



Cooperation versus Competition: The Daxing and Yuhua Cotton Mills in Crisis, 1931-1937

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We usually view the creation of the modern corporation as a crucial factor in the modern development of Europe and America. Historians of Chinese business also focus on the modern corporation in understanding China's modern economic development. Although many scholars testing China's enterprises in light of the "corporation" standard concluded that modern China failed to follow a Western model, few have searched for an indigenous pattern of modern Chinese companies. In this research, I trace the origin of one early twentieth-century *jituan* (business group). I argue that the indigenous Chinese *jituan*, rather than the imported Western corporation, is the key to understanding the transformation of China's modern companies. The story of Daxing and Yuhua Cotton Mills reveals that intensifying Sino-foreign competition triggered the formation of this business group in the early 1930s. Studying its development can contribute significantly to our understanding of an indigenous Chinese path toward modernization.

Western history suggests that a number of characteristics distinguishing the "corporation," including limited liability, transferability of shares, juridical personality, and indefinite duration, make it a superior instrument for large-scale business activities. The creation of this specific form of organization is usually seen as having been a crucial factor in the development of modern Europe and America.¹ Accordingly, historians of modern Chinese firms have also focused on the introduction of the "modern corporation" in understanding China's economic development since the late nineteenth century. While many scholars have emphasized China's failed attempts to follow the Western business model, few of them have ever asked if there is an

¹ Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass., 1977); and *Strategy and Structure: Chapters in the History of the Industrial Enterprise* (Cambridge, Mass., 1990).

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indigenous form of Chinese modern enterprises.² The answer to this new question might help us understand the evolution of Chinese business firms, and thus offer a well-rounded picture of Chinese business development during its modern period.

As a preliminary effort to address this new issue, in this essay I look at two Republican-era cotton mills as they faced crises triggered by intensifying Sino-foreign competition in the textile industry. While competition was surely not the only factor that shaped entrepreneurs' activities and their perception of business organization, it played an important role in this specific case. Before the crises, the two companies fell under the leadership of the same group of owner-managers, but they were registered independently and operated separately. The financial difficulties during the 1930s forced the managers to modify their previous arrangement in allocating human and material resources. By creating a combined purchasing office and a shared sales network, and by jointly investing in a new cotton mill, the two mills formed a special "business complex," labeled by contemporary scholars as "*jituan*." Without legal recognition, this newly formed *jituan* became a widely accepted organizational form for large-scale industrial operation in China. My purpose in this paper is to trace the formation of this special business complex and to highlight the significance of *jituan* in understanding Chinese business history.

Intensifying Sino-Japan Competition in the Cotton Textile Industry

The Chinese Textile Industry before the 1930s

Scholars have observed the rapid growth of the Chinese textile industry during the years immediately following the First World War.³ The war resulted in the withdrawal of the majority of British companies from Asian markets, creating an unprecedented opportunity for the Chinese textile industry. While British companies left a big void in the China market for Chinese entrepreneurs to fill, the same event affected Japan and India, shifting their industrial emphasis from coarse yarn to high-count yarn. Previously, these two countries with young cotton textile industries had relied on British imports to meet domestic demand for refined cotton yarn. Because China was one major market for Indian and Japanese textile manufacturers, their industrial adjustment left Chinese cotton mills with decreasing foreign rivalry in the market for coarse products.

² For example, see William Kirby, "China Unincorporated: Company Law and Business Enterprise in Twentieth-Century China," *Journal of Asian Studies* 54 (Feb. 1995): 43-63.

³ For example, see Marie-Claire Bergère, *The Golden Age of the Chinese Bourgeoisie, 1911-1937* (Cambridge, U.K., 1989), and Yan Zhongpin, *Zhongguo Mian Fang Zhi Shi Gao, 1289-1937* [History of China's Cotton Textile Industry, 1289-1937] (Beijing, 1955).

The founders of Yuhua and Daxing took advantage of this postwar opportunity and made huge profits during the Chuxing period.⁴ From 1913 to 1921, the company earned a net profit of more than ten million taels while operating the Hubei Textile Bureau under a lease agreement, compared to its initial investment of 270,000 taels.⁵ The year 1920 had the best performance, with net profits rocketing to 3.5 million taels.⁶ The high profit margin was extraordinary, but not exceptional. It was, in fact, a nationwide phenomenon for this new industry. Wuxi Zhenxin Cotton Mill, founded in 1906, had performed poorly for several years, but in 1919 the company became a big success, with its dividend yield reaching as high as 60 percent. Tianjin Yuyuan Cotton Mill tripled its capital in four years after it began operation in 1918. The new industry had attracted many Chinese business people because of its high profit margin. From thirty-one on the eve of the war, the number of Chinese cotton mills increased by fifty-four between 1914 and 1922.⁷

However, the prosperity brought by the war was only temporary. As early as 1922, the Association of Chinese Cotton Mills started the first curtailment operation in response to an industry-wide recession. During the remainder of the 1920s, the industry experienced “ups and downs,” but the golden days never returned. From 1923 to 1931, the number of the Chinese cotton mills stayed relatively stable. There were twenty-five new players in contrast to twenty-eight dropouts, among which twenty-three mills were newly built by Chinese merchants and two were bought from foreign owners; eleven Chinese mills were closed down and seventeen were transferred to foreign hands. This means that the industry became more mature at this stage. Risk and profit coexisted.⁸

Daxing and Yuhua both began operations in 1922. During their first ten years of operation, the market was obviously not as favorable as it had been in the Chuxing period. However, as experienced business people in both cotton manufacture and the cotton products trade, the owner-managers made a go of the business. Though sometimes troubled by unpredictable fluctuations in market prices, political and military instability, and workers' resistance, both companies realized reasonable profits. According to its annual reports, Yuhua made an average profit of 420,000 taels per year from 1923 to 1930, and Daxing's average annual profit was 582,000 taels during the same period.⁹ Given that the initial investment in Yuhua was only 1,560,000 taels, and that of Daxing 2,100,000, the return on investment was

⁴ Chuxing was the parent company of Yuhua and Daxing.

⁵ *Hankou Shangye Yuekan* [A Monthly Journal of Hankou Business] 1 (May 1934): 25.

⁶ *Hubei Shiye Yuekan* [Monthly Journal of Hubei Industry] 1 (Oct. 1924): 8.

⁷ Yan Zhongpin, *Zhongguo Mian Fang Zhi Shi Gao, 1289-1937*, 171-72.

⁸ *Ibid.*

⁹ I calculated the figure based on Daxing and Yuhua's annual reports from 1923 to 1930, Company Files of Daxing and Yuhua, Wuhan Municipal Archives, JZ111 and JZ109, respectively.

considerable.¹⁰ However, the situation began to worsen for Daxing and Yuhua, as well as for most other cotton mills in China, in the fall of 1931. The industry-wide depression lasted about five years and affected all the cotton mills in China, especially those in the hands of Chinese owners.

The Depression of 1931-1936

Both contemporary observers and later historians often cite the Mukden Incident as a direct initiator of the industry-wide crisis. On September 18, 1931, Japanese officers arranged the incident, and proceeded to take over Manchuria. The following March, they proclaimed a puppet government in Manchuria, known as the state of Manchukuo, with Japanese advisers in indirect control. One immediate impact of this political event on Chinese cotton textiles was the discouraging tariff law of the newly founded Manchukuo. To protect Japanese interests in Manchukuo, the import tax of the region reached a prohibitive high. For example, with the average wholesale price for a piece of coarse cloth under 10 yuan, the tariff increased to 1.3 yuan, a rate over 10 percent.¹¹ Before 1931, Chinese cotton products accounted for a significant share of the Manchurian market. From 1926 to 1930, Manchuria spent an average of 12,888,977 taels per year on imported cotton products; 77 percent of the cotton yarn and 26 percent of the cotton cloth were from elsewhere in China.¹² After the Mukden Incident, Chinese cotton goods almost disappeared from Manchuria.¹³ The loss of the Manchurian market was a shock for most of the mills in China, including those owned by Japanese. Mill owners were forced to ship substantial quantities of cotton goods manufactured by Japanese mills in China to Japan and then re-export them to Manchuria to get around the high tariff imposed on Chinese products and to enjoy the preferential tariff rate between Japan and the Manchukuo regime.¹⁴

The military invasion and Japanese economic aggression both caused the Chinese cotton industry crisis. Following the Mukden Incident, Japanese manufacturers initiated a price war in China with dramatic cuts in the price of Japanese manufactured cotton goods in 1932. Coarse yarn was reduced to 30-50 yuan per bale less than Chinese products, while it previously had been priced higher than the Chinese competitors' yarn. Meanwhile, the price

¹⁰ *Yudahua Fangzhi Ziben Jituan Shiliao* [Selected Company Records for Yudahua Conglomerate] (Wuhan, 1984), 37; Daxing's Director Meeting, 20 May 1924. Company Files of Daxing, JZ111.

¹¹ According to Daxing's annual report released in April 1935, its 14-pound coarse cloth sold for 7.465 yuan per piece. Then, the tax rate reached nearly 20%. Company Files of Daxing, JZ111.

¹² Yan Zhongpin, *Zhongguo Mian Fang Zhi Shi Gao, 1289-1937*, 197-98.

¹³ Still, some products succeeded in entering the Manchurian market through smuggling. However, because there are no statistical records left on smuggled goods, we do not know the scale of this market.

¹⁴ Kang Chao, *The Development of Cotton Textile Production in China* (Cambridge, Mass., 1977), 166.

difference between Japanese and Chinese refined yarn expanded even further, ranging from 70 to 136 yuan per bale.¹⁵ To compete with the Japanese mills, Chinese companies were forced to cut product prices, sometimes to unprofitable levels. For example, in 1934, Daxing cut the price of its “Shan Lu” (Mountain Deer) refined cloth to match that of Japanese-manufactured “Shuang Long” (Double Dragon) cloth on the Tianjin market. To the outsider, Shan Lu appeared to win over Shuang Long: most of the yarn and cloth traders preferred Shan Lu, which offered better quality for the same price. However, this competition seriously damaged Daxing, for it suffered a 0.2 yuan net loss for each piece sold.¹⁶

Yuhua and Daxing in Crisis

Both Yuhua and Daxing went through some harsh times during the years between 1931 and 1936. The proclamation of Manchukuo and its new tariff policy most severely affected cotton mills in Tianjin and Qingdao, forcing them to give up their market share in Manchuria and rush into the north China market. Because of Daxing’s location and marketing in the North China plain, the heightened competition immediately affected that firm. Three financial indicators illustrate the depth and the breadth of the crisis. The first is Daxing’s net losses, which appeared in its financial reports. During the first ten years of operation, Daxing took advantage of its special location, and its shareholders profited every year, though profits varied as a result of price fluctuations on the global market, occasional famine, military conflicts among warlords, and labor disputes. In 1933, however, Daxing reported a net loss for the first time in its history. From 1933 to 1934, the mill lost 440,000 yuan, slightly over 20 percent of its initial investment.¹⁷ The second indicator is decreased profit margin. Compared to 1933, factory prices of all eight major cloths dropped in 1934; the reductions ranged from 5.4 to 17 percent. In contrast, the purchase price of raw material increased. The price for coarse cotton increased 4.2 percent and for refined cotton 2.2 percent.¹⁸ To borrow a phrase from the contemporary mill owners, “*sheng gui shu jian*” [raw material is expensive while the final product is cheap], leaving little space for the company to make a profit. The third indicator is depreciated stock value. According to a 1963 interview with one of the former managers, in the fall of 1934 the poor performance and deteriorating market situation frustrated the shareholders so much that the market price hit its all-time low: 60 percent of its face value.¹⁹ This forced the managers to address the issue at the 1934

¹⁵ Yan Zhongpin, *Zhongguo Mian Fang Zhi Shi Gao 1289-1937*, 214.

¹⁶ *Yudahua Fangzhi Ziben Jituan Shiliao*, 104.

¹⁷ See Daxing’s annual report from 1922 to 1937, Company Files of Daxing, JZ111.

¹⁸ See Daxing’s annual report released in April 1935, Company Files of Daxing.

¹⁹ Though the company stock never went public, there were still random transactions in private. *Yudahua Fangzhi Ziben Jituan Shiliao*, 104.

annual shareholders meeting and to suggest that everybody hold the stocks longer to help the company through its difficulties.²⁰

Compared to Daxing, Yuhua was in better condition. During the five-year depression, Yuhua reported no losses on its financial statements. However, the statements did not always reflect reality, for mills tended to cover up their losses for a better public image. The annual reports from 1931 to 1936 did picture an unmistakable buyer's market. Prices were falling, the market was shrinking, and the competition was intensifying. As one middle-level manager later recalled, the period between 1931 and 1934 was one of the toughest in the company's history. Cheap Japanese goods, priced almost 10 percent lower than comparable Yuhua products, flooded the Hankou market. From 1933 to 1934, the company was often overstocked, though shutting down a thousand spindles in 1934 had already reduced its manufacturing capacity.²¹

The Creation of a Combined Purchasing Office and a Shared Sales Network

The New Chief Executive and His New Leadership

Xu Rongting founded both Daxing and Yuhua textile companies, and he had served as chief director of both companies since their foundation. Already in his 60s, however, the owner-manager was physically incapable of reviewing all the detailed managerial issues for large-scale cotton manufacturers. Even before his resignation, Xu relied heavily on his assistant Su Taiyu (who had worked with him since 1907 and had just reached his 40s in 1926) in managing the two mills.

In the fall of 1926, Wuhan experienced considerable political instability during the United Front's Northern Expedition. Throughout the political crisis, the rising conflicts between workers and managers further threatened the business. From July 1926 to January 1927, the mill lost 438,000 taels in seven months, a figure comparable to the annual profit in a normal year. Temporarily losing confidence in their business, Xu and some other top managers fled to Shanghai with working capital. During their absence, Su stayed on and acted as a deputy to Xu. When the tension was relieved in the winter of the following year, Xu resigned immediately upon his return from Shanghai and Su was appointed as his successor.²² Six years later, in 1933, when Daxing was also troubled with crises, Xu resigned from the position of general manager, and Su came into power as the chief executive of both companies.

Su faced two major tasks after he came into office: consolidating his new leadership in Daxing and rescuing the business from crisis. The first task was relatively easy, as he already had experience in reorganizing Yuhua's

²⁰ Daxing Annual General Meeting, 23 Oct. 1935, Company Files of Daxing.

²¹ *Yudahua Fangzhi Ziben Jituan Shiliao*, 117-18.

²² Huang Shirang, "Yudahua Qiye Sishi Nian" [Forty Years of Yudahua's History], *Wenshi Ziliao Xuanji* [Selected Reminiscences on History and Culture], vol. 44: 1-55.

management team after taking charge of the company in the late 1920s. Before Su came into office, Zhang Songqiao and Xu Rongting equally shared the top authority in Yuhua during Xu's regime. Although Xu was theoretically the head, he had no say in production-related issues, which was Zhang's domain. Consequently, there were two groups in the middle-level management team. Conflicts often arose between the old subordinates of Zhang from the Chuxing period, and the new school graduates hired by Xu Rongting. Zhang Songqiao had resigned from the position of chief manager in 1927.²³ His nephew, Xiao Housheng, was designated Zhang's successor. To limit Xiao's power, Su took the following actions. First, he replaced "chief manager" with "factory director" as Xiao's official title. According to custom, a "factory director" (*changzhang*) had less managerial authority than a "chief manager" (*jingli*). The change in title was probably also accompanied by a decreased salary, meant to reflect Xiao's position in the organizational hierarchy. Second, Su recruited some young engineers from Shanghai and gave them important positions in Yuhua. Because Su selected all the new engineers, they owed their loyalty to him. Third, in a directors' meeting of 1931, Su threatened to remove Xiao from his position if he could not improve productivity within one year.²⁴ Because Zhang still had influence within the company after he retired, Su's official warning for his nephew was probably more a gesture than a real threat. The event, however, reflected the emergence of a centralized leadership in Yuhua.

In Daxing, Su adopted similar strategies to rebuild a new, centralized leadership. Daxing's first chief manager, Zhang Yingpu, was fired after only one year in the position. After Zhang left, everyday operation of the company was under the supervision of Shi Fengxiang, a graduate of Kyoto College of Technology in textile engineering. When Shi was sent to Daxing to succeed Zhang Yingpu, he was only 29, probably too young for such an important position. He was, therefore, appointed as the "factory director," while the old vice-manager, Xu Songzi, was promoted to "chief manager." In practice, however, Shi's control went beyond that of a factory director. Though receiving a salary lower than the chief manager, Shi was in fact the real boss in Shijiazhuang. The distance between Shijiazhuang and Wuhan disrupted the hierarchical structure inside Daxing. Except to provide information directly related to shareholders' interests, Shi seldom reported to the central office in Wuhan.²⁵ Therefore, when Su came into office, his first concern was to limit Shi's power and to regain centralized control. Soon, Su started to send regular investigative teams to Shijiazhuang to get first-hand information about the mill's everyday operations.

At the same meeting in which Su was appointed as general manager, it was announced, as a company bylaw, that the Hankou office would send

²³ Yuhua Annual General Meeting, 24 Feb. 1927, Company Files of Yuhua, JZ109.

²⁴ Yuhua Directors' Meeting, 21 June 1931, Company Files of Yuhua.

²⁵ See Shi Fengxiang, *Shi Fengxiang Xiansheng Zizhuan* [Autobiography of Mr. Shi Fengxiang] (Taiwan, 1967), and Huang Shirang, "Yudahua Qiye Sishi Nian."

investigators to Shijiazhuang twice a year. Previously, the investigations were sporadic and usually occurred only when problems were exposed by the financial statements. After Su discovered some serious managerial problems inside the business, he reassigned Shi to a better-paid but less powerful position.²⁶ The new Daxing factory director was one of his favorite managers in Yuhua, who had helped Su to reorganize the Wuhan company a few years earlier.

The managerial duties, which formerly belonged to the on-site managers of each company, were brought together under a centralized authority, unavoidably increasing the connections between Daxing and Yuhua. Frequent exchanges between the managers and technicians of the two companies reflected the new organization. In addition to having a factory director at Daxing who was an old employee of Yuhua, both mills shared one chief engineer, who worked eight months a year in Yuhua, and the other four in Daxing.²⁷ It is also very likely that the two companies occasionally shared their working capital. When one mill was short of cash to take advantage of a temporary price drop on the local cotton market, Su would likely transfer some idle money from its sister company. Most important, the later creation of a combined purchasing office and a shared sales network fundamentally changed the organizational structure of the two companies. Formerly, they were two alienated twins who, despite their genetic similarities, lived separate lives. Now, a new centralized leadership brought the siblings back together, and connected them institutionally. The foundation of shared purchase and sale networks was the companies' response to the industry-wide crisis, as well as an outcome of the newly centralized leadership.

The Foundation of a Shared Sales Network

Consolidating his new leadership was only one of Su's tasks. As he came into office in a period with unprecedented difficulties, a more urgent task was to outwit competitors and to find a way to survive. As noted earlier, the problem troubling both Daxing and Yuhua was intensifying competition, effectively a price war, in a shrinking market. As an experienced businessperson, Su approached the problem with some basic business strategies: to exploit new markets and to cut costs. These strategies led to institutional transformation in both the purchasing and the marketing sections of the business.

Marketing reform started inside Yuhua. Initially, Yuhua relied on a handful of big yarn traders to distribute its products; it did not have its own sales network until the early 1930s. During the 1910s, when Chuxing was still the only cotton manufacturer in town, its products were so popular on the Hankou market that the yarn traders had to fight for quotas to get them. Over time, Chuxing built stable partnerships with a group of big cotton traders, who, through monthly agreements, purchased the products in advance. This

²⁶ Shi was reassigned as the chief manager of the Daxing Mill No.2, which was still under construction at the time.

²⁷ Daxing Directors' Meeting, 8 Nov. 1936, Company Files of Daxing, JZ111.

tradition survived the dissolution of Chuxing and the establishment of Yuhua. Many of these frequent consumers, the big yarn traders, became shareholders of the new textile company, and their business partnership continued. During the 1920s, when the business of cotton products was still largely profitable, the big traders who dominated the Hankou Yarn Guild even established a guild rule to prohibit transactions between Wuhan cotton mills and other direct customers. Beginning in the early 1930s, however, the national depression affected cotton products traders as well as the manufacturers.²⁸ The depression drove many of Yuhua's distributors out of the business, and others began purchasing lower-priced Japanese products. Marketing became a new problem for the company, forcing Yuhua to build a new sales network with local outlets in the consumer markets, instead of selling directly to the big wholesalers in Hankou.

In September 1931, Yuhua hired a commissioned sales agent in Chongqing, the Yiyongchang Yarn Shop. According to the contract, Yiyongchang would represent the manufacturer in the city and sell its varied products for a one percent commission. The contract itself did not endow Yuhua with much direct control over its sales agent. Most of the time, agents had the right to decide how, when, and to whom they would sell the products, as well as the selling price. Most of the clauses concerning the agents' responsibilities presumed the traders' honesty, and thus had little binding force. The contract even allowed the parties to terminate their partnership whenever they wished, on one month's notice. The only explicit restriction on agents was that they could not carry cotton goods from any other mills in Wuhan. However, similar terms also applied to the manufacturer. Except for Yiyongchang, Yuhua could not trade with any other yarn traders in Chongqing.²⁹

The real connection between the manufacturer and the sales agent was personal, rather than contractual. Huang Zhongqian, one major shareholder of Yiyongchang, was the younger brother of a key figure in Yuhua, who later became the successor to Su Taiyu. After years of cooperation, the general manager of Yiyongchang and some other managers were promoted to important positions in the business complex centered on Yuhua and Daxing. In addition, unsurprisingly, the owners of the sales agency held some shares in the industrial company. Through these personal connections, Yuhua successfully controlled the activities of its sales agent.

From 1933 to 1934, using the same method, Yuhua expanded its sales network to Wanxian in Sichuan, Laohekou in Hubei, and Changde and Changsha in Hunan. Most of the contract sales agents were local yarn traders and banks that knew how to evade various local taxes and levies. All of them were financially independent. However, in practice, most had some

²⁸ In the Yangzi region, it was the 1931 flood rather than the Manchurian takeover that precipitated the depression. The impact of this new political event reached the mills in Northern China first.

²⁹ See contract between Yuhua and Yiyongchang, Company Files of Yuhua, JZ109.

attachment to the giant industrial producer. Normally, those who were successful in promoting the products in their regions all developed and maintained some intimate relationship with the manufacturer and its owner-managers.

If a binding contract was one form of indirect control, and an in-house distribution system was an example of direct control, the personal networks connecting the manufacturer and its distributors provided an alternative means of informal control that reduced the need for extra resources, financial or managerial, to a minimum. The company did not need to invest in establishing a new sales office, which was not only costly, but also risky; the lack of local connections often induced harassment by local authorities.³⁰ In addition, the manufacturers did not need to devote extra personnel for on-the-spot supervision: even a meticulously formulated contract could hardly protect one's interests unless the monitoring of the execution process was meticulous as well. But informal control had its own flaws. The personal connections forged much less reliable bonds than contracts or investments. In addition, one's social network was limited. This led to managerial success where there were concentrated personal connections and failure when those were lacking. In Yuhua's case, cooperation with the Chongqing agent was most successful. Many Yuhua managers were from Sichuan, so they had strong connections with this city on the upper Yangzi. Yuhua was not so lucky, however, in some other markets. The poor performance of its agent in Laohekou, for example, forced the company to terminate that contract in 1937.³¹

While Yuhua founded its new trans-regional sales networks, Daxing also experienced transformation in its marketing policy. In the 1920s, Daxing's major market was the small local sales network the company owned. A sales team consisting of at least three full-time salespeople was busy traveling across the region and selling products directly to the small-town retailers. Beginning in 1933, when the Manchurian Incident triggered intensified competition in the North China plain, Su and other managers began to expand Daxing's sales network to the south.³² Given the complexity of establishing a trans-regional sales network, Daxing relied heavily on Yuhua's pre-existing marketing resources during its southern expedition. The sharing of a sales network became the first institutionalized cooperation between the two companies. Between 1933 and 1935, Daxing signed similar contracts with most of the Yuhua sales agents.³³ In 1935, after Daxing exploited a new

³⁰ In the Yuhua Directors' Meeting on 20 July 1933, Su suggested that he preferred hiring a local sales agent to building a sales office, because a new sales office was too costly and required special social connections; Company Files of Yuhua.

³¹ Yuhua Directors' Meeting, 20 Jan. 1937, Company Files of Yuhua.

³² See Daxing's Annual Report of 1933, Company Files of Daxing.

³³ See the contracts between Daxing and the sales agents, Company Files of Yuhua.

market in Xi'an in West China, it also offered to sell Yuhua products there.³⁴ Thus, after the mid-1930s, both Daxing and Yuhua owned a trans-regional sales network targeting the national market. The two networks largely overlapped: Yuhua allowed Daxing to share its marketing resources in the upper and middle Yangzi region, and Daxing offered Yuhua its territory in Shaanxi province.

In summary, three factors contributed to the institutional innovation of the shared sales network. The intensified competition made it necessary for the companies to build a trans-regional sales network that connected factory manufacturing directly to the ultimate markets. The complexity involved in managing a large sales network and the lack of managerial resources forced the managers to consider cooperation between Daxing and Yuhua. Finally, the new centralized leadership made the cooperation possible.

The Foundation of a Combined Purchasing Office

Similar reforms had taken place in the purchasing departments in Daxing and Yuhua. First, both companies started to expand their purchasing offices from local markets to the primary markets, where they could get cheaper cotton of better quality. For normal production, the mills needed two types of raw cotton. The basic short-stem cotton grew in the counties near the factories, while the supplementary long-stem variety came from the remote Northwest. Originally, the companies purchased both types locally, leaving cotton merchants the job of importing long-stem cotton to the local market. Starting in the late 1920s, the companies began to send purchasers to the primary markets for long-stem cotton. Small, temporary purchasing houses were set up first in Zhengzhou, and later in more remote Shanzhou.³⁵ During the process of expansion, the two companies began to cooperate actively. In 1936, they built a combined purchasing office in Xi'an to purchase refined cotton in Shaanxi province for both companies. This special office brought the cooperation between Daxing and Yuhua to a new stage. During their cooperation in developing a marketing system, the sales network in a given region always belonged to the company that established it. The other company was invited to use the resource, but had neither the right to intervene managerially nor the obligation to contribute financially. In contrast, both Daxing and Yuhua established the new purchasing office in Xi'an, and thus it belonged to both. The two companies split the operating expenses, transferred personnel from either Daxing or Yuhua, and the managers made the business decisions from both sides.³⁶

Like many other business innovations, the combined purchasing office was first proposed by a hired manager rather than by the owner-manager.

³⁴ See business letters from Daxing to Daxing Mill No. 2, 26 Aug. 1935 and 24 Sept. 1935, Company Files of Daxing.

³⁵ Yuhua Annual General Meeting, 9 Sept. 1928, Company Files of Yuhua.

³⁶ See Business letter from Jiang Hanzhang and Xu Zhiping to Su Taiyu, 19 March 1936, Company Files of Yuhua, JZ108.

Xu Zhiping, the director of accounting in Daxing, was a member of the middle-level manager team. Like many of his peers, Xu Zhiping had personal connections with the owner-managers at the top: he was a cousin of Xu Songzi, Daxing's chief manager. Because Songzi was a nephew of Xu Rongting, Zhiping was also a relative of the director of the board.³⁷ He probably got the job in Daxing and promotion to department director through this special personal connection. In the spring of 1934, under the pressure of intensified competition, Zhiping was sent to Xi'an to investigate the market. After he came back, he reported that the area had a promising market for manufactured cotton goods. Local demand was strong and the market price was highly profitable. He also noticed that the huge raw cotton outflow and cotton goods inflow suggested the need for a local cotton mill. Thus, he proposed that, instead of stealing a market share by exporting, Daxing should dominate the market by building a new factory there.³⁸ Su Taiyu happened to be in Shijiazhuang when Zhiping proposed the new project, and Zhiping's ambition impressed the chief executive. Though the company was actually losing money every year, they adopted this new investment project. Zhiping was appointed vice-manager for the new plant, Daxing Mill No. 2, and was put in charge of the new construction.

On March 19, 1936, four months before construction ended and normal operations began, Zhiping wrote a long letter directly addressed to Su Taiyu. Instead of reporting issues related to the plant construction under his supervision, Zhiping proposed establishing a shared purchasing office, to procure raw cotton in Shaanxi province for Yuhua, Daxing Mill No. 1, and Daxing Mill No. 2, once it began operations. The benefit of this shared purchasing office, according to Zhiping, was obvious. Both Daxing and Yuhua had spent a significant amount on purchasing in the Shaanxi market, but, because they lacked a well-organized purchasing house and experienced employees, the companies had to purchase indirectly from local cotton merchants. Thus, they lost considerable profit to intermediaries—around two yuan per picul, according to Zhiping's estimate.³⁹ If the two companies could combine their resources to build a purchasing office, the new institution would benefit all three mills by offering a channel for direct purchase from the cotton planters. Aware that the success of this combined purchasing office lay in institutionalized management, Zhiping also attached a tentative set of regulations that detailed the organization and operation of the office.⁴⁰

³⁷ Yang Junke and Liang Yong, *Daxing Shachang Shigao* [A History of Daxing Cotton Mill] (Shijiazhuang, 1990), 24.

³⁸ Huang Shirang, "Yudahua Qiye Sishi Nian," 43, and Yang Junke and Liang Yong, *Daxing Shachang Shigao*, 141.

³⁹ In 1936, Daxing spent an average 33.35 yuan per picul on purchasing long-stem cotton; see *Yudahua Fangzhi Ziben Jituan Shiliao* [Selected Company Records for Yudahua Conglomerate], 153.

⁴⁰ See Business letter from Jiang Hanzhang and Xu Zhiping to Su Taiyu, 19 March 1936. Company Files of Yudahua, Wuhan Municipal Archives, JZ108.

The rationale for building a combined purchasing office is probably as obvious as it appeared in Zhiping's proposal. What deserves scholarly attention is the person who proposed the project. As a hired manager in Daxing who held no interests in Yuhua, why did Zhiping bother to propose a project in the interests of both companies? As the vice-manager of Daxing Mill No.2, did he not have other things to do than write a detailed proposal for a project that had no immediate effect on his mill, which was not yet operating? Also, as a vice-manager, why did he not first report to the chief manager instead of writing directly to Su?

The event reveals the dynamic relationship between top owner-managers and middle-level hired managers. Though the titles, and probably the salaries, were hierarchical as in a bureaucratized corporation, the relationship between the top leader and the employees was personal. There was no hierarchical reporting system. Information transmission was through social networks rather than via a corporate hierarchy. In this case, Su personally promoted Zhiping, and Zhiping reported personally to Su. This mechanism encouraged business innovation. A mid- or lower-level manager with a great innovative idea could report directly to the top manager. If the top manager adopted the idea, the manager who made the suggestion could receive an exceptional promotion. Therefore, even shop-floor supervisors could be motivated to improve everyday management.⁴¹

In this specific case, the personal connection between top owner-managers and mid-level hired managers also helped form a centralized leadership for Daxing and Yuhua. Because Su was in charge of both companies, he took the mutual interests of the two enterprises under consideration when making strategic decisions. After Su established a strong personal connection with his hired managers, the mid-level managers started to feel responsible to Su rather than to their managerial positions. Consequently, the mid-level managers would adopt Su's vision and view the two companies as an integrated interest group, although most had direct personal interests in only one company. Thus, a centralized leadership for the two companies emerged without the formation of a central office.

Dahua: A Joint Venture between the Sister Companies

From Daxing Mill No. 2 to Dahua

The initial proposal to build Daxing Mill No. 2 was meant to relieve the financial crisis triggered by intensifying competition. The managers had no plan for aggressive expansion; their original idea was to purchase 5,000 new *dingspindles* for the factory and move another 5,000 from the old factory in Shijiazhuang, to keep investment costs as low as possible.⁴² However, the

⁴¹ See Sherman Cochran, *Encountering Chinese Networks: Western, Japanese, and Chinese Corporations in China, 1880-1937* (Berkeley, Calif., 2000), for further debate on the pros and cons of social networks.

⁴² Daxing Annual General Meeting, 27 Oct. 1934, Company Files of Daxing.

plan was modified six months later after the new chief manager, Shi Fengxiang, assumed his office. Shi Fengxiang, removed from his original post as factory director in Daxing Mill No. 1, was assigned this new job, while the new general manager, Su, made some adjustments in personnel. Shi's reappointment could be considered a demotion. Although the new position ranked higher and probably was better paid, it removed Shi from his well-established social network in Shijiazhuang and threw him into the unforeseeable risk of a smaller factory that was still under construction. Surprisingly, however, the "demotion" did not seem to upset Shi; probably offered lucrative compensation for his loss of status, Shi was soon motivated and actively involved in the new project.⁴³

Although the company had some serious financial problems, Shi actively promoted an aggressive plan for the new mill. First, he proposed expanding the scale from 10,000 *ding* spindles to 12,000 *ding*. Second, he suggested that the new factory purchase brand new machines rather than moving old ones from Shijiazhuang. Third, he insisted the new machinery be state-of-the-art. The directors approved the new plan at their May 1935 meeting. The meeting minutes imply that the modified plan was justified; the cost of transporting the old equipment was considerable and the emerging new technology had already made Daxing's machinery outdated. Both factors favored purchasing new machinery.⁴⁴

However, this aggressive new plan made Mill No. 2 a major financial burden for Daxing. The proposed investment for the new factory increased to 1.5 million yuan, about one-fifth of Daxing's total assets.⁴⁵ Given that Daxing had experienced severe losses since 1933, this figure was especially remarkable.

Construction began in February 1935. It is not clear how Su managed to finance the early stages of the new project. However, in early 1936, when costs accelerated, the financial arrangement for the new factory became a challenging task. Su could not expect any new investment from the shareholders, because the company was in poor financial condition and had failed to offer regular dividends since 1933. Moreover, the company's conservative tradition of avoiding borrowing from banks made bank loans an unlikely option. Therefore, Su turned to the better-off sister company, Yuhua, for financial help.

Using his personal power as the general manager for both companies, Su could easily transfer some working capital from Yuhua to Daxing for

⁴³ As is documented, Shi started as a hired manager and ended as one major shareholder in the 1940s. Therefore, although such action is not mentioned in the company documents, it is possible that the general manager compensated Shi's loss by offering some company stock.

⁴⁴ Daxing Directors' Meeting, 11 May 1935, Company Files of Daxing.

⁴⁵ According to Financial Statements of Daxing, personal collection of Mr. Yang Junke, Daxing had total assets of 8 million yuan at the end of 1934.

temporary use.⁴⁶ What Daxing needed, however, was more than a small temporary loan. To arrange a large low-interest, but high-risk, loan to Daxing would obviously put Su in an awkward position among Yuhua's shareholders, a situation he had to avoid. Therefore, he proposed a joint venture between the two sister companies. They would increase the initial investment for the new factory to 2.5 million yuan to achieve an economy of scale. The two company investors could split this amount. Thus, the new factory was no longer part of Daxing Textile Company; the need to register it separately gave birth to the third company in this business complex: Dahua.⁴⁷

Partnership or Corporation?

Both Daxing and Yuhua were registered as unlimited liability companies. The new company, Dahua, was going to follow the same pattern, but the 1929 Company Law specified that a corporation have at least seven investors. If Daxing and Yuhua co-founded the new company, it would need only two investors; legally, it would be a partnership rather than a corporation.⁴⁸

Should the new company embrace partnership as its organizational form rather than seeking status as a corporation? Surprisingly, the question was not much of an issue for the mill owners. For Su and other early twentieth-century entrepreneurs, corporation was more a fashionable label than a superior organizational form with any special legal recognition. When the first generation of Chinese corporations appeared in the late nineteenth century, many Chinese merchants attached the label *youxian gongsi* (limited company) to their enterprise because it was a "modern" idea; it was promoted by the central and local governments, and it frequently appeared in the newspapers. None of the managers of these "corporations" ran them as limited liability companies; some small "corporations" with only one or two investors were practically sole proprietorships. The larger ones could not escape from the old pattern of family business, and thus cautiously kept both ownership and managerial control inside the founder's family. The busy owner-managers considered shareholders' meetings optional and often skipped them. Moreover, many did not even register the corporations with the government. The few registered corporations completed the legal

⁴⁶ In prewar China, this was normal practice among companies independently registered, but sharing the same major owner-managers. One example was Dasheng Company; see Elisabeth Köll, *From Cotton Mill to Business Empire: The Emergence of Regional Enterprises in Modern China* (Cambridge, Mass., 2003) for details of Dasheng's operation.

⁴⁷ See Daxing Annual General Meeting, 7 July 1936, and Yuhua's Director Meeting, May 20, 1936, Company Files of Daxing and Yuhua, JZ111 and JZ109.

⁴⁸ According to the 1929 Company Law, there were four company categories: unlimited liability companies (*wuxian gongsi*); simple partnerships (*lianghe gongsi*); joint-share partnerships (*gufen lianghe gongsi*); and limited liability companies (*gufen youxian gongsi*).

procedure only for some political-risk insurance.⁴⁹ If “corporation” were a fancy label with hardly any organizational or legal meaning, Su would welcome it; he did not intend, however, that his new company would follow the organizational arrangement or the legal requirements of modern corporations.

To Su, the real concern was how to register the partnership as a legitimate corporation. What Su did was quite traditional: he used an expanded social network to solve the problem. First, after consulting other top managers in the firm, Su found out that Huang Shirang (who was his nephew and a major figure in the business complex) had a friend, probably his classmate at Fudan University, working in the Ministry of Industry. Su asked Huang to contact the department head in charge of business registration personally. Negotiations took place in informal meetings among “friends” before the application was filed, thereby avoiding conflict with the government. After acquiring some “personal” advice from government officials, Huang suggested that Su add at least five individual investors to the two corporations to reach the required seven. Thus, the government officials indicated they would not consider the company a legal corporation unless Su submitted seven names.⁵⁰

Who would these extra five investors be? Although the seven-person requirement rule encouraged Chinese corporations to attract capital from multiple sources, our entrepreneurs did not intend to invite any outsiders to join their team. On one hand, they had accumulated enough wealth since the Chuxing period that they did not need outside financial sources; on the other hand, like many other early industrialists, they were afraid of losing managerial control to outsiders. The owner-managers were even wary of bank loans, especially after they witnessed many other cotton mills lose control to their creditors during the early 1930s. Therefore, the ideal investors would be the owner-managers themselves.

The final arrangement was that both Daxing and Yuhua invested one million yuan in the new company and distributed the remaining 500,000 yuan evenly among Daxing and Yuhua’s major shareholders.⁵¹ As a result, the new company, although a registered corporation with more than fifty private investors, was in reality a joint venture between Daxing and Yuhua. The company name “Dahua” confirms this: “Da” was the first character from Daxing and “Hua” was the second character from Yuhua.

⁴⁹ See Kirby, “China Unincorporated,” and Zhang Zhongmin, *Jiannan de bianqian—jindai zhongguo gongsi zhidu yanjiu* [Corporations in Modern China] (Shanghai, 2002).

⁵⁰ The Joint Director Meeting of Daxing and Yuhua, 21 June 1936, Company Files of Yudahua, JZ108.

⁵¹ *Ibid.*, 7 July 1936.

Yudahua: The Birth of a Jituan

Once Daxing and Yuhua co-founded Dahua, the history of the two companies turned in a new direction. Their mutual interests in the new business further connected the two mills. In fact, contacts among the three textile companies became so frequent that neither contemporary managers nor later historians would consider them as independent business entities. They sometimes held joint meetings of directors from different companies for special situations. Even when they held directors' meetings separately, they normally chose the same day to save extra trips for the senior managers, included similar key speeches from the same major owner-managers, and were probably recorded by the same clerk. This suggests the possibility that they held and recorded meetings separately only to meet the legal requirement.⁵² A special channel for documents frequently circulated among the companies was also established. With their standardized writing format, the messages sent through this channel seemed more like forms of internal business communication than external business letters.

In the late 1930s, the term "Yu-Da-Hua," with each character representing one of the three companies in the business complex, started to appear in company documents, such as business letters between major managers. In the 1960s, when historians collected and archived the business documents of the three companies, they labeled the three companies and their affiliated offices "Yudahua Textile Group" (*jituan*). Since then, scholars referring to this particular business complex have frequently used "Yudahua," and often define it as a "group," or *jituan* in Chinese. Even now, the company files kept in the Wuhan Municipal Archives are still gathered under the category of "Yudahua Textile Group."

What is a *jituan* (group)? Was the concept only a later invention by historians? Alternatively, was it an institutional innovation by early twentieth-century entrepreneurs? To what degree did these owner-managers perceive Yudahua as an integrated group?

A closer look at the company files tells us that, before historians created the label, neither the government nor the public recognized "Yudahua." The three companies filed taxes independently and reported to different local governments, because their locations varied. Their names appeared separately in newspaper reports and contemporary surveys of modern industry; neither journalists nor economists bothered to relate one company to another. In the eyes of the owner-managers, an integrated business group did exist. They acknowledged it not as a well-formulated organizational form, however, but as a series of expedient arrangements, such as a shared sales network and a combined purchasing office developed in response to the business crisis. The managers themselves repeatedly used the term Yudahua, but its meaning was often vague: sometimes it read more like a combination

⁵² In the 1929 Company Law, corporations were required to hold regular directors' meetings and shareholders' meetings.

of three abbreviated names than an integrated business entity. In other words, Yudahua as a business complex gradually took shape over time; its meaning changed whenever the owner-managers faced new challenges.

On the other hand, *jituan* is another modern invention with changing meanings. Following the May Fourth Movement, the word first appeared in the new vocabulary promoted by linguistic reformers. Its original meaning had nothing to do with the business world. It often denoted a group organized for a specific goal, such as a book club.⁵³ In the 1940s, the word first appeared in the business domain as a new category of business organization for large business complexes, including companies in varied fields emerging in China.⁵⁴ Though the term sometimes appeared with confusing meanings, it seemed defined largely as the Chinese translation of multi-unit corporations—probably influenced by the contemporary English literature on big business. It was not until the early 1960s that the term first included business complexes without a holding company, such as Yudahua. Starting in the late 1950s, the central government sponsored a large-scale project to preserve the company documents from a handful of major industrial companies in the “old” China, including Yudahua and many other companies more familiar to modern readers, such as Dasheng and Rong Brothers. Nearly one hundred historians and economists participated in the project, organized into teams devoted to one particular company group. After carefully reviewing the company documents, the scholars noticed that, although legally independent, companies in one company group worked closely with one another and practically became an inseparable business entity. Therefore, they borrowed *jituan* as a new label for Yudahua and other similar business complexes. Because this project produced the best-maintained documents for pre-1949 Chinese companies, it significantly influenced later scholarship on company history. *Jituan* came to be widely used in historical studies of business complexes that their contemporaries might have viewed differently.

Obviously, historians should be more cautious when applying *jituan* to early business complexes like Yudahua. Both *jituan* and “Yudahua” are newly invented terms whose very meanings changed. If we can properly label Yudahua a *jituan*, it was not one of the sort that the term was meant to describe at the turn of the twenty-first century. By labeling Yudahua a *jituan*, subsequent historians have shaped our understanding of these three Republican-era Chinese companies and have shed light on their interconnections. However, the *jituan* label has also misled scholars by anachronistically associating Yudahua with some of the new meanings that term acquired much later in Chinese business history. In the 1990s, for example, the term was widely used for newly formed Chinese corporations with holding companies and groups of business ventures under their control.

⁵³ See definition of *jituan* in Luo Zhufeng comp., *Hanyu da cidian* [Grand Dictionary of Chinese] (Shanghai, 1997).

⁵⁴ See Zhang Zhongmin, *Jiannan de bianqian—jindai zhongguo gongsi zhidu yanjiu*, 182-196.

Therefore, recent studies on Yudahua and some other early business complexes tend to appear simply as a part of the history of Chinese corporations, and thus neglect the unique significance of the *jituan* form in understanding the transformation of Chinese business organizations.

Conclusion

In sum, I argue that the indigenous Chinese *jituan* (business group), rather than the imported Western corporation, is the key to understanding the transformation of China's modern companies. The origin of one early twentieth-century *jituan*, where the founders had no conception of modern corporate structure and the founding process was not an imitation of Western corporations, supports this argument. The introduction of corporations to China and the development of Chinese *jituan* were two relatively separate processes. Moreover, it seems that the latter development has been understudied, because the changing meaning of *jituan* gave historians a preconception that *jituan* was simply a variation of the modern cooperation.

If we stop testing Chinese businesses with the "corporation" standard of the West, we might be able to find more evidence of dynamic changes within Chinese companies. In the search for an indigenous pattern of modern business organization—Chinese *jituan*—what the Chinese early industrialists faced was not a simple choice between "bad" Chinese social networks and "good" Western corporate hierarchies. Instead, there were long-lasting tensions between personal relationships and contractual relationships, which still exist in the Chinese business world at the beginning of the twenty-first century. Often, entrepreneurs had to respond to a particular problem with a particular management arrangement. Some abandoned those expedient arrangements after the particular business crises were relieved. Others remained inside Chinese firms over the long term and became a unique feature of Chinese business. Gradually but deliberately, Yudahua—and other business organizations like Yudahua—had moved toward a modern form of Chinese company.