Economic Transition And Business Risks
In Chinese Private Firms: Disentangling Organizational And Project Risks
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ABSTRACT

To the extent that firm decisions are made under uncertainty, all firms need to deal with risk. The concept of risk is relatively unexplored in transitional economies. This study attempts to examine risk issues in Chinese private firms during different phases of economic transition. I distinguish between organizational and project level risks and argue that China’s economic transition affects the two levels of risk in different ways. I investigate private firms’ risk behavior based on the specific risk they face. My central argument is that firm risk needs to be examined beyond a unidimensional perspective and firms’ risk behavior may vary, depending on the risk they deal with. This study takes a step toward understanding the relationship between private property and risk taking in China’s transitional economy, a question raised by Phan, Zhou, and Abrahamson (2010) recently.

Keywords: Economic transition; Organizational risk; Project risk; Private firms; Risk behavior

INTRODUCTION

China is the world’s largest transitional economy. Private business has been one main force driving its economic growth since 1980s. Historically, private firms operated in an unfavorable institutional environment: inadequate protection of property rights and hostile regulatory attitude toward private business. To survive, they had little choice but to take risk (Tan, 1996). After more than two decades of economic transition, China’s regulatory regime has become more favorable to private business (IFC, 2000; Tan, 2005). Laws and regulations have been established to protect property rights. China’s entry into WTO in 2002 has strengthened its obligation of respecting private ownership. As a result, the private sector has seen a fast growth in recent years (He, 2009).

Given that the regulatory regime has substantially improved for private business, we may ask: do private firms display different risk behavior? No research has directly addressed this question. In their recent comments on how the economic transition in China might provide opportunities for examining “creativity, innovation, and entrepreneurship”, Phan and colleagues (2010) raised a similar question: with China’s recognition of property rights, what is the relationship between private property and risk taking? This study attempts to fill the gap by investigating risk and risk behavior in private firms in a new era when China’s economy becomes more market-based.

China’s economic transition has presented two opposing forces: the “iron fist” control and the “invisible hand” control which “co-exist, compete, and counteract” (Tan, 2005). Clearly, when the economic transition was in the early phase, the “iron fist” control dominated. However, the struggle between the two forces has finally led to a more market-based, the “invisible hand” control model, though “uniquely Chinese” (Tan, 2005), because of undisputed inefficiency of the “iron fist” control. Based on the relative strength of the two opposing forces in China’s economic transition, I distinguish between the early phase which saw the relatively stronger “iron fist” (regulatory forces) and the competitive phase characterized by the relatively stronger “invisible hand” (market forces). I address risk issues in private firms by comparing the two phases of economic transition.
Risk behavior has been studied extensively in the West. One problem in existing risk research is inconsistent definitions of risk and risk behavior (March and Shapira, 1987; Palmer and Wiseman, 1999), leading to inconsistent arguments and empirical results. In this study, I use a multi-dimensional perspective to address risk issues in Chinese private firms. I distinguish between organizational and project risks and argue that private firms deal with the two levels of risk in different ways. In a transitional economy where business activities are governed by opposing forces (the “iron fist” and the “invisible hand”), a one-dimensional approach to the study of risk may not capture the difference between the two forces. Figure 1 depicts the research model.

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

In China, a private firm is defined as “a for-profit organization that is owned by individuals and employs more than eight people” (IFC, 2000). I follow the definition. In the entrepreneurship literature, owner-managers are often referred to as entrepreneurs, so I use “owner-managers” and “entrepreneurs” interchangeably in this study.

TWO PHASES OF ECONOMIC TRANSITION

As a transitional economy, China shares the following basic features: low-income, rapid growth, underdeveloped legal systems, inadequate protection of private property rights, and market imperfections (Hoskisson et al, 2000). During the early phase of economic transition, all these features were salient. SOEs dominated the whole economy. Their inefficiency, along with the inefficiency of the centrally planned system, created serious market shortages, information and resource asymmetries (Peng, 2001), and “institutional holes” (Yang, 2004). Private firms were presented with both opportunities and challenges. On the one hand, they could take advantage of the inefficiencies of both SOEs and the planned system and exploit numerous market niches through connecting different markets and answering market deficiencies (Tan, 2001). On the other hand, they had to deal with adverse situations brought about by the regulatory regime, including political threats and restricted access to resources. These opportunities and challenges led private firms to display the followings behaviors: using guanxi (relationship or network) or a “red hat” (a strategy used to disguise private ownership by registering as a collectively-owned enterprise) as a substitute for formal institutional support (Xin and Pearce, 1996), pursuing short-term profitability and reluctant to make long-term investments (Nee, 1992), and acting proactively to identify and occupy market niches (Peng, 2001).
China’s economy has now become more market-oriented. Accompanying the establishment of market-based rules is intensified competition. Private firms not only compete against each other, but also confront more powerful competitors: domestic SOEs and foreign firms. SOEs have gradually been weaned from their dependence upon state budget allocations during the economic transition. With a separation from the government and clarified rights and responsibilities, SOEs have greatly transformed themselves. Endowed with abundant resources and oriented toward the market, they are now globally competitive (Ralston et al, 2006). Foreign firms have rushed to China in response to the “opening-up to the outside world” policy and preferential treatments. Because of its consistency in implementing the policy and its huge internal market, China has now become the largest foreign direct investment recipient (Chang and Xu, 2008) and the most appealing host for investments (UNCTAD, 2009) in the world. As Stuttard (2000) commented, “everyone is here” in China – Americans, Europeans, Japanese, others – “whether it be automotive, consumer products, electricity generation, electronics, or new technology.” Foreign firms are often equipped with advanced technology, know-how, and management and marketing experience, as well as plentiful financial resources (Ralston et al, 2006).

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

Who run private firms in China? He’s survey reports (2009) show that private business owners come from five social groups: individual household business owners, industrial workers, peasants, former cadres, and professionals. I regroup these individuals into three broad categories: blue-collars, former cadres, and professionals. The blue-collar group, including farmers and industrial workers, represents private entrepreneurs from a lower social class. Many of them lived in poor rural areas or lost their job from poorly-run SOEs before starting their own business. Blue-collar owner-managers are close to craftsman entrepreneurs described by Smith and Miner (1983). They are characterized by “narrowness in education and training”, “low social awareness” and “a limited time orientation”. Former cadres were government officials or SOE managers. They gained social and political capital and owned business networks during their employment. They have advantages in accessing information and mobilizing resources. Professionals, often well-educated, largely use their own specialized skills and knowledge to develop new products or services and fill unserved markets.

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

Ownership and control can be aligned or separated. Survey reports (ADB, 2003; IFC, 2000) indicate that most private firms in China are managed by owners, suggesting an alignment between ownership and control. In addition, ownership concentration is often high. The major decision makers tend to be owner-managers. Schlevogt (2001) used “dictatorship by the owner-manager” to describe power centralization in Chinese private firms. However, there is a small percentage of private firms whose board of directors has begun to exercise influence.

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

Risk is an important concept in organizations (Miller and Leiblein, 1996; Sitkin and Pablo, 1992). Risk taking has important implications for firm survival and growth (Shapira, 1995). In decision making theory, risk is often defined as “variation in the distribution of outcomes, their likelihoods, and their subjective values” (March and Shapira, 1987), indicating that risk includes both upside and downside outcomes. Scholars have questioned the application of the risk definition in the field of business (Miller and Leiblein, 1996). Empirical studies suggest that negative outcomes are much more relevant to practicing managers than outcomes variability (Baird and Thomas, 1990; March and Shapira, 1987). Therefore, risk in the business context is more likely to be viewed as likelihood of loss and magnitude of loss (March and Shapira, 1987; Mullins and Forlani, 2005). Uncertainty is a main feature of risk (Sitkin and Pablo, 1992).

Table 1
Economic Transition and Private Firms

<table>
<thead>
<tr>
<th>Economic Transition</th>
<th>The Early Phase</th>
<th>The Competitive Phase</th>
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<td><strong>Business Environment</strong></td>
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<td><strong>Implications</strong></td>
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<td>Private property protection: Low</td>
<td>Private property protection: Increasing</td>
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<td>Opportunity: Many market niches</td>
<td>Opportunity: Fewer market niches</td>
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<td>Threat: Regulatory</td>
<td>Threat: Competition</td>
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| **Private Firms** |        |        |
| Owner-Managers    |        |        |
| Blue collars: High | Blue collars: Decreasing |
| Former cadres: Medium | Former cadres: Decreasing |
| Professionals: Low | Professionals: Increasing |
| **Ownership Forms** |        |        |
| Proprietorship: High | Proprietorship: Decreasing |
| Partnership: Low | Partnership: Low |
| Limited liability: Low | Limited liability: Increasing |
| **Business Control** |        |        |
| “Red hat”          |        |        |
| Owner-manager: High | Owner-manager: High, but decreasing |
| Board of directors: Low | Board of directors: Low, but increasing |

Risk behavior is the way how individuals deal with risk. Typical risk behavior includes risk taking and risk averse. In the business field, scholars have employed different theoretical perspectives, including agency theory (Wright et al, 1996; Wright et al, 2007), behavioral decision theory (Greve, 2003; Singh, 1986; Sitkin and Pablo, 1992), and psychological bias theory (Li and Tang, 2010), to examine factors influencing firm risk behavior. It has been found that risk behavior can be affected by a variety of factors at different levels, including the environmental level (Palmer and Wiseman, 1999), the organizational level (Rajgopal and Shevlin, 2002; Singh, 1986; Wright et al, 2007), and the individual level (Li and Tang, 2010; Sitkin and Weingart, 1998). However, the empirical results have been inconsistent.

There are at least two reasons for the inconsistent results in risk research. First, the meaning of risk and risk behavior has always been fraught with confusion (Palmer and Wiseman, 1999). For example, scholars have defined risk as outcome variations or downside outcomes (Miller and Leiblein, 1996); organizational risk has been used as a proxy for managerial risk taking (Fiegenbaum and Thomas, 1988); R&D investment has been used to measure both firm risk taking and managerial risk taking (Li and Tang, 2010; Palmer and Wiseman, 1999). Because of inconsistent definitions in risk research, comparisons between studies become difficult. Second, risk tends to be treated as a one-dimensional concept. However, risk is multidimensional (Gomez-Mejia et al, 2007; Palmer and Wiseman, 1999), so risk behavior needs to be addressed in a multidimensional way. Based on study by Gomez-Mejia and colleagues (2007), I distinguish between organizational and project risks. Firms take or avoid risks at both organizational and project levels.
Risk and Risk Behavior at Organizational and Project Levels

Organizational risk has been defined as “income stream uncertainty (Palmer and Wiseman, 1999) or “performance hazard” (Gomez-Mejia et al, 2007). Performance hazard is reflected in two ways: organizational failure and below-target performance. The target for comparison can be the firm’s own performance in the past or other firms’ performance in the same industry. At the project level, risk is about outcome uncertainty of investment projects such as innovation (Li and Tang, 2010; Palmer & Wiseman, 1999; Sanders and Hambrick, 2007), acquisitions (Sanders and Hambrick, 2007), and diversification (Palmer and Wiseman, 1999). In this study, I view risk as downside outcomes at both organizational and project levels.

Risk taking at the organizational level is firms’ willingness to accept possible organizational failure or below-target performance (Gomez-Mejia et al, 2007). At the project level, risk taking is committing resources toward activities with a likelihood of loss. A firm may display different risk behaviors at the organizational and project levels. Gomez-Mejia and colleagues (2007) found that family firms were willing to accept potential organizational failure and below-target performance in order to retain family control, but they were conservative in choosing risky investment projects at the same time. Most studies have addressed firm risk behavior at the project level, that is, a decision to invest in risky projects. The reason may be that firms are profit-making, so it does not seem reasonable that they are willing to accept organizational risk in the long run, except for very unusual circumstances such as threatening family control (Gomez-Mejia et al, 2007). However, some firms do take risk, consciously or unconsciously, at the organizational level. Examples include emphasizing the present and failing to invest for the future. These firms risk their future performance. Dickson and Giglierano (1986) used “missing the boat” to describe this situation.

Cultural Impact on Risk Behavior

China is classified as a collectivist society whose culture is likely to have negative impact on risk taking from “lay predictions” (Hsee and Weber, 1999), but cross-cultural studies do not seem to support lay predictions. Some studies suggest that Chinese people can be more risk taking than people in other countries (Brumagim and Wu, 2005; Weber and Hsee, 1998). Other studies indicate that Chinese people’s risk behavior depends on situations (Hsee and Weber, 1999; Kachelmeier and Shahata, 1992). In this study, I assume that the collectivist culture does not have significant impact on owner-managers’ risk decisions.

ECONOMIC TRANSITION, RISK, AND RISK BEHAVIOR

The “iron fist” and the “invisible hand” forces guide business activities in different ways, thus having different implications for business risks. In this section, I examine risk and risk behavior in Chinese private firms by comparing the two phases of economic transition.

Risk at Organizational Level

In the early phase of economic transition, most private firms in China were started by individuals from lower social classes such as farmers and industrial workers (He, 2009). The former planned economy left numerous unfilled market niches yet to be exploited. Those who were bold enough ventured into an uncertain world with a hope of “earning money” or “getting rich”. Prospects for making money also attracted cadres such as government officials and SOE managers. A few of them were motivated to quit their job and “pulled” into the uncertain but exciting private sector. With privileges in accessing information and mobilizing resources, former cadres were in a good position to exploit arbitrage opportunities generated by the old economic system. Compared with the blue-collar and cadre groups, the group of professional entrepreneurs was relatively small in the early phase.

Though the early phase of economic transition provided numerous profitable opportunities, it was not risk free to run a private business. As a matter of fact, it was very risky because of the unfavorable regulatory regime. Threats such as expropriation and extortion by governmental officials were enormous (Xin and Pearce, 1996). In order to reduce political threats and keep their private business safe, many owner-managers chose to cover up the private nature of their firms by putting on a “red hat”. At the same time, they hid their revenue (Che and Qian,
1998), pursued short-term returns, and were uninterested in long-term development (Nee, 1992). All these behaviors suggest that private firms bore high organizational risk in the form of possible expropriation, implying organizational failure, in the early phase of economic transition. In the competitive phase, however, this type of risk is relatively small due to improved regulatory attitudes toward private business and specified property rights.

Organizational risk can also be manifested by below-target performance. However, this type of risk is much smaller than the risk of possible organizational failure which is “the worst case scenario” (Gomez-Mejia et al, 2007). Given the dominant impact of the regulatory regime in the early phase of economic transition, most private firms faced the likelihood of possible organizational failure. In the competitive phase, fierce competition may also lead private firms to perceive a possibility of organizational failure, but this perception is likely to be less salient than that in the early phase when regulatory threats were constant. Thus, I propose the following:

**Proposition 1:** Private firms bear less risk at the organizational level in the competitive phase than in the early phase of economic transition.

**Risk at Project Level**

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

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

In summary, private firms are facing different situations in the new era: fewer opportunities, fierce competition, and less effective competitive strategies. These situations would make any investment projects, whether they are new technologies, products, or business expansion, highly uncertain in terms of economic returns. In contrast, private firms competing in the early phase would perceive less uncertainty about their investment projects in generating profits due to market shortages, unsophisticated customer needs, and inefficient competitors (SOEs).

**Proposition 2:** Private firms bear more risk at the project level in the competitive phase than in the early phase of economic transition.

**Risk Behavior at Organizational Level**

As China’s economic transition reaches the competitive phase, ownership rights have become more recognized. Ownership makes it possible for owner-managers to control their business. The relationship between ownership and control has been extensively studied, particularly from an agency perspective (Fama and Jensen, 1983). Scholars have emphasized the role of ownership and control alignment in innovation (Francis and Smith, 1995; Wright et al, 2000), but Chandler (1990) advocated professional management of the firm governed by a board of directors.

Survey reports (ADB, 2003; IFC, 2000) suggest that owner-managers in most Chinese private firms are not willing to cede control over their business. Decision making is highly centralized (Schlevogt, 2001). One benefit of
tight control is efficiency. According to Carney and Gedajlovic (2002), Chinese family-controlled firms employ a model of “parsimony”. They make every effort to improve their operational processes and reduce costs: deploying capital sparingly, cutting indirect costs, and minimizing third party monitoring. However, centralization may lead to flawed decision making. For example, owner-managers as decision-makers are not likely to use internal and external monitoring. Opportunistic investments can be made on the basis of “animal spirits” or “gut feel” and “without regard to internal and external processes of accountability” (Carney, 2005).

In a competitive phase of economic transition, firms’ internal resources and capabilities would be more important than external relationships and networks (Peng, 2003). Tight control by owner-managers may have negative impact on the development of resources and capabilities. Because any formalized human resource management practices may weaken their business control, owner-managers are likely to hire employees on the basis of nepotism and select top executives because of family ties, instead of professional expertise (Carney, 2005). In addition, they are often unwilling to disclose financial information. Lack of transparency, a common problem in Chinese private firms (ADB 2003; IFC, 2000), would make it hard to obtain external financing for capability development. Meager financial resources and limited managerial capacity have constrained growth of many private firms, though examples exist of successful large private firms tightly controlled by owners.

It seems that owner-managers’ high desire to control their business has negative implications for firm performance. Their efficiency advantage would diminish as firm size increases because of constraints in managerial capacity (Carney, 2005). They could choose to share control with others in order to adapt to the competitive environment in a better way. For example, an increasing number of Chinese private firms have adopted a limited liability form of ownership in recent years (He, 2009). In a limited liability company, ownership is spread, a board of directors installed, and management practices more formalized. Cooke (2008) studied 30 top performing Chinese private firms and found that successful family-owned firms have moved away from family control to professional management. If owner-managers are unwilling to cede control over their business, they are likely to accept suboptimal performance. They may tolerate possible low performance relative to their past or their competitors. Study by Gomez-Mejia and colleagues (2007) show that family firms were willing to accept greater performance hazard in order to keep family control.

Proposition 3: In the competitive phase of economic transition, private firms whose owner-managers have high desire for business control are more likely to accept organizational risk in the form of below-target performance than those whose owner-managers have low desire for business control.

Risk Behavior at Project Level

Owner-managers of private firms in China are from three groups of individuals: blue-collars, former cadres, and professionals. Among the three groups, the blue-collars could be in the most disadvantageous position in the competitive phase. They were able to exploit shortages in most markets previously due to their courage, not necessarily their competitive skills. In the competitive phase, however, skills are becoming important. Because of their limited education and short-term orientation, blue-collars tend to be “rigid in nature” (Smith and Miner, 1983). As a result, they are less likely to develop competitive skills for the new era. He’s survey reports (2009) show that the proportion of blue-collar entrepreneurs has already decreased recently. Cadre entrepreneurs succeeded because they were able to exploit arbitrage opportunities during the early phase. Equipped with social and political capital, they are likely to be more adaptive than blue-collars during the economic transition. They compete on relational and informational advantages. This “dominant logic” (Prahalad and Bettis, 1986) may hardly change. Based on He’s survey reports (2009), the number of cadre entrepreneurs would decline as marketization continues.

Compared with blue-collars and former cadres, professionals are more likely to have the right skills to deal with competition. Their strengths are less based on exploiting failures of the old economic system, but more on their professional knowledge and skills in developing new technologies, products, or markets. The current environment in China also seems to favor professional entrepreneurs. For example, the Chinese government has established large incubation programs (Lalkaka, 2002) and science and technology parks (Watkins-Mathys and Foster, 2006) to facilitate technology entrepreneurship and innovation. Clearly, professionals would benefit more from those programs than non-professionals.
China’s economic transition seems to pose more challenges to non-professional entrepreneurs because of their less effective skills. Skills contribute to perceived control over behavioral activities. Low perceived control is less likely to initiate a behavior (Aijen, 1991). Scholars in the field of entrepreneurship have similar arguments. According to McClelland (1961), entrepreneurs do not take risk deliberately. Instead, they pursue initiatives that are achievable and controllable, using their own skills to realize a profit (Cunningham and Lischero, 1991). Entrepreneurs (owner-managers) represent their firms to make decisions. It is reasonable to argue that entrepreneurs’ behavior does not deviate from their firms’ behavior. Thus, I make the following proposition:

**Proposition 4:** Private firms whose owner-managers are non-professionals are less risk taking at the project level in the competitive phase than in the early phase of economic transition

**DISCUSSION**

China’s economic transition has led to fast growth of the private sector. Private firms bear risks due to environmental uncertainties. This study attempts to examine risk issues in Chinese private firms during different phases of economic transition. I distinguish between organizational and project level risks and argue that China’s economic transition affects the two levels of risk in different ways. The early phase brought more risk to the organizational level due to regulatory threats, while the competitive phase might create more risk at the project level. Risk behavior is related to specific risks private firms deal with. The propositions in this study provide implications for the relationship between private property and risk behavior, a question raised by Phan and colleagues (2010). When property rights are poorly specified, risk may be salient at the organizational level. Concerns about property expropriation tend to be great. When property rights are gaining legal recognition and protection in a more market-based economy, risk may become salient at the project level. The nature and amount of risk private firms bear would affect the way they deal with it.

This study takes a step toward an understanding of risk issues in Chinese private firms in a context of economic transition. A main theoretical contribution is that it examines the concept of risk in firms from a two-level perspective. Extant risk research has largely focused on the project level, but risk is a multi-dimensional concept. Project level risk may not fully explain organizational risk (Palmer and Wiseman, 1999) and firms may be risk taking at one level and risk averse at the other (Gomez-Mejia et al, 2007). China’s economic transition presents a complex business environment in which business activities are governed by both the “iron fist” and the “invisible hand” forces. It is likely that the two forces create different uncertainties, thus conveying different risk implications for private firms. A one-dimensional approach to the study of risk may overlook the difference of the two forces.

There would be ample opportunities for researching the multi-dimensional nature of risk in organizations. In this study, I address business risks at the organizational and project levels. To the best of my knowledge, there are only two studies examining risks explicitly at these two levels (Gomez-Mejia et al, 2007; Palmer and Wiseman, 1999), but some studies have already implied the two levels of risk. For example, Dickson and Giglierano (1986) used a nautical analogy to describe two types of entrepreneurial risk: sinking the boat and missing the boat. The former, acting too quickly on an opportunity yet to be justified, is a project level risk, often leading to a high rate of new product failures. The latter, “missing out on a strategic opportunity”, is close to organizational risk because future opportunities affect firm long-term survival. The missing-the-boat risk has been overlooked because it is a “non-action” risk, which is difficult to assess (Palmer and Wiseman, 1999). Future research attention may be directed toward how non-action might cause organizational risk.

Risk research in a context of transitional economies has been limited. To date, very few studies have been conducted on private firms’ risk behavior when they face a more market-based environment. The propositions developed in this study are subject to empirical test. I use two phases of economic transition as a research context. Empirically, it can be challenging to identify the point in time when the economy moves from the early phase to the competitive phase. Two studies provide implications for exploring the transitioning point. According to Peng (2003), when an economy is in the early stage of transition, relationship-based and personalized exchange has relative advantages; when the economy becomes more market-oriented, rule-based and impersonal exchange works better. To determine the transitioning point, researchers may ask private firms which type of exchange they would prefer. Tan (2005) propose three important transitioning points in the history of China’s economic transition: the
start of economic reform (1978), the Tiananmen Square event (1990), and China’s entry into WTO (2002). His empirical study suggests that though China’s marketization has been progressing since 1978, its entry into WTO could be a turning point toward a more market-based control of its economy.

CONCLUSION

To the extent that firm decisions are made under uncertainty, risk is unavoidable in business. As the largest and fastest growing transitional economy in the world, China provides a research context in which almost all entrepreneurial activities, often involving risk, can be studied as “natural experiments” (Phan et al, 2010). In this study, I attempt to explore risk and risk behavior in private firms by comparing two different phases of economic transition. My central argument is that firm risk in the context of economic transition needs to be examined beyond a unidimensional perspective and firms’ risk behavior may vary, depending on the specific risk they deal with.

AUTHOR INFORMATION

Chuanyin Xie obtained his Ph.D. in Strategic Management from the University of North Carolina at Chapel Hill. He is currently an assistant professor at the University of Tampa. His research interests are in risk behavior, entrepreneurial behavior, and innovation, particularly in transitional economies.

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