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Family Business Governance Evolution during Intergenerational Succession

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Abstract:
Intergenerational succession stands as one of the most complex and defining junctures in the life cycle of family enterprises. It is during this phase that the firm's governance structure, management philosophy, and cultural underpinnings undergo rigorous testing and strategic transformation. As control shifts from the founder to the successor generation, family firms must evolve from relationship-oriented, centralized models of governance toward more institutionalized, professional systems capable of balancing family values with business efficiency. By drawing on socioemotional wealth (SEW) theory, institutional theory, and agency theory, this study develops a multi-dimensional analytical framework to examine the evolutionary trajectory of governance during intergenerational succession. It focuses on the interaction between emotional attachment and rational management, exploring how family cohesion, successor capability, and external pressures collectively delineate governance outcomes. Using China's Midea Group as the primary case and Fotile Group as a comparative reference, this paper identifies three dominant governance pathways of family firms during intergenerational succession—progressive hybridization, transformative professionalization, and conservative family reinforcement. These findings underscore that sustainable intergenerational transition necessitates the harmonization of socioemotional wealth with institutional adaptation.

Keywords: Family Business Governance, Intergenerational Succession, Socioemotional Wealth (SEW), Governance Transformation, Chinese Family Firms

1. Introduction

Family businesses serve as the backbone of the Chinese private sector, accounting for over 80% of all private enterprises and making substantial contributions to employment generation, technological innovation, and regional economic development [1]. However, empirical evidence suggests that fewer than one-third of these enterprises survive the ownership and management transfer from the founder to the second generation [2]. The failure of succession is often rooted not in strategy or finance, but in governance fragility—centralized authority, informal decision-making, and an absence of institutional continuity [3]. Existing literature on family business succession primarily focuses on outcomes—namely success or failure—rather than the evolutionary process of governance systems [4]. In emerging markets like China, where informal institutions and personal networks exert a significant influence, the transformation from family-based to professionalized governance is both culturally sensitive and structurally complex [5].

The goal of this paper is to explain how family governance evolves through different phases of succession. Specifically, it seeks to address:

(Q1) How does governance evolve as control transitions across generations?

(Q2) What internal (family-centric) and external (institutional) factors propel this evolution?

(Q3) Which governance pathways ensure sustainable succession while preserving family identity?

This study adopts three theoretical perspectives to construct the analytical foundation for the governance evolution of family firms. First, Socioemotional Wealth (SEW) theory elucidates how the emotional needs of family members impose constraints on governance decisions. Second, Institutional theory examines how external pressures—including regulatory requirements and market expectations—catalyze governance transformation. Finally, Agency theory reveals the incentive conflicts that emerge during the intergenerational transfer of power. By combining multiple theoretical perspectives and analyzing real-world cases, this paper deepens understanding of how Chinese family firms navigate the tension between emotional heritage and institutional reform.

2. Literature Review

2.1 Socioemotional Wealth (SEW) and Family Governance

SEW denotes the non-financial value that family members derive from their firms, including family control, reputation, and legacy continuity [2][6]. This perspective elucidates why family owners frequently prioritize emotional objectives over short-term profit maximization.

Research indicates that SEW preservation influences governance choices across generations. When founders step back, successors must navigate the delicate balance between maintaining family control and introducing professional structures. High SEW orientation leads to resistance to external managers and a preference for insider governance. Conversely, a pragmatic orientation allows hybrid models that blend family oversight with professional expertise [6].

2.2 Comparison Between Chinese and Western Family Business Governance

A comparative lens reveals notable differences in the governance evolution of Chinese and Western family businesses, particularly in terms of professionalization, socioemotional wealth preservation, and institutional influence.

Western Family Enterprises: Early Professionalization and Lower SEW Retention

Western family enterprises—particularly those in Europe and North America—tend to attain professionalization at an earlier stage. Many adopt formal ownership structures such as dual-class share systems, family trusts, or supervisory boards, that effectively segregate ownership from management. As a result, the degree of SEW retention is relatively lower, since control is more often shared with external managers, institutional investors, or independent directors. In these firms, rational governance, transparency, and legal contracts often take precedence over emotional bonds or familial authority.

Chinese Family Enterprises: Strong SEW Influence, Gradual Institutionalization

In contrast, Chinese family businesses are profoundly shaped by Confucian values, including filial piety, hierarchy, and family loyalty. This cultural foundation strengthens socioemotional wealth preservation and reinforces family dominance in strategic decision-making, especially during generational transitions. However, in recent years, institutional pressures—such as the revision of the Company Law, the tightening of capital market regulations, mandatory ESG disclosure requirements, and intensified global market competition—have accelerated governance transformation. Consequently, Chinese family firms are transitioning away from relationship-centric governance toward more standardized, institutionalized governance models—all while still attempting to retain core family values.

2.3 Institutional and Agency Perspectives

Institutional theory underscores the importance of external norms, regulatory frameworks, and market pressures in shaping governance systems [8]. As China's corporate

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governance standards have advanced, family firms confront heightened expectations regarding transparency, accountability, and compliance. Institutional isomorphism—the tendency to mimic legitimate peers—encourages family firms to adopt practices like independent boards and standardized reporting [9].

Agency theory complements this institutional perspective by centering on incentive alignment between owners and managers. In family firms, agency conflicts manifest themselves not only between family shareholders and managers but also among family members. Successors lacking legitimacy are prone to encountering distrust, which in turn gives rise to inefficiencies in monitoring mechanisms [10]. Governance evolution thus requires designing mechanisms that maintain trust while ensuring accountability.

2.4 Integrative Perspective

While prior research tends to treat these theories in isolation, this paper adopts an integrative perspective. It posits that governance evolution in family firms is co-determined by emotional forces and institutional pressures, with agency mechanisms acting as a mediator. Emotional attachment drives continuity; institutional reform ensures efficiency. The balance of these logics determines the trajectory of governance transformation.

3. Governance Evolution in Practice: Evidence from Midea Group and Fotile Group

Prior to conducting the detailed analysis, it is essential to clarify the logic and criteria underlying case selection. This study employs a typical case study approach. Selected enterprises must satisfy three criteria: (1) they are family-controlled enterprises; (2) they have experienced or are in the process of intergenerational succession; (3) their governance evolution pathways are representative and comparable. Based on these criteria, Midea Group and Fotile Group were chosen.

Midea Group exemplifies the model of *progressive hybrid governance*. The founder gradually transferred authority, brought in professional managers, and implemented modern corporate governance mechanisms. This renders Midea an ideal case for analyzing the process of “family authority delegation → professionalization and institutionalization”.

In contrast, Fotile Group embodies a *conservative family-reinforcement governance model*. Core control remains within the family, Confucian values and trust-based mechanisms inform decision-making, and governance reform is cautious rather than fully professionalized. This case illustrates the pathway of “family dominance → preservation of socioemotional wealth”.

The clear contrast between these two cases in terms of governance logic, power transition, and professionalization degree enhances the explanatory strength of this study.

3.1 Pre-Succession: Relationship-Based Governance

In the early stage of family business development, governance tends to be relationship-based. Founders rely on personal charisma, kinship trust, and informal decision-making. This model facilitates agility and loyalty but lacks scalability and resilience [4].

Midea Group, founded by He Xiangjian in 1968, embodied this centralized governance model. Major decisions—investment, recruitment, and diversification—were made directly by the founder. While this ensured coherence during rapid expansion, it also created dependence on one individual’s authority.

Fotile Group, established in 1996 by Mao Zhongqun, pursued a distinct path that emphasizes Confucian benevolence. Fotile’s governance stressed virtue, moral leadership, and long-term harmony. Employees were viewed as family members, and trust replaced formal contracts. Such culture built unity but reduced adaptability to market shifts.

3.2 During Succession: Hybrid Governance Formation

As founders aged, both Midea and Fotile confronted pressures to institutionalize their governance. Between 2009 and 2016, Midea launched governance reforms that introduced independent directors, professional managers, and strategic planning committees [9][10]. In 2009, Midea adopted the independent director system in compliance with the guidelines of the China Securities Regulatory Commission (CSRC) guidelines. Independent directors accounted for approximately 36% of the board members. Subsequent to this reform, the average decision-making time in board meetings decreased by approximately 20–25%, signifying a shift from trust-based family supervision to rule-based monitoring. Midea finalized its shareholding restructuring in 2012 and was officially listed on the Shenzhen Stock Exchange in 2013. After the listing, the proportion of institutional investors rose from approximately 8.7% to over 25%, whereas direct family ownership fell below 35%. This shift enhanced external supervision and mitigated tunneling risks that are typical of highly family-controlled firms. Furthermore, subsequent to the implementation of a comprehensive performance management system and equity incentive plan in 2015, Midea witnessed a significant improvement in human resource stability and operational efficiency. The employee turnover rate fell from approximately 18% in 2014 to around 12% by 2017, and the attrition of core technical staff and middle-to-senior managers decreased significantly. At the same time, per capita productivity rose by nearly 15%, and the alignment between performance evaluation and compensation improved organizational execution and strategic responsiveness. This shift illustrated Midea's transition from a "family-trust-based" management model to an "institution-driven incentive-based" governance system. The company's transition to public listing further accelerated the formalization of its governance. The family retained strategic control but withdrew from daily operations.

Fotile's transformation proceeded at a slower pace but was deliberate. The Mao family established a family council to segregate ownership from management. The firm commenced the introduction of performance-based management and engagement of external advisors, while integrating family values with professional logic(Table 1).

Table 1. Governance Differences Between Midea Group and Fotile Group During Intergenerational Succession

Dimension	Midea Group	Fotile Group
Founder's Governance Style	Strong leadership, and market-oriented, efficiency-focused decision-making.	Confucian culture, family-oriented governance, and emphasis on ethics and harmony.
Succession Approach	Institutionalized transition; the founder gradually withdrew from daily operations and transferred control to the next generation and professional managers.	Slow and conservative handover; decisions are often made through family meetings and consensus within the family.
Professional Manager System	Early adoption of professional managers; clear separation between ownership and management.	More cautious introduction of professionals; cultural and value alignment prioritized over managerial expertise.
Equity Structure Change	After listing, introduced institutional investors and adopted equity incentives for key managers.	Equity is highly concentrated within the family; the family maintains tight control over strategic decisions.
Governance Reform Mechanisms	Established independent board of directors, audit and strategy committees, ESG reporting, and internal control systems.	Formed Family Council, created a written family constitution, and maintained moral governance traditions.
SEW (Socioemotional Wealth) Retention	Moderate to low; more willing to sacrifice SEW for globalization, innovation, and capital efficiency.	High; strong emotional attachment to family legacy, reputation, and cultural continuity.
Outcomes and Challenges	Successfully achieved globalization and digital transformation, but faces risk of de-familyization and loss of identity.	Strong cohesion and stable culture, but slower innovation speed and lower capital efficiency compared to Midea.

3.3 Post-Succession: Institutionalized Governance

The long-term impacts of governance evolution in family businesses are evident not only in internal organizational dynamics but also in external market performance and customer satisfaction. As Midea and Fotile advanced toward more institutionalized governance systems, their sustainability and competitive advantage were significantly enhanced.

Post-succession, Midea established a highly institutionalized governance structure. He Jianfeng, the son of the founder, formally assumed leadership while delegating operational authority to a professional team. The firm implemented corporate governance reforms that are aligned with international standards, which include risk committees and ESG frameworks [11]. For Midea Group, the institutionalization of governance post-succession resulted in enhanced operational efficiency and improved strategic alignment. This transformation was reflected in the company's annualized stock return, which rose by 9.3% from 2013 to 2018, outperforming industry averages and demonstrating the financial success of its governance reforms. Furthermore, Midea's customer satisfaction index exhibited consistent improvement, with surveys indicating a 15% increase in customer loyalty and brand trust from

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2015 to 2019.

Fotile Group, while retaining more traditional governance structures, also witnessed positive impacts post-succession. The company's emphasis on socioemotional wealth retention enabled it to sustain strong customer relationships. Consequently, Fotile reported a 12% increase in customer satisfaction over the past five years, which reflects the firm's ability to retain its family values while competing effectively in the market. Despite its slower pace of professionalization, Fotile's commitment to high-quality products and cultivation of strong customer loyalty contributed to its long-term competitiveness.

In both companies, the shift toward more professional governance facilitated sustained growth, improved decision-making efficiency, and enhanced, and increased external investor confidence. These improvements, combined with an emphasis on customer-centric strategies, have positioned both firms for long-term success, while enhancing their market position and capacity to adapt to changing market conditions.

4. Internal and External Drivers of Governance Evolution and Governance Pathways

4.1 Internal Drivers

1. Family cohesion and culture. Shared values foster unity and long-term commitment. In Midea and Fotile, family culture served as both a governance mechanism and a symbolic resource [6].

2. Ownership concentration. High ownership concentration stabilizes decision-making but constrains accountability [9]. A balanced equity distribution can enhance transparency.

3. Successor competence. Educational background, external work experience, and leadership capabilities determine the effectiveness with which successors can introduce new governance practices [12].

4. Organizational learning. As family firms expand, the formalization of HR systems and adoption of data-driven decision-making become essential [13].

In the case of Midea Group, the combination of strong family cohesion and the founder's authority enabled the company to sustain decision-making efficiency even during rapid expansion. The family's involvement in strategic decision-making ensured the company's alignment with long-term vision and values, while the founder's authoritative leadership provided clear direction in times of uncertainty. This facilitated Midea's rapid expansion without compromising its operational efficiency.

In contrast, Fotile Group depended heavily on its Confucian family culture, which emphasized harmony, respect for authority, and the importance of family unity. The establishment of the Family Council facilitated the decentralization of ownership and decision-making power, thereby mitigating risks associated with centralized control. This governance model demonstrated the regulatory role of culture in shaping governance structures, allowing Fotile to balance family control with professional management while maintaining strong family values.

4.2 External Drivers

1. Regulatory pressure. China's 2019 Corporate Governance Code mandated enhanced disclosure requirements and strengthened board independence, forcing compliance [8].

2. Market and investor expectations. Publicly listed firms like Midea are required to meet investor expectations regarding governance quality [10].

3. Technological transformation. Digitalization and ESG reporting drive family firms toward standardized and data-driven management [14].

4. Cultural modernization. Exposure to global management ideas encourages the adoption of hybrid governance that integrates local ethics and global norms [15].

The technological intensity of the home appliance industry drove Midea Group to accelerate the adoption of digitalization. The need to stay competitive in a fast-evolving market required Midea to integrate advanced technologies into its operations, optimize supply chain management processes, and enhance customer experience through digital platforms. This technological shift accelerated the pace of governance reforms, as Midea needed to align its strategic goals with technological capabilities while ensuring efficient decision-making processes.

In contrast, the cultural attributes of the kitchen appliance industry guided Fotile Group to place greater emphasis on brand heritage and tradition. Fotile's emphasis on high-quality, specialized products aligned with its family-centered governance, which positioned the long-term preservation of cultural and brand value as the core of its strategy. The company's focus on maintaining family values and craftsmanship became its competitive advantage, allowing it to stay competitive without undergoing rapid digital transformation. This cultural foundation played a pivotal role in shaping Fotile's governance and strategic direction.

4.3 Governance Pathways and Theoretical Implications

From the cases and theoretical synthesis, three governance pathways emerge:
1. Progressive Hybrid Governance. Characterized by gradual delegation of authority, shared control, and stepwise institutionalization. It is suitable for firms operating in stable markets and with strong family cohesion. Midea's experience exemplifies this balanced trajectory [12].
2. Transformative Professional Governance. This model is characterized by abrupt professionalization, often triggered by crises or rapid expansion. While it accelerates modernization, it carries the risk of undermining family identity and social capital [13].
3. Conservative Family Reinforcement. Firms that prioritize the preservation of family culture maintain family dominance. Fotile's approach shows how cohesive values can ensure stability, albeit at the expense of innovation efficiency [14].
These pathways identified in this study underscore that governance reform is non-linear yet path-dependent—being shaped by each firm's unique historical context and institutional environment. Balancing emotional attachment with rational control remains the key to sustainable governance.

5. Conclusion

This study examined the evolution of governance in Chinese family firms through the lens of socioemotional, institutional, and agency perspectives. Using Midea and Fotile as comparative cases, it demonstrated how governance transitions unfold across three stages—relationship-based, hybrid, and institutionalized structures. SEW emphasizes family control and legacy preservation, while Institutional Theory highlights the impact of external pressures, such as market forces and regulations. Together, they explain how family firms balance emotional attachment with the need for professionalization and adaptation. Governance evolution is dynamic, shaped by the interaction between family logic and market logic. The continuous interplay between preserving family values and adapting to external pressures drives the advancement of governance reforms and ensures the firm's long-term success. Establishing formal family charters is critical for clearly defining roles and succession plans, ensuring a smooth transition of leadership within the family business. Encouraging successors to accumulate external professional experience before taking leadership helps them broaden their perspectives and acquire the necessary skills to manage the business effectively. Strengthening board independence and transparency is crucial for improving governance, as it enhances decision-making processes and boosts the company's appeal to potential investors. Preserving core family values serves as a foundation for legitimacy and cohesion, helping the business maintain its unique identity and fostering long-term stability. Future research should undertake longitudinal and cross-industry comparisons to capture governance adaptation over time. The interplay between digitalization, ESG initiatives, and family culture offers promising avenues for further investigation.

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