

## **The Relationship between Enterprise and Government <sup>1</sup> ---- Case Study on Two “Chinese Old Brand” Companies (Heniantang, Tongrentang)**

**Zhang Jijiao <sup>2</sup>**

*Institute of Ethnology and Anthropology, CASS*

### **Abstract**

It is a kind of miracle, and a valuable topic for anthropologists to research. In this paper, based on two medical case studies of “Chinese Old Brand” companies (Heniantang, Tongrentang), the author analyzed the relationship between enterprise and government in the different political and economic periods of the past over 60 years. As a result, Heniantang became an Ugly Duckling, and Tongrentang became a White Swan.

**Keywords:** Chinese Old Brand, Enterprise, Government, Heniantang, Tongrentang

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2 Prof. & Dr., Institute of Ethnology and Anthropology, CASS.

## 1. Introduction

### 1.1 The Origin of the Issue

“Old Brand” enterprise<sup>3</sup> is not only a business phenomenon, but also carries historic cultural sense. For example, the “Huishang” (Merchants of Huizhou)<sup>4</sup> which started in Tang and Song period, boomed in Ming dynasty, and some other old brands managed to flourish for hundreds of years such as the 349 year old Zhangxiaoquan Scissors (originated in 1663), the 343 year old Wangzhihe (originated in 1669), 337 year old Wangshuyou Vinegar (originated in 1675), 207 year old Huyumei Sauce and Pickles Shop (originated in 1805), 138 year old Huqingyu Pharmacy<sup>5</sup>, 137 year old Xieyuda Tea (originated in 1875), and the 112 year old Zhangyiyuan Tea (originated in 1900). These enterprises lasted for tens evens hundreds of years and are still flourishing today became the so called “Chinese Old Brand” enterprises. This is a field worth researching.

This paper discusses an issue calling for scrupulous academic study: the enterprise and government relationship and its resource allocation role in the development of the “old brand” enterprises. So, what is it like of the “old brand” enterprises’ relationship

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3 In 1949, after the founding of the PRC, China had more than about 16,000 old brands. In 2006, the Ministry of Commerce began implementing the “Old Brand Revitalization” project, and in the same year issued the first batch of Chinese “Old Brand” enterprises directory. In 2008, the Ministry of Commerce and other 14 ministries jointly issued the policy “On the Protection and Promotion of the Development of Old Brand Enterprises”. In 2011, in order to further promote the Old Brands’ development, the Ministry of Commerce has issued a second batch of the “Old Brand” enterprises directory. So far, there are more than 1,128 “Old Brand” enterprises entitled as “Old Brand” by the Ministry of Commerce. These enterprises should be established before 1956 (at least 50 years old), which covers the food and beverage industry, traditional Chinese medicine, alcohol, tea, jewelry, handicraft products, clothing footwear and other industries.

4 the “Huishang”, also called Xinan Merchants or HuiBang, i.e. the Merchants of Huizhou, which means the merchants or merchants union originated in Huizhou, but not all merchants from the Anhui province. Huishang started in Tang and Song period, boomed in Ming dynasty. The 300 hundreds years between Mid-Ming Dynasty and Qian Long Period of Qing Dynasty was another golden age for Huishang. Compared with other merchant groups, their business size, scope of activities, and managing capital were all among the first class across the country.

5 Founded in the thirteenth years of Tongzhi (1874), by Hu Xuanyan, a famous Huizhou merchant. The pharmacy used the royal pharmacopoeia of the Song Dynasty and was still much valued in China and foreign countries. Huqingyu and Tongrentang are referred as the most prestigious pharmacies respectively in south and north China.

with the government? Whether there exists close relationship between the two? Let us look deeper into the following situations: (1) the relationship of enterprises and government is not close. The enterprises take on full responsibility for their own business's success? (2) They are close enough that the government becomes a kind of "asylum provider" to the enterprises? (3) They are close enough that the government is the "agent" or "Trust" of the enterprises?

This paper from a smaller facet might demonstrate the last 30 years' huge economic and social transformation in China in which caused the change of the "old brand" enterprises, and yet raised another question that is its (the old brand's) business tradition broken during the changes? Or the tradition remains continuous? Simultaneously, this paper may also from a bigger view verify the driving force behind China's economic rise is laissez-faire capitalism? Or state capitalism? Or socialism?

## **1.2 The Analysis Model of the Old Brand Enterprises and Government Relationships**

It is generally believed that there are two hands influencing resource allocation and business performance of enterprises: the visible hand, government; and the invisible hand, market. Karl Polanyi (1957) in his book *The Great Transformation* summarized three types of human economic mode of production: market economy, redistribution economy and reciprocity economy. Since the 1980s, the Soviet Union, Eastern Europe and China had went through a series of major social changes, simply from the redistribution economic transitioned to market economy, a subject arousing a large number of domestic and foreign scholastic studies. The famous Hungarian economist Janos Kornai (1980) in his book *Economics of Shortage* gave a classic exposition of centrally planned economies (CPEs) <sup>6</sup>. The new institutionalism sociologists did some

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6 In his view, in the planned-economy redistribution system, the state monopolies almost all important scarce resources in society. Scarce resources mentioned here, include not only material resources, but also the access to employment, housing, power, prestige and other opportunities. In an economy that trading rights are under control and even prohibited, information are not transparent or even serious distorted, and resources are often in shortage, the function of particularism interpersonal relations would be strengthened in resource allocation.

influential explore of the relationship between local government and enterprises in China's market transformation. Oi (1992), based on empirical methods described the behavior of local government under fiscal reform excitation, and further brought up his *Local State Corporatism* theory<sup>7</sup>. Walder (1995) clarified why the local government, compared with senior government, has greater incentive and ability to exercise as the owners of the equity, ensuingly formed his *Local Governments as Industrial Firms* theory<sup>8</sup>. Chinese scholars, Hong and Cao (1996) conducted a comprehensive analysis on the vital role of local government in promoting market-oriented reform. From the perspective of institutional change, Yang Ruilong (1998) analyzed the special functions and roles of local government in the transition. Li Peilin (1993) not only analyzed the social and economic exchange of township enterprises with outer society, and noted that to establish township enterprises in rural community, special relation network can help to reduce the cost of the enterprise's internal organization, but it will increase the outer transaction costs of enterprises. In other words, the special relationships network may be conducive to the development of enterprises but also can be harmful to the development of market economy. Li Peilin (1993) further pointed out that in the exchange of interests among relatives and small circles, Renqing Credit Card (which means "I own you a favor") was invented as a coproduct.

Thus, in the process of China's reform from planned economy to market economy, the relationship with government was an important way of resources allocation. Probably it was even more important than the enterprises' marketing capability.

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7 She believes that "in the process of economic development, the local government has many features of a company. Officials act exactly like a board member. This new system of government and economy integration, I call it the Local State Corporatism ... Local State Corporatism refers to that the local government coordinates various economic institutions within its jurisdiction, and seemingly behaves as a diversified industrial corporation."

8 His research on local government's role in economic development stems from the reflection and the deepening of Kornai's theory. The relationship between government and enterprise is similar to the internal relationships within a factory or company, that the government, as the owner, is similar to a company's chairman of the board, and the actual manager of the enterprise is similar to the director role of a factory or workshop.

## **2. The Basic Statistics of the Survey and the Two Main Cases (Heniantang and Tongrentang)**

### **2.1 The Basic Statistics of the Survey**

In 2010, we have conducted a survey lasting for 10 month on 378 managers of the old brand enterprises across 12 provinces (Beijing 34, Shanghai 50, Tianjin 35, Chongqing 38, Zhejiang 41, Guangzhou 51, Liaoning 32, Fujian 11, Yunnan 11, Jilin 31, Hebei 20 and Sichuan 22) (Zhang, Ding and Huang, 2011, p. 11 - 12)<sup>9</sup>. We conclude from the survey that different enterprises ownerships will have a main influence on the relationship between the government and the enterprise, and as the relationship varies, it will pose a different impact on the development of the old brand enterprises.

The survey shows that there are 144 managers from joint-stock enterprises, accounting for 38.1% of all the enterprises surveyed, which is the prevailing old brand enterprises ownership type; Second, the number of managers from private sector and state-owned enterprises respectively were 109 and 102, accounting for 28.8% and 27.0%; 23 managers from joint ventures and other corporate types accounted for 6.0%. It can be seen there are several government-enterprise relationships co-exist presently. The state-owned enterprises remain directly subordinate to the government; the relationship between the government and the joint-stock companies, private enterprises, joint ventures is like "supervisor to supervisees", and "helper to those being helped". For enterprises of different ownership, the closeness of government-enterprise relationship differs. Most closely connected to the government are the state-owned enterprises, followed by joint-stock enterprises, and next the private enterprises, and finally for the joint ventures (Zhang et al., 2011, p. 228).

### **2.2 The Basic Condition of the Two Old Brand Pharmaceutical Enterprises**

Based on the two cases of old brand enterprises Heniantang and Tongrentang, this paper will study on the relationship of enterprises and government and its influence on the enterprises' development.

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<sup>9</sup> This project has been supported by the commercial sectors and Old Brand Unions of above 12 provinces and cities. More than 350 enterprises actively cooperate with us to assist the research. We express our sincere gratitude for their generous contribution.

### (1) Case One: Heniantang<sup>10</sup>

Heniantang was founded in 1405, during Ming dynasty, by Ding Henian, a famous Huis poet and expert in health preserving<sup>11</sup>. The brand “Henian” was from his name, and it also carried a propitious meaning indicates that people will enjoy a long life. From then on, Heniantang had been runned successively by the Ding Henian family, Cao Pufeng family, Wang Shengyi family and Liu Yifeng family for 17 generations, several hundreds of years. Heniantang’s establishment was 264 years ahead of Tongrentang(the latter was founded in 1669), 15 years ahead of the Forbidden City and 125 year ahead of the Temple of Earth. Its existence has passed more than 7 centuries, 600 years. Heniantang is the oldest existing pharmacy in Beijing, made itself famous both at home and abroad for making medicine diets , health liquors and teas for the royal family in the Ming and Qing dynasties.

Before 1949, the structure of Heniantang was *front shop and backyard factory*, comprised of manager, accountant, shops, bucket room, pill pharmacy (pellets, paste and Dan making workshop), knife room (cutting workshop), deer farm, electric grinding room and printing room. Heniantang set up the first branch in early 1929, in Dong’an market; in August 1935 set up a second branch, located in the Xidan Department Store; in April 1936 set up the third branch, located in Xi’an Drum Tower Shaanxi Province, (closed down in 1951).

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10 June and July of 2011, the author with the Beijing project team personnel, carried out a field survey in Heniantang, and conducted in-depth interviews with its managing leaders. The team members were Zhang Xiaomin, from Chinese Academy of Social Sciences Institute of Ethnology and Anthropology, Chen Hao, Guo Xiaofei and Liu Ping-ping from CASS Graduate School, and Chu Haobo from China Anthropology Ethnology Research Council, etc.

11 According to “Beijing Municipal Annals” Volume III “Commercial and Business” records: “The oldest and the most famous pharmacy in Beijing was Heniantang, which started its business in Ming Dynasty .....” “Beijing Municipal Annals” comprised of 15 volumes, more than 400 million words. The completion of the annals was about 1938 to 1939, and the editors was Wu Tingxie and Xiaren Hu, etc. Currently seen in Beijing Yanshan Press the June 1998 1st edition, 1st printing version, which was organized by the Beijing Municipal Planning Office of Philosophy and Social Science. It took relevant units and scholars more than 10 years to complete the collation.

In 1999, the former Ministry of Domestic Trade awarded Heniantang the “Chinese Old Brand” title; in 2005, the Old Brand Association awarded Heniantang the title “NO.1 Old Brand Pharmacy; Expert in Health Preserving”. In 2008, “Heniantang Chinese Medicine Health Preserving Culture Project” was included in the National Intangible Cultural Heritage Protection list.

## **(2) Case Two: Tongrentang**<sup>12</sup>

Tongrentang was founded in 1669 the Qing Dynasty, during the reign of Emperor Kangxi. The family name of the founder of Tongrentang was Le. The Le family came to Beijing during Yongle period in Ming dynasty. The ancestral home of the Le family was Ningbo, Zhejiang province. By the fourth generation, Mr. Le Xianyang became a royal doctor in the imperial hospital and he later founded Tongrentang Chamber. In 1702, Le Xianyang’s third son expanded his father’s chamber to Tongrentang Pharmacy. Since 1723, Tongrentang had been designated to provide medicines for the royal pharmacy of the imperial palace of the Qing Dynasty for duration of eight generations of Qing emperors, a total of 188 years.

So far, Tongrentang is a brand over 300 years, and has become an international state-own enterprise—Tongrentang Group Company. It has established three business sectors under the overall framework of the group: modern pharmacies, retail business and medical services. It has also established 10 companies, 2 bases, 2 institutes and 2 centers, out of which there are 2 listed domestic and overseas companies, over 800 retail stores at home and 28 overseas joint ventures (stores) over 40 countries and regions.

## **(3) Summary**

Heniantang and Tongrentang, the two Chinese old brand pharmaceutical enterprises, started from the initial little pharmacies, growing into joint-stock enterprises or group companies, had went through the Ming dynasty and Qing dynasty, witnessed

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12 Tongrentang is a listed company, thus a lot of information needs to be available to the public disclosures. Therefore, the relevant informations about Tongrentang are mainly from its official website: China Beijing Tongrentang (Group) Co., Ltd.: [www.tongrentang.com](http://www.tongrentang.com).

the collapse of dynasties and several foreign invasions, experienced the Warlord Rein period and the New-Democratic Revolution. Along with the changing of history, their forms of ownership, management methods had also experienced fundamental changes. However, Heniantang and Tongrentang's flags have never fallen for 600 years and 300 years. How did they manage to do this?

### **3. 1950-1970 The Relationships of the Two Old Brands with Government**

#### **3.1 1950: The Different Impact of the Joint State-private Ownership Reformation<sup>13</sup> on the Two Old Brands**

From the 1952 socialist reformation of the private industry and commerce, to the 1956 joint state-private ownership reformation, the old brands of China has went through the first shock.

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13 After the establishment of the People's Republic, the central government carried out the socialist reformation towards the national capitalists and private business sector, which was meant to transfer them into state-private ownership. The reformation and movement completed the confiscation of imperialism, feudalism and bureaucrat-capitalist property. June 1953, according to survey of the Central United Front Work Department, the CPC Central Committee drafted the "Regulations on the Utilization, Limitation, and Reforming of Capitalist Industry and Commerce." October, the China Federation of Industry and Commerce held a convention to convey the Chinese Communist Party's policy of the socialist transformation of capitalist industry and commerce during the transition period. On September 2, 1954, the 23rd State Council meeting passed through the "Provisional Regulations on State-private ownership Reformation". In the second half year of 1955, the trend of a industry-wide ownership reformation emerged in many large and medium cities. In November, the CPC Central Committee convened provincial and regional party leaders to strengthen leadership of the reformation. In early 1956, the nationwide socialist transformation reached climax, the capitalist industry and commerce had been transformed into industry-wide state-private ownerships. The state implemented the "fixed interest method" for the redemption of capitalism private shares, and regulated the annual interest was five per cent. From then on, the production goods were deployed by government. The capitalists, except for the fixed interest, had no rights to exercise their powers and were gradually transformed to self-reliant workers. In September 1966, the "fixed interest method" period expired, consequently the state-private ownership enterprises finally transformed into socialist ownership. The process can be summarized as follows: (a) private capitalists enterprises become public and private joint ventures; (2) capitalists began to lose the right as business managers; (3) enterprises profits were distributed by the "four horses split up the spoils" method.



### **(1) Heniantang in the Joint State-private Ownership Reformation**

In the reformation, the medicine production centre of Heniantang was incorporated into Tongrentang and Xuanwu Hospital pharmacy. Slice decoction, as Heniantang's main business, after the segmentation, had been peeled off. Without products, and all the patent prescriptions donated to the country, Heniantang completely lost its feature and competitive edge. Heniantang, which used to equal each other with Tongrentang, began its different fate. A large number of smaller pharmacies, home-shops were canceled. Only a small number of outstanding old ones were preserved ("Beijing Old Brand Enterprises", 2004).

### **(2) Tongrentang in the Joint State-private Ownership Reformation**

In 1948, the 13th generation descendant of the Le family, Le Songsheng took over as manager of Tongrentang. Starting from the 1952 socialist reformation of the private industry and commerce, Le Songsheng gradually began to convince the family to accept the joint state-private ownership reformation. In 1954, Tongrentang took the lead in the implementation of state-private ownership reformation. Le Songsheng was the very first manager submitted the state-private ownership application to the government, to accept the direct administration of the Beijing Municipal Government<sup>14</sup>. In early 1955, Peng Zhen, the Secretary of Beijing Committee of the CPC inspected Tongrentang and met Le Songsheng. Peng affirmed Le's performance in the joint state-private ownership

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14 July 28, 1954, an 11-member working group took over the management of Tongrentang. At that time, Tongrentang set up an asset liquidation group, and drafted the state-private ownership agreement. On August 27, Tongrentang state-private ownership reformation meeting was held, and the two sides signed the agreement, which embarked this old brand private pharmacy, after 258 years' operation, now entered in the socialist gate. For Tongrentang workers, the state-private ownership reformation is a pleasing thing, because all of a sudden they felt liberated. Tongrentang used to have a rule, which was that the apprentices have to change their names after becoming a worker of the pharmacy. The apprentices felt insulted, but they had no choice. After the reformation, the workers returned to their former names, and worked more efficiently. In 1956, Tongrentang established a Factory Management Committee, whose purpose was to achieve democratic management. The Committee would only make decisions, rather than being a production executive body. The establishment of the Committee further improved the management system of Tongrentang.

reformation. Sooner, Le Songsheng was received by Chairman Mao Zedong and Premier Zhou Enlai in Zhongnanhai. The same year, Le Songsheng was selected as the representative of Beijing Municipal People's Congress, and served as vice mayor of Beijing. He successively held as the representative of the 1st, 2nd and 3rd National People's Congress, and deputy director of the All-China Federation of Industry and Commerce.

On January 13, 1956, under the influence of Tongrentang, the whole pharmaceutical industry in Beijing was approved by the Beijing municipal government to carry out the industry-wide state-private ownership reformation. On January 15, a celebration party was held in Tiananmen Square to celebrate the victory of the socialist reformation. On behalf of the industry and commerce sector, Le Songsheng, holding a huge annunciation letter, boarded the Tiananmen gate, and presented the letter to the CPC Central Committee and Chairman Mao about the good news of the reformation.

In 1957, famous for its pellets and paste Dan, Tongrentang set up the first traditional Chinese medicine refinery to produce westernized Chinese medicines. In 1959, the factory and the brand of Tongrentang were resumed.

After the state-private ownership reformation, Tongrentang never worried about its products sales. At that time, the shops filled prescriptions from dozens of daily service to more than 200 per day. It was most obvious in the Mailing department. Previously there were only a few people in that department, and later it increased to more than 40 people. Even that sometimes it often needed help from other departments. Le Songsheng, so much preoccupied by social intercourses, hired Le Yiqing and Liu Jingyu from Tongjitang as deputy managers so that himself could take time to do other social works.

After the reformation, the enterprise profits were divided into four parts: income tax, corporate fund, workers' welfare, and shareholder bonus, namely the so-called "four horses split up the spoils". The government and workers took away the main part of the profits. As a representative of the national capitalists in China, Le Family of Tongrentang experienced the process from the initial uneasiness to taking initiative to accept the reformation. And later the Le family found that the "four horses split up the spoils" did not reduce their income, on contrary gave them a higher incomes, and the

incomes of workers almost doubled.<sup>15</sup>

### **(3) 1950s: The Different Impact of the Joint State-private Ownership Reformation on the Two Old Brands Heniantang and Tongrentang**

From the perspective of state-enterprise relationship, we can see the reformation exerted different influence on the two old brands, Heniantang and Tongrentang, which resulted in two obviously differentiated Patron-client ties.

Thanks to the active performance in the state-private ownership reformation, Tongrentang not only won the strong support of the Beijing municipal government, and also was appreciated by China's top leaders and the central government. Thus the patron-client ties with the local government and the central government were established. Subsequently the "self-financing" private enterprise turned into a state-owned enterprise under strong protection and support by the local and central government. After the reformation, the business nature of Tongrentang has undergone a fundamental change. Internally Tongrentang strengthened the leadership of the party and the government, established labor union and Communist Youth League organization, and regulated all their management system. The government also invested in Tongrentang's plant expansion, helped to renew equipments to promote rapid development of production. In management, Tongrentang got rid of the out-of-date mode of operation to suit the development of productive forces. The original Tongrentang was one-plant-one-shop mode, which lacked mass production power and products varieties. After the reformation, under the unified arrangement of government, Tongrentang was able to produce and sell medicines from other pharmacies; the government support promoted

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15 For example, the salary of workers in Tongrentang was more lucrative than other pharmacies. In other pharmacies, one month's income was equal to 60 kilogram of millet. In January 1953, Tongrentang workers' monthly income equaled to 90 kilogram of millet. After the "four horses split up the spoils" method deployed, a worker's salary was 62.5 yuan per month, at a time equaled to 480 kilogram of millet. As another example, before the liberation, the Le family extracted 40,000 taels of silver annually; after the liberation the Le family annually extracted 56,000 taels of silver. In 1953, according to the "four horses split up the spoils" principle, the Le family obtain bonus of 171,561 yuan, twice more than the original incomes. The manager Le Songsheng overjoyed: "I was concerned that the joint venture will affect production. I did not expect the business develops so well after the reformation."

Tongrentang to update its lagging-behind workshop-style production, simple manual operation gradually to mechanization and semi-mechanization production; In sales channels, Tongrentang expanded the one-shop sales mode to nationwide sales mode.<sup>16</sup>

On the other hand, after the state-private ownership reformation, Heniantang was no longer a “self-financing” private enterprise, but a state-owned enterprise. However, Heniantang had donated all its recipes to the country, and its traditional Chinese medicine production department had been segmented. Without these competitive edges, Heniantang, used to be a certain scale pharmacy, degraded itself into a small pharmacy. It had no access to the strong “asylum” of Beijing municipal government, and hardly won any political and economic asylum from the central government.

### **3.2 1960-1970: Heniantang and Tongrentang in the “Cultural Revolution”**

#### **(1) Heniantang**

During the 1966-1976 “Cultural Revolution” period, Heniantang had undergone the second wave of shocks. It was forcibly renamed as the People’s Pharmacy and Caishikou Pharmacy. Until the 1980s, “Heniantang” brand was then restored.

#### **(2) Tongrentang**

During the “Cultural Revolution”, Tongrentang experienced various vicissitudes, even the brand “Tongrentang” was canceled. At that time, Tongrentang was simply renamed as Traditional Chinese Medicine Factory One, and Factory Two. After the “Cultural Revolution” the brand of Tongrentang was able to be restored.

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16 There is a set of data that best describes the impact of the reformation. From 1948 to 1959, the workers number increased from 190 to 539, an increase of nearly 2.4 times; the production value increased from 160,000 yuan to 12.519 million yuan, an increase of 78.3 times; honey pills increased from 1.4 million pills to 68.642 million, an increase of 49 times; Shuifan pills from 4,000 jin to 313,800 jin, an increase of 78.5 times; tiger bone liquor from 30,000 jin to 305,000 jin, an increase of 10 times.

#### **4. The Different Impact on Heniantang and Tongrentang of the Transformation to Market Economy**

Since the 1980s, in China's Reform and Opening up and the process of marketization, the "separate government functions from enterprise management" principle exerted different impact on Heniantang and Tongrentang. Janos Kornai's theories (1980) that only if cut off the ownership link between government and enterprises, should the bargaining mechanism disappear, and the budget constraints harden<sup>17</sup>. However, before the mid-1990s, China's economic development has demonstrated a strange picture of "non-privatization progress". Why the theory contradicts China's reality enormously? Andrew Walder proposed two explanations: the first is the SBC (Soft Budget Constraint) analysis usually assumes that there is only one "owner", the "state". However, the fact is that layers of the potential owners of public ownership enterprises are as much as the government administrative layers. The second explanation is closely related with the first one, which is the interest of different level of governments with regard of the correlative enterprises are different and the governments' abilities to control the enterprises vary. Walder (1995) presented his central argument: the effectiveness of Kornai's hypothesis about organization varies along with the change of executive-levels, which provides the explanation why the public enterprises under local governments' jurisdiction developed so well.

Jean Oi (1992, p. 118 – 122) believes that local government controls and intervenes in the operations of enterprises through the following four levers: First, factory management. Local government uses contracted management or lease enterprises to individuals rather than privatize the enterprises, which can help the governments to intervene and control the enterprises. The collective contract mode decentralizes the enterprises' daily management, and motivates the factory managers with financial incentives to improve efficiency and increase productivity. Contractor can make recommendations about personnel, development, investment and production to

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17 He found that the past failure of Hungarian market reforms was not because of lacking economic incentives from the manufacturers or the government, but rather the relationship between the two, especially the bilateral monopoly system which often brought about bargaining, and consequently the bargaining soften the budget constraints and weakened the economic performance.

the enterprise, but the final decision-making right rests in the hands of the government. Second, the allocation of resources. Local government grasps the planned-price goods the central government allocated to them and owned scarce resources, so the local government can conduct selective allocation of resources to enterprises. Third, administrative services, including assisting enterprises to obtain a business license, product certification, product awards and tax reduction policies and other conventional services; and mobilizing subordinate agencies and organizations to support the key township enterprises; or even directly allocating administrative appropriations to the favored enterprises. Fourth, investment and loans. The control over investment and bank lending decisions is one of the most effective levers of local government to guide economic development. The control over investments and loans mainly are achieved by three ways, namely: making guarantees for the enterprises' loan; assessing enterprise's credit rating; supporting the establishment of local quasi-private credit organizations.

As the bearers of historic and cultural heritage, the development process of the two pharmaceutical enterprises in Beijing, Heniangtang and Tongrentang, can be seen as the epitome of the development of Beijing or even China's national pharmaceutical industry.

In the state-owned "Old Brand" enterprises, government is the actual representatives of state-owned assets, thus the enterprises' managing authorities themselves are the main body of enterprise-government relations management. In state-owned enterprises, government relations management is mainly through direct management (strong ties). Meanwhile, the investment and operations of state-owned enterprises have to some extent to meet the public needs, and keep in line with the interests of relevant interest groups. State-owned enterprises also can influence government policies through changing the public and the relevant interest groups' expectations, thus the indirect management (weak ties) exists as a secondary method of government relations management.

From a general viewpoint, the "Old Brand" enterprises' relationship with government can be classified as four types, namely "Strong ties - Strong development", "Strong ties - Weak development", "Weak ties - Strong development", and "Weak ties - Weak development" (Zhang et al., 2011, p. 227 – 234). Generally speaking, Heniantang's relationship with the government is "Weak ties - Weak development", however Tongrentang's relationship with the government is "Strong ties - Strong development".

### **(1) Heniantang: "Weak Ties - Weak Development" Relationship with Government**

Just walked out from planned economy, Heniantang now had to face the unfamiliar market economy. Beginning in 1992, the reconstruction of the old city town in Beijing weakened Heniantang's vitality. The old brand experienced a total of four times' demolition, lost more than 3,000 square meters. In 1995, Heniantang Pharmacy was restructured to Heniantang Pharmaceutical Company. Soon after experiencing another two restructurings, the business model of Heniantang had undergone tremendous changes.

Now, Heniantang is limited liability company comprises three corporate units and five individual share-holders. After the restructuring, Heniantang leaders realized that the current medicine distribution business was facing market integration. 20 large and medium-sized enterprises dominate the market: the 10 companies (sales above more than 2 billion) and 10 companies (sales above 1 billion) accounted for 90% of the market, the rest small enterprises only accounted for 10%. Heniantang's pharmaceutical distribution business sales was 100 million yuan, and was not dominant in competition. In face of rapid development of the market, Heniantang with many other old brands, confronted with same difficulties: the slowing development, the lack of talents and funds, heavy historical burden and so on. In order to revitalize its glory, Heniantang began digging in the heritage of the traditional health-preserving culture. Today, Heniantang has excavated and sorted out 108 kinds of herbal cuisines, 138 kinds of herbal porridge, 36 kinds of medicinal liquor, and 82 kinds of herbal stew, mostly from the royal and private prescriptions.

December 2005, Heniantang signed a cooperation agreement with Guangzhou Baiyun District to establish the "Heniantang Health City" covering an area of 1,000 acres. Under the agreement, Heniantang provides management, technology, brand, and Guangzhou Baiyun District will provide funding and land. The prophase investment will be 2 billion yuan. The Health City will become the distribution center of Chinese herbal medicine in southern China. Heniantang also set up their own ginseng and deer antler production base in Jilin Province, and establish a long-term partnership with the national GMP enterprise Jilin Changyuan Pharmaceutical Company to jointly develop new health-care products.

## (2) Tongrentang: “Strong Ties-Strong Development” Relationship with Government

In the development of Tongrentang, we can clearly see a strong shadow of government “asylum (strongly support)”. Specifically on the following aspects:

First, the government protects Tongrentang’s brand and supports its upgrade and expansion. For example, in February 1985, Beijing government conducted the 315 Anniversary Celebration of Tongrentang at the Great Hall of People<sup>18</sup>. In 1989, the State Administration for Industry and Trademark Office authenticated “Tongrentang” as well-known trademark, and gave special protection<sup>19</sup>. In 1991, Tongrentang Pharmaceutical Factory was promoted to “Grade One National Enterprise”. July 1992, the Beijing municipal government decided to bring all the resources of traditional Chinese medicine in Beijing together to form intensive management. Tongrentang was appointed to integrate all the resources and to establish a group company; On July 3, Beijing Medicine Company, Tongrentang Pharmaceutical Factory and Tongrentang Drugstore, etc. 21 core units incorporated into the “China Beijing Tongrentang Group”; On August 19, the inauguration celebration of the Group was held at the Great Hall of People<sup>20</sup>. March 2000, the Tongrentang Building completed. July 2010, the Beijing

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18 CPC Central Committee and the State Council were very concerned about Tongrentang’s development, and attached great importance to this commemoration. State leaders Li Xiannian, Peng Zhen, Wulanfu, Wang Zhen, Bo Yibo, Zheng Tianxiang, Fang Yideng and so on wrote more than 30 pieces of inscriptions to Tongrentang.

19 “Tongrentang” trademark was China’s first application of international registered trademark in Madrid, and the first registered trademark in Taiwan.

20 President Jiang Zemin wrote an inscription for Tongrentang, “Carry forward the fine tradition of quality first, and serve the cause of health service for the people.” At that time, Tongrentang Group’s total sales was about four or five hundred million yuan, with profit only tens of millions. The traditional Chinese medicines of Tongrentang were handmade, with very low added value. By 1980, the fixed assets of Tongrentang hardly reached 20 million, and all the common problems of state-owned enterprises could be found in Tongrentang: stock structure was irrational; chaotic market operation, and financially heavily in debt with loans up to 780 million, owning 40 million yuan’s interests to the banks; the asset-liability ratio reached 77.4%; banks no longer issued loans, and required to take previous loans back. By 1995 no bank was willing to lend money to Tongrentang, and the enterprise’s bank credit rating is “BBB”.



Tongrentang (Group) Co., Ltd. authorized by the Chinese government officially inaugurated. This marked the Tongrentang has transformed to a standardized corporate system, also signified a major institutional change. In 2011, Tongrentang started its restructuring plan, the integration of its 10 subsidiaries to 6 subsidiaries, namely the Tongrentang Group, Tongrentang Technologies Group, Tongrentang Pharmaceutical Group, Tongrentang Health Pharmaceutical Group, Tongrentang Herbs (ginseng) Group, and Tongrentang Commercial Group.

Second, the government supports Tongrentang to issue shares over domestic and overseas stock markets. In 1997, the central government listed 120 large state-owned enterprises as experimental units of the reform and establishment of modern enterprise system. Tongrentang as the only one of pharmaceutical industry companies was enlisted. In June, six blue-chip companies of Tongrentang group comprised the Beijing Tongrentang Co., Ltd.. In July, Tongrentang shares came into market at Shanghai Stock Exchange. This marked Tongrentang has taken an important step forward in the process of establishing modern enterprise system. At that time, Tongrentang Group, stripping out 200 million yuan assets, successfully listed and raised more than 300 million of funds. Now, this part of assets' market value reached more than 20 billion yuan. In October 2000, Tongrentang established Heji (Hong Kong) Pharmaceutical Co., Ltd in Hong Kong and listed on Hong Kong's Growth Enterprise Market. This was the first mainland state-owned enterprise that achieved a successful spin-off listing. Tongrentang raised funds of HK \$ 238,784,000 from Hongkong GEM, striding a key step for the Tongrentang products entering the international mainstream market. This was the first case of a spin-off A-Share that listed on H shares, known as "Tongrentang mode".

Third, the government encourages and supports Tongrentang's standardization and diversified development. In December 1997, the eight main production lines of Tongrentang's subsidiary enterprises passed the Australian GMP certification, laying a firm foundation for Tongrentang products entering into the international market. February 1999, Tongrentang Development Committee was established. The Committee's aim is: Face the Mainland market, look into the world and focus on the future; improve the technological level of products, produce hit products with own intellectual property rights, to guarantee Tongrentang's leading position in the 21st century. In May 2000, the Beijing Tongrentang Technologies Co. Ltd established; same month, Tongrentang Maierhai Biotechnology Co., Ltd. established, starting its preliminary exploration in

the bioengineering field. In June 2010, cooperating with the Chongwen District Health Bureau, Beijing Tongrentang Traditional Chinese Medicine Hospital was officially inaugurated on June 18, marking Tongrentang's endeavoring exploration in the organic combination of traditional Chinese medicine and traditional Chinese medical science.

Currently, Tongrentang has developed three main plates under the overall group framework namely the modern pharmaceutical industry, retail business and medical services, formed the "1032" project group, namely ten subordinate companies, two large production bases, two hospitals and two centers. Tongrentang Group now has two listed companies in domestic and abroad, more than 800 retail stores and 28 overseas joint ventures (stores) across 15 countries and regions.

### **(3) Different Effects of Government Relations in the Market Transition**

In the planned economy era, due to Tongrentang and Heniantang's strong or weak "asylum" relationships with the government, after the transformation to market economy, these strong or weak the "asylum" relationships evolved into strong or weak "agent" or even "trust" relationship with the government.

Obviously, Heniantang's "asylum" relationship with the government was weak, so it was unable to develop a strong "agent" relationship with the government. Tongrentang's "asylum" relationship with the government was strong, therefore it developed a stronger "agent" relationship with the government, or even we can say a "trust" relationship.

The below takes Tongrentang as a business case for analysis. In 1991 Tongrentang was promoted to the "Grade One National Enterprise". In 1992 Tongrentang Group Company was established. It was successfully listed in Shanghai Stock Market in 1997, and Hong Kong Stock Market in 2010. Behind a series of major actions, we can see a looming figure backed by the Beijing Municipal Government.

Among the games of the central government, the Beijing municipal government (local government) and Tongrentang (the microscopic body), the three parties were playing different roles in the institutional changes from provision-oriented structure to the diffusive structure at the intermediate level, and finally to the demand and supply structure. The institutional changes of the Chinese market economy system demonstrated a step-by-step progressive characteristic. In such institutional changes, the central government lacked knowledge of institutional innovation, thus it had to

depend on the accumulation and transmission of knowledge by Beijing municipal government, but in order to control the risks of uncertainty, the central government also need to prevent "excessive" reform by the local (Beijing) government; under such administrative decentralization environment, the Beijing municipal government officials hoped that through the introduction of market economy system to invigorate local economy, and won political achievement recognized by the central government. Thus, the local government had the motivation to push the institutional change in order to capture potential interests. But the precondition of institutional innovation was to have the Central Government authorize the local government the administrative power and afterwards recognize their reform achievement; to grasp more economic freedom and opportunities, Tongrentang was also thirsty for the market economy system which could expand their autonomous decision-making power. However it was difficult for Tongrentang to become a direct negotiator with the central government, and the widespread free-rider mentality of the industry obstructed collective actions, so Tongrentang welcomed the Beijing municipal government to act as their cheap organizer of collective actions. Meanwhile Tongrentang also received institutional innovation constraints both from the central government and the local government. Obviously, the Beijing municipal government acted as an important intermediary agent to connect the central government's willingness of institution provision with the institutional demand of Tongrentang. The part the Beijing municipal government played in the institutional reforms brought a significant impact. The involvement of Beijing government in institutional innovation greatly reduced the chance of the reform evolving into an "explosive revolution"; the Beijing government's active participation made China's market-oriented reform enter a step-by-step progressive trajectory, thus weakening the institutional legacy's constraints on the gradual market-oriented reform; Beijing government's involvement also weakened the "political constraints" of the reform, and made the reform possessing a Pareto Improvement characteristic.

China was in a period of transition from planned economy to market economy. The original planned economy disintegrated and the nascent market economy was not yet mature, thus an institutional rupture appeared in the transition process, forming an "institutional hole" (Bian & Zhang, 2011). Thus the local government in transition needed to play an active role to compensate for system deficiencies, and the local government also held some special resources, so that it had the "chips" to participate

in the economy. For example, the implementation of “dual price” system at the early stage of reform partly was because the local government held the distribution rights of the planed-price commodities, making it possible for the government to give certain enterprises the selective support. As another example, the Beijing government awarded many preferential policies to Tongrentang. Therefore, it can be understood from the market-oriented dimension why local government played a more active role than the government under mature market economy.

### **5. Summary: Different Destiny—to Become “White Swan”? Or “Ugly Duckling”?**

Heniantang and Tongrentang, both as old brand state-owned enterprises, with different “asylum” relations with the government, lead to different governmental management approaches, which in return caused uneven development of the two. In a variety of resources and funding distribution and acquisition, Heniantang was in a much more disadvantaged position compared with Tongrentang, which explained why the two had such vast difference in development.

In 1920-1930, Heniantang made a public appeal against the “Abolition of Traditional Chinese Medicine Case”, which received nationwide response. At that time, Heniantang was China’s most influential pharmaceutical brand. In the 1950s, after the implementation of state-private ownerships reformation, Heniantang gradually “fall from grace” with the central and local government, and gradually become an unknown “ugly duckling”, and even not a well-known brand in Beijing. However, Tongrentang had another destiny. After the reformation, Tongrentang was favored by the central government, and the Beijing municipal government. It subsequently grown into a prestigious pharmaceutical company, and became the “White Swan” of China’s traditional pharmaceutical industry. Even “Tongrentang” these three words, have become a household name among all Chinese community.

Due to historical reasons, China’s old brand enterprises once were all state-owned enterprises. The direct consequence of this situation was unclear property rights, dated management, and high management costs. This was called the “stiff disease of the state-owned enterprises”. For example, going through the state-private ownership reformation and several corporate restructurings, Heniantang finally transformed from a state-owned enterprise into a limited liability company. Since 1992, Heniantang had totally

encountered four times' demolition, lost more than 3000 square meters. Many outlet stores were demolished due to the reconstruction of the old city town in Beijing. But because of the unclear property rights, the old brand could not obtain compensation from the government. There are currently more than 2000 square meters of Heniantang stores are rented, with the rental expenses over millions, which greatly increased the burden on the enterprise. After restructuring, due to the low level of employees and restrictions on the types of works, the apprentice model was still the main way to train mature technical workers. However, the problem was after the apprentice training, mature workers wouldn't stay for long; usually they resigned and started their own business. The senior executives of Heniantang thought that although Heniantang became a joint stock limited company, and the government was no longer in direct supervision of the company, they still wanted to get more government supports. For Heniantang, the government support was far from enough for the enterprise to gain more scarce resources.<sup>21</sup>

In the Tongrentang case, government support became the most reliable resource for its capital accumulation and company expansion. The enhancing "asylum" relationship with government led to Tongrentang's strong development. Tongrentang as a successful old brand case, illustrated that the direct management relation with government (i.e. the "asylum" relationship) will bring a strong impetus to enterprise's development, and correspondingly increase the market competitiveness.

According to preliminary study, we also found that since the mid-1990s, with the deepening of property rights reform, especially after Tongrentang listed in mainland China and Hong Kong respectively, Tongrentang experienced the "non privatization progress" and then the "privatization progress". The introduce of the shareholding system of Tongrentang obviously formed institutional constraints on the central and municipal government's direct involvement in the business management. The governments no longer directly played the "entrepreneur" role. Instead of being a

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21 June and July of 2011, the author with the Beijing project team personnel, carried out a field survey in Heniantang, and conducted in-depth interviews with its managing leaders. The team members were Zhang Xiaomin, from Chinese Academy of Social Sciences Institute of Ethnology and Anthropology, Chen Hao, Guo Xiaofei and LIU Ping-ping from CASS Graduate School, and Chu Haobo from China Anthropology Ethnology Research Council, etc.

“patron” to the enterprise, now the governments converted into a role of “trustee”. Governments quited direct management of Tongrentang business, converted to indirectly promote the development of Tongrentang. However, Heniantang’s “asylum” relationship with the government became weaker and weaker, and obviously the government could not become Heniantang’s “trustee”. Heniantang has to be more on its own.

Thus, we can see that under the context of last 30 years’ tremendous economic and social change in China, due to the different “asylum” relationships with government, the changes of the old brand enterprises and the commercial tradition they beard demonstrated different states. In the “Cultural Revolution” there had been a short “break” between the changes and the traditions. Since the 1980s, the transformation to market economy made the relationship between the two present as seemingly “non-continuous”. In fact, the changes were based on their own business tradition, and evolved into “market transformation” or “modernization”, which formed the “new tradition”. For example, over the years, relying on the support of Beijing municipal government and its own market competitiveness, Tongrentang solved the initial problems encountered at the beginning stage of market economy, such as the enterprise’s survival and employees’ life problems. After solving these problems, Tongrentang entered into a fast growth period, completed the reform from traditional pharmacy to modern enterprise, from front-shop backyard-factory mode to modern mass production, from single production-operation type to capital management combined with the production-operation type, from extensive management to intensive management, basically formed a cross-regional, cross-border and cross-ownership operational pattern. Currently, Tongrentang is in the “develop first, regulate later” and “developing while regulating” phase.

Thus, we can conclude that as one of the main driving forces of China’s economic rise, the old brand enterprises, as entity enterprises, their development pattern is never single but multivariate. In the two cases of Heniantang and Tongrentang, the Tongrentang case let us see that despite state capitalism is dominant, the component of liberal capitalism is also evident, and we can also find a trace of socialist planned economy ingredients. However, the Heniantang case let us see that, despite liberal capitalism is dominant, still some ingredients of socialist planned economy remains, and even there is a bit of state capitalism.

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