharing technical information to support each other, but targeting different markets (e.g. W8 and his cousin, SH1 and YY2). The third type of cooperation is discrete cooperation, which not only integrates the first two types of cooperation, but also includes other forms of support based on a greater variety of relationships. In this form of cooperation, individuals do not necessarily all work in the industries which the entrepreneurs are in. Family members, relatives and friends of the entrepreneurs, can work in any industries as officials, academics, lawyers, but can still offer a different source of support to the entrepreneurs when they are in need (e.g.W1,W2,W5, and W6; SX1, SX2, SX3 and SX4). It is argued by the present researcher that this kind of cooperation, which is mainly facilitated by personal relationships, is key to cluster formation.

In addition to engaging in cooperative activities, individuals and their families also play an active role in maintaining personal relationships and business relationships whether they relate to the cooperation or not. SX1's accounts are typical: *'We care a lot about the relationship between us and other people. Regular contacts are very important. It is not only because we can get feedback about the quality of our product, you know, if any problems emerge, we could solve it straightaway. More importantly, it is about our attitude and reputation in doing business. I don't want to see other companies delay their production or be affected because of us, if that happens, as well as solving the problem, I would also visit the business owner of that company to apologise. That's our tradition since my father set up the firm. If I was not available, my brother or my sister would make the visit.'*

SX1: *'When festivals and the New Year are coming, we will greet all people related to us, or sometimes, go for a visit. Every year, when new teas come to the market, we will send them to our clients as a gift, whether we are in a business relationship or not. We would not forget those people, especially those who have cooperated with us, helped us when we were in difficulties. You can't always remember and contact others when you are in trouble... If we sincere to others, others will treat us the same. From my father to me, we get along with others quite well.'*

W3: *'Doing business is not one day's work, you need to maintain your relationship and develop it. To some extent, no matter whether they are your suppliers or clients, they are equally important. If you treat the business seriously and treat them fairly, they would definitely know. People with common sense would not treat their friends discourteously in business.'*

From these accounts, it can be inferred that those who maintain good personal relationships tend to maintain good business relationships, and vice versa.

Moreover, the names of the key informants (normally the key introducers) were often mentioned during the interviews even when they were not locally based. It appears that ‘knowing’ and ‘hearing of’/ ‘knowing of’ are associated with different levels of trust and thus different results in terms of forming cooperation. The results suggest that trust, built over time through ongoing interaction among individuals, can help to foster and facilitate cooperation from which individuals can benefit. It is argued by Todtling and Trippel (2004) that trust as a particular form of social capital can be seen as both the precondition and the result of networking. As discussed in the Conceptual Framework Chapter, for the network to function, Maskell and Malmberg (1999) point out that, it is more important to accept the local rules of the game and the potential sanctions for non-compliance rather than focusing on cooperation. Therefore, in order to understand the ‘local rules of the games and potential actions for non-compliance’ that give rise to formation of the clusters, it is necessary to understand the institutional environment, i.e., economic political, social, cultural contexts, in which individuals are embedded.

## **6.6 Institution and interaction**

The above discussion shows that the essential dynamic for informants to start a business is mainly the need to make a better living, interviewees pointing out that it was difficult to make a living and to feed the family from their income prior to starting a business. The majority of the informants started their business after China had adopted a series of reform measures and open-door policies, which moved the

country from a highly-centralised, planned economy to a socialist market economy. This supports other research findings, that SMEs have rapidly emerged and their role has been expanding in the changing institutional context of China (Malik 1997; Anderson *et al.*, 2003; Siu, 2005), although government intervention still exists. From the accounts in the preceding sections, informants pointed out that developing private business was not accepted by the government during the initial phases of the development of their businesses. Due to the uncertain socio-political environment, entrepreneurs operated their business carefully by using their wit to find a way to survive, notably running their business through *Chenbao* state-owned enterprises, operating as red hat enterprises, becoming the sub-contractor of SOEs or foreign companies, and other such strategies. In this way, running a private business could be achieved with some security and entrepreneurs were able to benefit financially, as well as gaining legitimacy. These types of strategies are very much in line with Malik's arguments (1997). However, from the accounts of informants, since there was still a lack of access to formal resources (financial, technical, etc) and support from government and institutions, they had to resort to informal ways to get what they needed, such as their families, relatives and friends. The fact that private individuals could not get resources, support and assistance from government from formal institutions and other actors formed the 'reality' of the environment of the entrepreneurs. The accumulated experiences of the people interviewed and the experiences of people around them reinforced this 'reality' and generated the perception that to get support from government in a formal way would not be an option for the owners of private enterprises. Due to the lack of confidence and low levels of trust in government and society, it became an instinctive reaction for individuals to go to the people they trusted for support, such as family, relatives and friends. This enabled them to cope with their environment and explore a way survive



and improve their lives. There was a clear contrast between the low level of trust in the government and society, and the high level of trust in families, friends and relatives. This is the ‘reality’ with which people live and it is in this environment that clusters emerge. Therefore, to understand the conditions under which clusters emerge, it is necessary to look at the context of where people live and how people make sense of it.

The majority of the informants interviewed were born and bred in rural areas in Zhejiang Province, either in Wenzhou or in Shaoxing. Most of their families had been farmers for generations.

*‘We used to be farmers, plant vegetables and rice, leave some for ourselves, and sell most of them to others. And that was all our income. It is a hard job and at low income, and also highly dependent on the weather. If the weather was good, the harvest would be better, but if the weather was bad, there would be no income and no food. The people of our age all experienced the ‘three year natural disaster’ (三年自然灾害), Life was really tough in those years.’ (W9)*

*‘Farmers are always poor. [You] need to plant the crops, harvest them, give them to the collective commune, pay taxes etc. There were not many things left for farmers, and it was difficult to feed the family. So some people went to large cities to look for a job, some began to engage in some small business. We had no choice.’ (W1)*

Informants also considered other factors in their decision to start a business:

*‘To be a businessman, you always need to bear the risk, even though, in many cases,*

*high risk could not guarantee high income and high profit. We are different from those people working in state-owned-enterprises. If you work in SOEs, you would have employment insurance, endowment insurance, medical insurance, etc. The country would take care of you, even though, those amounts of insurance are limited or sometimes useless, but at least, you are entitled to have it. But for private business owners, we take care of our employees, but who takes care of us? The country would not provide this assistance to you. When we are ill, we need to take the money out of our own pocket. Everybody knows how expensive it is to go in hospital nowadays. If you just caught a cold you could spend over hundred RMB, not to mention serious illness. How could people afford to go to hospital with limited, fixed salaries? So by doing business I earn more money. I can afford to look after myself when I am old, at least, to go in hospital.’ (YY1)*

YY1’s account was very typical of the informants, and reflects the lack of social security and low confidence in the government. The sense of social insecurity can also be found in other informants’ accounts. Education is another area of concern:

*‘The tuition fees for children to go to school are getting higher and higher. [If you] have no money, [you] might not be able to afford to go to school, and [you] cannot go to a good school, unless are you really good.’ (W5)*

*‘It is quite common to pay fees if you want your children go to a better school, which might not recruit pupils in your local area. SX2’s son and my daughter are now studying in the same primary school, one of the best in our city. Most people said, ‘Don’t let your children lose from the starting line’. So I hope I can offer the best standard of living for my child, so that she grows up in a good environment and studies. Most parents are the same nowadays. Everyone doesn’t mind paying extra to*

*get their children into a better school if they have the financial means. No matter how, better financial means can offer more opportunities for ordinary people like us.'*  
(SX1)

*'Education is highly regarded by the Chinese. In China, a university certificate nowadays might no longer be a guarantee of a good job, but it is a 'brick to knock the door' (敲门砖), something you must have. There is a large population in our country, and the competitiveness is obvious for our kids. Now the country has lowered standards and increased the quotas for students to go to university. If your child did not do well enough in the university entrance exams, there are still ways to get in. Some universities offer a few quotas for people with special guanxi, they only need to pay more tuition fees, and that sorts it out. If you don't study well and have no money, when the exam is finished, you have no prospects. Children in poor areas normally work really hard, because going to university is the only way out and escape from poverty. However, many of them still can't afford the tuition fees, except for those who are really outstanding, and the country would then offer them a studentship to continue their study. But you know, these kinds of cases are very, very exceptional.'* (SX3, who was a university lecturer before he set up his business).

To summarise the accounts of the informants, the way individuals make sense of their environmental experience evolves over time. To make a living, the first priority is just to survive or have food to feed the family. When this has been fulfilled, individuals then begin to think about their family, the next generation and themselves. To take care of the next generation, people interviewed try to offer the best environment they can afford for their children to grow up in. Greater financial resources can create more opportunities for their children to get a high education, which to some extent, raises

the possibilities for their children to find a good job with a better income. When their children begin to work and have a sufficient income, it means informants have fulfilled one of the most important responsibilities of their lives. Firstly, they do not need to worry about the standard of living of their children. It also increases the ability of their children to look after them when they get old. If their children do not have a good standard of living they may need to support them.

From their own perspective, when they feel secure enough to survive (financially), they start to consider their lives from a longer-term perspective. In view of the limited welfare provision provided by the government, to start a business and earn more money is a way to guarantee they can afford the medical fees when they fall ill and get old. Moreover, most of them hope to have a better life after retirement. With good financial resources, they can do whatever they like, go wherever they like and enjoy life without financial worries.

It can be inferred from the informants' accounts that two aspects have become linked in people's minds: one is to aspire to a good life and the other is the lack of sense of security of society. These two become the 'reality' sensed by the people and form a base for shared meanings and shared understanding among them. Therefore, in order to cope and survive in this kind of 'reality', people consciously or subconsciously will become closer and naturally tend to stick with those in whom they have a certain level of trust and those who they are closely linked to in their social lives. The interaction between people and the environment and people and people, help individuals to sense, enact and create every opportunity to get rid of the obstacles for a better life. Through social interactions, people exposed to the same 'reality' around key individuals, are normally convinced by what they see and what they hear from the achievements of

related individuals (e.g. their peers, friends or relatives, etc), the wealth others generate, and the standard of living of others. With a common understanding and common aspirations for a better life shared with their friends and family, some people are being encouraged to start a business. The cycle of enterprise creation is perpetuated by a process of learning, from following and modifying the experience of existing business owners' entrepreneurial processes. The interaction between individuals and individuals (entrepreneurs and quasi entrepreneurs) and individuals and the environment both physically and mentally creates greater opportunities for entrepreneurial activities. They directly or indirectly connect the individuals, increase the chances of cooperation, and then give rise to the clustering phenomenon. From the embedded institutional context, people make sense of and enact the reality of their environment. Trust in families, relatives and friends are instinctive for individuals in this kind of reality. Trust among them is the reason for cooperation, but also the outcome. A combination of these different elements results in the formation of clusters.

## **6.7 Conclusion and implications**

The entrepreneurial stories of the key informants of the three empirical cases in China demonstrate the process of how the entrepreneurs started and developed their business, under what conditions, and with whom. From their different development processes, it can be concluded that a cluster is formed from entrepreneurial activities initiated by entrepreneurs through their ongoing interaction with the institutional context and other individuals. Based on the results of this thesis, the interaction between individuals and the institutional environment and individuals and individuals, has generated what has been termed the 'entrepreneurial climate'. Within this 'climate',

entrepreneurs make sense of and enact the world they are embedded in, reflecting cultural norms and expected behaviour. Their understanding and interpretations are shaped, reshaped and shared through this continuous interactive process. The emergence of the common understanding and meaning shared by different individuals also shows the ways in which the meanings are recognised by individuals, which then shape their behavior and actions. Simply speaking, the ongoing interrelated and interwoven interactions help individuals to shape a shared meaning, and thus to 'locate' the ideas for some form of gathering or networking process, which then gives rise to clusters. This finding supports and consolidates the arguments raised in the Literature Review Chapter (Chapter 2) and Conceptual Framework Chapter (Chapter 3), that not all clusters are developed entirely according to theoretical approaches. In other words, focusing on the common characteristics of clusters is not sufficient to explain the dynamism of cluster formation. In order to understand the process of cluster formation, 'individuals', the 'institutional context' of individuals, and their interrelationships must also be taken into account.

The present research argues that the formation of a cluster can be viewed from this alternative perspective. This perspective complements and takes forward the extant studies of cluster formation, which will be particularly useful when investigating cluster formation in different regional contexts, or transferring cluster concepts from theory to practice.

However, this does not mean that other approaches or elements for forming clusters are not important. It is worth mentioning some findings about the 'location' from the case studies of this research. Traditionally, 'location' is viewed as the most important element for cluster formation. However, from the accounts of the informants, it is

argued that this element was not a major consideration in the initial stage when informants were setting up their businesses. Compared to other elements, 'location' was not specifically considered and emphasised by most of the informants. For those informants, 'location' was normally the last thing for them to consider, since most of them started the business at home or in the nearby areas that were familiar and affordable. 'Location' issues only appear to be important and be considered by the informants when they want to upgrade or expand their businesses. Therefore, it can be inferred that 'location' issues are not a key consideration in the cluster formation stage (beginning stage) in the Chinese context, but rather that location is linked with the expansion of the business. It becomes an important concern for individuals when they consider relocating their firm. This finding can be further investigated in relation to the study of cluster evolution or cluster development life-cycle.

Moreover, the findings and discussions from the three cases reinforce the importance of understanding how clusters are formed in the initial stages. It is argued in this thesis that the dynamics underlying individual entrepreneurial activities are the root and power source for the emergence and development of a cluster. Policy makers who want to build up or support a cluster must bear this in mind and avoid being over ambitious, and attempting to cross too many stages at once.

Last but not least, let us return to the discussion of the definition of the term 'cluster'. Through the course of the whole research journey of this project, the researcher had developed an understanding of why it is so hard to define a cluster. The researcher still believes that reviewing definitions of cluster is a good starting point for researching clusters. However, the purpose of reviewing the definitions is not to employ a rigid or inflexible interpretation of the term, but rather to form a platform to

understand the basic concepts of a cluster. The research presented here suggests that clusters can be basically defined in a broad sense, but a clear rationale must be set up as a companion, especially when implementing empirical studies. It is believed that the five element framework (location, relationship, mutual benefit, individuals and institutional context) established by this research will be particularly useful in this respect. Including the elements of 'individual' and 'institutional context' is helpful as they complement the other three classical elements, and help to advance understanding of cluster research, whilst at the same time offering an important solution to removing some of the obstacles encountered in empirical studies. Since the 'individuals' and the 'institutional context' individuals are exposed to are never the same in different places, there is a need to take these into account as situational variables.



## **Chapter Seven: Conclusion**

### **7.1 Introduction**

Cluster development strategies, as one of the key instruments for facilitating change and development in national or regional economies, have been implemented widely across the world. The increasing utilisation and discussion of the ‘cluster’ concept means there is an ongoing need for critical and in-depth research in this area. This will in turn contribute to our knowledge and understanding of the differences in the application of the term ‘cluster’ enabling more effective progress to be made on sharing and developing cluster research studies. This thesis has aimed to contribute to the advancement of this understanding, focusing on the processes associated with SME cluster formation. The distinctive feature is the use of an integrated approach with a special emphasis on the social aspect. The empirical fieldwork undertaken in China generated three rich in-depth case studies, which offer a valuable complement to other cluster studies in both a practical and a theoretical sense. The findings are especially relevant for developing countries such as China.

### **7.2 Summary and findings**

The starting point for this research was a review of the relevant literature. Chapter 2, the literature review chapter, began with a discussion of various definitions of the term ‘cluster’ and pointed out that ‘individuals’ are one of the essential elements contributing to cluster formation and should not be taken for granted when conducting cluster research. Moreover, the review of the literature identified that there are differences between industrial clusters and SME clusters. The conclusion drawn suggested that most clusters in developing countries are more appropriately regarded

as SME clusters. The different perspectives on the approaches leading to SME cluster development were then presented. The main ones presented were the economic approach, the political approach, and the social approach. By comparing these different perspectives on the approach to cluster formation, the analysis concluded that the social approach warranted more emphasis and attention, as this provided the potential for new insights into the process of cluster formation and development. In summary, the discussions in Chapter 2 have helped the researcher identify the knowledge gaps that exist and built up the foundation for further discussion in Chapter 3.

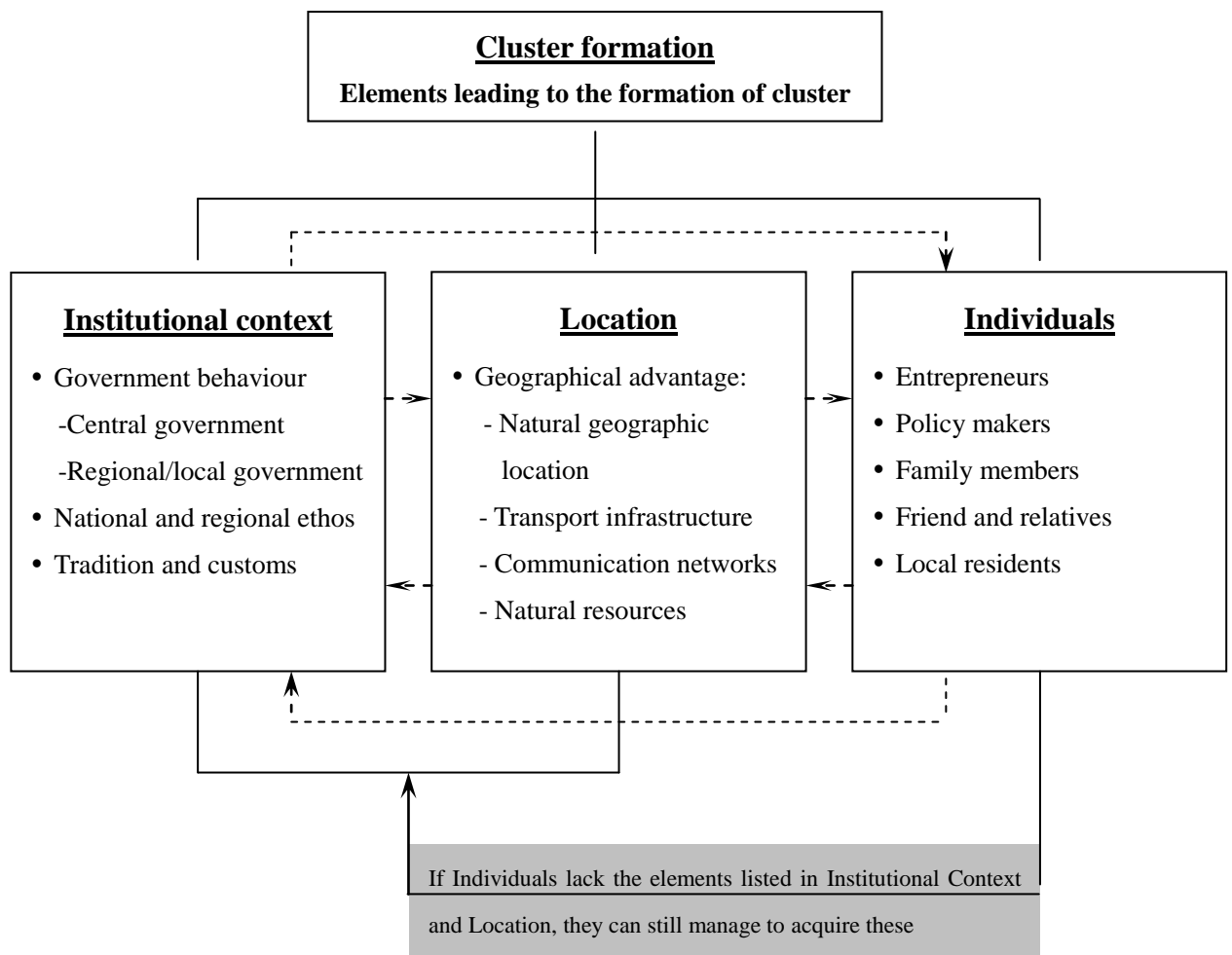
Recognition of the value and weaknesses associated with different perspectives and approaches to analysing cluster creation, resulted in the need to expand the discussion of cluster formation to include these perspectives and to conceptualise these in terms of their contribution (Chapter 3). An integrated approach was proposed to explain cluster formation with a particular focus on the social perspective. The conceptual framework was constructed by combining theories of institutionalisation, social embeddedness and sensemaking as a whole. This approach not only took into account the wider context of the characteristics of the region and its interaction with individuals, but more importantly, it helped to draw the individual back to the centre of the stage again without neglecting their relationships and ongoing interaction within their institutional context. The research methodology and methods were examined in Chapter 4 and the data obtained from the fieldwork were presented in Chapter 5. The analysis of the data derived from the interviews in the three major case studies (i.e. RB, HK and XD) generated five groups of significant elements which were already reflected in the literature review (Chapter 2) and the development thereof in Chapter 3. These elements were location, individual, institutional context,

relationship and mutual benefit. Chapter 6 extended the discussion of these initial findings, presented in Chapter 5, and the results were subjected to further analysis. The purpose of all the preceding chapters was to answer the research question of the thesis, i.e. how and why clusters are formed in the first place in China.

Through integrating the findings and discussions (Chapter 5 and Chapter 6) with the theories and arguments proposed in the Literature Review and Conceptual Framework Chapters (Chapter 2 and Chapter 3), a new model (Figure 7.1) was developed by the researcher to answer the research question. Based on the two afore-mentioned figures, namely, *Figure 3.2 Conceptualising the process of cluster formation* and *Figure 3.3 Cluster creation elements framework*, Figure 7.1 is designed to offer a clearer conceptual framework for demonstrating and improving the understanding of cluster formation, especially in the Chinese context. As shown in Figure 7.1, the understanding of cluster formation can be distilled into three main elements: Institutional context, Location and Individuals. *Institutional context* in this context includes Government behaviour (central and regional), national ethos (e.g. character, or fundamental values peculiar to a specific person or place) and factors such as tradition and customs. *Location* refers to geographical advantages and infrastructure, which includes factors such as geographical location, transport, communication networks, and local resources. *Individuals* refers to different actors in the (potential) clusters, including entrepreneurs, policy makers, family members of entrepreneurs, friends and relatives and other local residents. The lines (both solid and dotted), representing the interaction and relationship among each of the elements, provide the bridges to link and integrate these elements together to facilitate the forming of a cluster. In the process of cluster formation, since all these elements (listed in Figure 7.1) are interrelated, they all need to be considered simultaneously in a holistic sense

(The solid and dotted lines represent connection lines. Although they represent the same meaning, they differentiate the relative strength of the interconnection, solid lines representing more robust links than dotted lines).

**Figure 7.1: Conceptual framework of cluster formation:**



The primary basis of this framework relates back to the analysis of the results from the empirical study in the Zhejiang Province of China. This led the present researcher to the conclusion that cluster formations in the majority of rural areas in China result mainly from a group of entrepreneurial activities facilitated by local entrepreneurs.

The clustering happened naturally without any prior specific intention to create a cluster itself. The initial cluster formation originated from a natural gathering of certain entrepreneurs (e.g. informal networking). Clusters were then formed through the extension, expansion and overlap of the networks of these entrepreneurs and their interactive networking process.

Based on this finding, it is argued that even if the elements listed in the institutional context and location are absent, individuals (entrepreneurs) could still manage to find the necessary resources to create a cluster. Just as Rosa (1998, p.45) points out: 'Faced with adversity, an owner manager can either 'pull the horns' and concentrate on preserving the core, or he/she can try and diversity out of trouble.' In essence, the institutional context and location elements do help to facilitate cluster creation but may not be a necessary pre-condition in the whole formation process.

### **7.3 Contributions and implications**

#### ***- Contributions***

It is fair to say that cluster research is hardly a newly-emerging field. However, when it comes to understanding how and why clusters are formed, particularly, how individuals make sense of the cluster formation, how and why the ideas of clustering are located in certain individuals' minds at certain times are still fairly underdeveloped and understood. Therefore, this research could offer some contributions and implications for this field of study.

Firstly, there is a lack of a universally accepted framework in the field of SME cluster formation. It is believed that the conceptual framework developed in this research, i.e.

Figure 7.1 integrating the theories extracted from the main bodies of literature: institutionalisation, social embeddedness and sensemaking, can provide a useful tool for future research in this area. Rather than focusing on the ‘classical three’ elements (i.e. geographical concentration, relationship and mutual benefit) towards the understanding of cluster formation, the framework highlights the importance of individuals and the interactions between individuals and their institutional context. Individuals are highlighted as crucial to the formation process as they are the only resource or ‘workers’ who are able to integrate different elements and ‘make things happen’. The interaction between individuals and their institutional context helps to form the ‘entrepreneurial climate’, which then gives birth to a group of entrepreneurs, leading to different levels of entrepreneurial activity, and finally giving rise to the formation of a cluster.

The framework, generated from both the theoretical and empirical exploration, also reveals that cluster formation is a complex and staged growing process, which takes place within the dynamic and changing interrelations between the different elements. It is argued that when all these elements in the framework work simultaneously and cohesively, a cluster is more likely to be formed and to function effectively, reflecting what happened with the experience of three Chinese cases in this research.

Secondly, the methodological approach adopted in this research is believed to contribute not only to the effectiveness of this research but also has relevance for other research projects in similar fields. This thesis has argued throughout, that the understanding of cluster formation can be enhanced by an examination of the individual and their interaction within a certain institutional environment. Since the focus is on the individual, the research has relied on an ethnographic style approach supported by a social constructionist perspective, which offers a complementary

approach to extant and future studies of clusters. This approach is concerned with more than just understanding the ‘the behaviour of humans and their group from the point of view of those being studied’ (Bryman, 1988, p.46) by simply describing the institutional context. More importantly it is concerned with the relationship and interactions between different elements in the institutional context. The researcher would agree with Fletcher (2006, p.437), that the combination of ethnography and the social constructionist perspective helps to offer ‘a theory of knowledge about the becomingness of social reality’. Thus, to understand cluster formation, it is essential to recognise the importance of the individual and take into account the relationships between individuals and individuals, individuals and their actions and individuals and their institutional environment. This is crucial since individuals play the key roles at the point where shared meanings and collective actions are fostered and generated, which in turn shapes the way clusters are formed. Moreover, using multi-stage fieldwork and analysis in this research helps to enhance the depth and richness of the research material itself. This approach also allows the factors identified in the initial stage to be further explored and analysed in later stages, thus making a distinctive contribution in advancing understanding of different institutional factors and their relationship to cluster formation.

Thirdly, as clusters tend to be formed by small and medium sized enterprises, and most SMEs are family firms, thus doing business in clusters or in the form of a cluster might be a way for them to grow and develop sustainably. Based on the discussion and findings of this study, the process of cluster formation is a reflection of the processes associated with establishing, maintaining, fostering and extending relationships between individuals. It is through these relationships that shared meanings and understandings can be formed. Trust, cultivated through individuals’

interwoven and overlapping personal relationships (e.g. families, relatives, friends) and business relationships (e.g. business partners, suppliers, subcontractors), appears extremely important in facilitating trade or cooperative activities. When the cooperative activities take place on the basis of mutual trust, the individuals involved (including their families) are thought to be 'in the same boat', and thus term themselves as 'one big family', enabling them to work closely. In the Chinese context, it might be more appropriate to understand the cluster formation as the result and also as the pre-condition of a series of cooperative activities of a group of family firms run by a large number of relationship-oriented entrepreneurs. It is therefore believed that this research can also offer a substantial and original contribution to future cross-disciplinary research in clustering, entrepreneurship and family firms.

### ***- Implications***

It is expected that this research and the framework established can make a significant contribution to existing knowledge of cluster creation and has significant implications for different parties in different ways. Evaluating why clusters come into being, i.e. how individuals relate, communicate, and cooperate with each other in the same location, helps to provide a greater level of understanding of the context and processes associated with cluster formation.

- *Implications for policy makers*

For policy makers, this research suggests that it is better not to pour in financial investment in a rush and concentrate on one or a few key elements or strands only when deciding to build up a cluster. It is more effective to focus attention and support



to existing groups that have the potential to form a cluster. This can be achieved through a step by step approach. The first step is to investigate, identify, analyse and select those (e.g. emerging networks) with potential to form clusters. The second step is to mobilise the potential participants, build new relationships and enhance existing ones, then to design the necessary policies and make appropriate interventions, and finally to evaluate and adjust the policies and interventions based on reflections from the implementation process.

It is also recommended that policy makers provide resources and support according to the development stage of clusters. The findings from the case studies on which this research was based, reveals that clusters formed in spontaneous or organic ways tend to develop more successfully and are more likely to be sustainable. In the initial stages of cluster development, it is suggested that policy makers provide more constructive resources but intervene less, in order to help clusters to form and grow. However, when clusters develop into later stages ('established' or 'mature'), policy makers should consider the extent and balance of support and intervention they can offer if clusters lack the dynamism to develop on their own. As cluster development is an ongoing process policies designed and delivered by policy makers should also evolve accordingly.

Moreover, it is expected that this research will aid the understanding of Chinese entrepreneurship, and help to justify the hidden clues beneath cluster formation related to individuals (entrepreneurs), entrepreneurship, and their social interactions. This can help policy makers or service providers to better understand the aspirations and needs of the entrepreneurs and their firms, to develop and implement more effective policies and efficient service delivery programmes, and consequently to

foster and promote cluster formation through a spontaneous path rather than an artificial one.

- *Implications for entrepreneurs*

For entrepreneurs, this research helps to improve their understanding of the stages and processes involved in their business start up, reveals how their businesses operate and are sustained and shows the formation of ‘unintended’ clusters which they form ‘unconsciously’. The important outcome is that the entrepreneurs may view these not only from their own viewpoint, but from a wider set of perspectives associated with business generation and cluster formation. The most important contributions and implications are for those seeking to become business owners, the potential entrepreneurs: first, instead of seeking to join an existing cluster on the assumption that this would potentially gain more benefit than one targeting a specific field or sector, it might be more reliable to look for opportunities and benefits from their local resources. This may prove potentially more effective and suitable to develop their business in from a long term perspective. Secondly, entrepreneurship resources (for example, sources of finance) are not simply available ‘out there’ waiting to be accessed by the entrepreneur as required. The reality is that this is what the entrepreneurs themselves should be seeking, managing and resolving as key activities and responsibilities in the entrepreneurial process. They need to appreciate that these resources are not ready-made solutions prepared for them by others, but rather resources they must specify, seek, manage and sustain as part of their core roles and responsibilities as entrepreneurs.

#### **7.4 Limitations of the research**

In this section, it is pertinent to discuss some limitations of this study, offering some recommendations and appropriate improvements for further research. Adopting interviews as a data collection method means that a considerable amount of time, finance and effort needs to be devoted to the research process. However, due to the limited timescale of a PhD study, it was difficult for the researcher to re-interview all of the informants on a frequent basis, especially since this study was transnational, and was subject to financial constraints. If time and budget had allowed, an in-depth longitudinal study at regular intervals could have been conducted to generate richer data, findings and insights to understand cluster formation in the Chinese context. Such longitudinal research might also highlight the evolutionary process of a cluster, challenges to continuity, changing membership, survival and whether and why other clusters may ‘spin off’ the original cluster.

Moreover, the multi-stage data collection method also brought its own problems in dealing with data which was collected at different stages. It created difficulties for the researcher to identify, collate, organise and utilise the existing and emerging information in the research process. Faced with this massive amount of interrelated and interwoven information, the biggest challenge for the researcher was how to present them properly in the thesis. As mentioned in the Methodology chapter (section 4.5.3), the majority of the informants had never heard of the term ‘cluster’. Thus to avoid misleading them and any possible misunderstanding, the word ‘cluster’ was not used in the interviews. The dialogues with the informants mainly concentrated on the entrepreneurial process and their experience of it. Although this approach helped to offer sufficient openness and facilitate the data collection process, this also increased the difficulty for the researcher to manage and link the data to the theme of cluster

formation. In order to keep the integrity and validity of the data, the researcher chose to go through all the transcripts line by line instead of using the software NVivo. There are no short-cuts for a researcher to take if he or she really wants to undertake rigorous research and intimate understanding of the data.

In addition, this research only covered a very limited geographical area and focused on three different cases mainly in Zhejiang Province, mainland China. The findings of this study might be challenged due to the limits of focusing on one particular regional context. However, bearing the afore-mentioned constraints in mind, this can be justified as the best way of gaining detailed information for a PhD project. According to the nature of the research, this thesis is mainly concerned with the process of cluster formation on a more conceptual level. It is still believed that the findings of this research can contribute to expand the knowledge of cluster studies, for example, the concepts/models are applicable to similar situations and can be tested on the development of other clusters (See Denzin and Lincoln, 1994; Strauss and Corbin 1998), and at the same time to bring some inspiration, suggest some lessons and offer some comparative experiences for other clusters in similar or relevant contexts.

## **7.5 Future research**

This research on cluster formation in China has provided a platform for future exploration, especially around the relationship between individuals and the cluster development process. Given that the main focus of this research is on cluster formation in its initial stages, the conceptual framework built up in this thesis may be further adapted and developed to explain other types of cluster, patterns or stages in cluster development, or how the cluster transforms to meet changing demands,

membership and leadership. Comparative studies can also be undertaken to compare the experience of clusters elsewhere in China, or extending this to a more international level, seeking the potential to generate valuable lessons for cluster studies in a broader or more generic sense. It is suggested that the established conceptual framework and the empirical findings of this research can help to bridge the gaps in extant cluster research and pave the way forward for future research.

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