Improving Corporate Governance Efficiency in Macau SMEs: A View of Challenges and Solutions in the Globalization Process

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ABSTRACT

This paper analyzes the characteristics and the importance of corporate governance in small and medium-sized enterprises (SMEs) in Macau. We examine the structure of corporate governance in Macau SMEs which are facing increasing challenges brought by globalization, and provide suggestion on strategies and mechanisms in improving the corporate governance efficiency. As a conclusion, well-developed corporate governance will contribute to the improvement of SMEs, further to foster the diversification of local economic activities. The main contribution of this paper is that we build a theoretical model for corporate governance in Macau SMEs, based on the integration of agency theory and stakeholder theory.

Keywords: Corporate Governance; Small and Medium-Sized Enterprises; Macau
INTRODUCTION

As a common business organization worldwide, small and medium-sized enterprises (SMEs) play an active role in stimulating the market stability, and contribute to the development of local economy. Accordingly, SMEs have become a critical focus for both government and scholars during the past decades. With various types of empirical and conceptual studies, the contemporary SMEs literature has gathered abroad scope of findings. Most of the literature has emphasized the significance of SMEs, where the proponents of SMEs argue that SMEs enhance competition, and then have external benefits on economy-wide efficiency, innovation and aggregate productivity growth (Beck & Levine, 2003). Previous research on SMEs has investigated governance issues for SMEs (Clarke & Klettner, 2009), corporate social responsibility and corporate governance (Del Baldo, 2010), the growth and poverty of SMEs (Beck & Levine, 2003), and some of the research specially investigates the corporate structure of family firms in SMEs (Morck & Yeung, 2004). It should be noted that the research on governance has extended from comparatively large business firms to studies of SMEs (Huse, 2000).

In recent decades, globalization has changed the business developing mode in Macau. According to the data provided by Association of Small and Medium Enterprises of Macau, there are 15,000 SMEs which account for a substantial part (99%) of all the enterprises in Macau. SMEs constitute a significant part of local economy, which are inevitably influenced by global economic environment. The fact is that economy of Macau initially shows negative
growth in the second half of 2014, which indicates SMEs will face increasingly serious challenges from then on. The purpose of this paper is that taking the globalization process as the background, to examine the characteristics and importance of SMEs in Macau, and then to explore the solutions to resolve the challenges. As a conclusion, we build a theoretical model for corporate governance in Macau SMEs, based on the integration of agency theory and stakeholder theory. We aim to provide some theoretical supports for the development of local SMEs, as well as the moderate diversification of economic growth in Macau.

LITERATURE REVIEW AND CONCEPTUAL FRAMEWORK

Literature Review

*Compared to large ones*

SMEs do make the contribution to the economic development (Zitek, 2011). They play a significant role in many aspects for society, such as employment, economy, and innovation, every country attaches importance to legislation which encourages the growth of domestic SMEs (Günay & Apak, 2014). It is no doubt that not only large companies, SMEs also stimulate the progress of society, so proper corporate governance is needed for SMEs, even if the managers and owners are the same persons. And the scores of public SMEs seem better than non-public SMEs (Gülsevim Yumuk Günaya & Sudi Apakb, 2014).

There is ample literature that studies corporate governance of large corporations, theoretically as well as empirically (Daily, Dalton, & Cannella, 2003). It is worthwhile to note that SMEs
are relatively less focused compared to large ones (Fiegener, 2005). However, governance issues for SMEs have been examined for several years in succession. Clarke and Klettner (2010) argue that SMEs corporate governance structures, processes and the principles which SMEs have chosen to implement should be explored, as well as the consideration of these choices will be of importance. Thus, we argue that SMEs indeed need appropriate regimes that differ from large companies.

**Family firms and social networks**

A part of research concentrates on family firms. The evidences show that non-family members without sufficient sources in top management team (TMT) may participate limitedly; members influence the decisions of upper echelons significantly (Patel & Cooper, 2014). Compared with non-family firm, family involvement will positively affect productivity of firms (Barbera & Moores, 2013). However, Hamelin (2013) demonstrates that family ownership negatively influences small business economic growth, with the evidence form French SMEs. It has been proved that family councils in some circumstances play the role of shareholders’ meeting and the board of directors. Especially in family SMEs, agency theory has not been well applied, with few scheduled shareholders’ meeting. In most cases, family members take in charge of management (Gnan, Montemerlo, & Huse, 2015). An inevitable result in family based SMEs is that inadequate protection for the minority shareholders, because of ownership concentration (Umran, Johl, & Ibrahim, 2015). Also, scholars have been stressing the social networks in SMEs. Social networks play the mediating role in
obtaining physical resources, valuable information, and developing business. In this context, social networks mean knowing the chances of foreign market, suggestion and learning with experience, and cooperation in trust (Zhou, Wu, & Luo, 2007). The research above provides solid academic foundation to study Macau family firms.

**Innovative potentiality for SMEs and globalization**

Lodh, Nandy and Chen (2014) argue that the effects of family ownership on innovation are positive. The business group affiliations of family firms differ from the innovation productivity of group-affiliated as well as stand-alone family firms. The venture capital should play a considerable role in supporting SMEs financing, so as to widen financing channels for SMEs, especially for the innovative enterprises (Vasilescu, 2014). Owing to information and communication technology, SMEs have much more opportunity to get into international market, district Kendal is one of the best examples, which manage the business online (Suprihadi et al., 2015). SMEs are vulnerable to the impact of the global economic crisis. In view of this, it is essential for SMEs to establish knowledge-based-economy as well as innovation (Man & Macris, 2014). More important than material resources is innovative potentiality for SMEs, not only does it constantly meet the needs of customers, but also it is the core driving force to maintaining SMEs’ competitiveness (Apak & Atay, 2014). Thus, it is necessary to improve the scientific and technological level to Macau SMEs, leading them innovation oriented.
Scholars usually connect innovation of SMEs with globalization. Globalization brings SMEs the increasingly competitive market. In order to survive in the fierce competitive environment, SMEs must develop the innovation ability (Şener, Savrul, & Aydı̇n, 2014). The factors affecting the progress of globalization could be divided into external and internal. What is more, managers of SMEs should know well about the pressure from international competition, the nature of specified industry, competitive potentiality, together with strategy, which contribute to the development of SMEs (Ensari & Karabay, 2014). Competitive relationship among local SMEs, make it not easy to share information and other kinds of resources (Sharma, Garg, & Sharma, 2011). The management of risk and crisis has been emphasized, besides innovative strategy, cooperation and business environment (Tsai, Shen, & Chiang, 2014).

In the trend of internationalization, the development of SMEs has been challenged. Owing to the flexibility, it is more convenient for SMEs to make the change for their financial, social and economic resources (Vățămânescu, Pinzaru, Andrei & Alexandru, 2014). The internet is a connection between customers and entrepreneurs to offer them the chance of transaction, which facilitates the globalization (Cho & Tansuhaj, 2013). Under the international background, factors that reflect individual and corporate global mind-set are different. For the former, the influencing factors are acceptance to new concept and values, willingness to work abroad, tendency to long-term planning, experience in international business, innovative spirit as well as cooperative personality of the management layer (Felício, Caldeirinha &
Ribeiro-Navarrete, 2015). Also, Scholars emphasize the role of language in immigrant-owned SMEs, which means mother languages are of great importance for immigrant SMEs. Compared to regional markets, immigrant firms are inclined to global internationalization, owing to the language gap seems more serious (Sui, Morgan, & Baum, 2015).

Regardless the length of time, any enterprise has the potential to accelerate the process of internationalization, which mainly affected by the factors of know-how, international network, and international experience. Meanwhile, the great efforts to communicate with the local, the positive attitude of the SMEs, and the flexible entrepreneurial policy will have an effect upon international commitment (Kalinic & Forza, 2012).

**Governance mechanisms in SMEs**

The relationship between insiders and outsiders has been focused, at the same time, in terms of small and medium-sized firms, governance mechanisms are affected by ownership, board composition and top management teams (Bruningne, Nordqvist, & Wiklund, 2007). Van Den Heuvel, Van Gils and Voordecker aim to study the performance and significance of board role in small and medium-sized family firm. Extant research shows that the board’s strategy involvement has been remarkably affected by leadership behaviors but also by processes (Machold et al., 2011). Besides, the corporate performances of SMEs are influenced by insider ownership (Hung & Chen, 2009), as for insiders in SMEs, it is necessary to examine the minimum shareholding requirements. Parum (2005) argues that as institutional
arrangement, disclosure in corporate governance plays an essential role to create a mechanism between enterprises and their shareholders as well as stakeholders.

According to Cheng, Kadir and Bohari (2014), some patterns of formal strategic planning could be found in SMEs, the majority of the strategic planning follows the example of the Strategic Planning Model proposed by Wheelen and Hunger (2008) in the west. Furthermore, economic factors that include but not limited to national economic growth, purchasing power, employment, currency inflation and taxation, have become the most important factors which affect the development, strategy and even the fate of enterprises (Cheng, Kadir, & Bohari, 2014).

**Financial support**

Financial support helps the enterprises to overcome the difficulties involved. Since most SMEs have limited sources of finance support, with the characteristic of ownership concentration, and the limited protection of minority shareholder rights, private equity and venture capital funds play important function in improving the efficiency of corporate governance in SMEs (Teixeira Latini, Rubens Fontes-Filho, & L. Chambers, 2014). Financial support provided by government is of importance for SMEs, besides, the regular assessment for related support policies is more fundamental (Man & Macris, 2014). In fact, to adjust the policies on the basis of assessment brings practical meaning to SMEs.
Corporate social responsibilities of SMEs

Substantial literature reviews the relationship between corporate social responsibilities (CSR) and corporate governance of SMEs. The goals to CSR will positively affect the corporate governance of SMEs (Del Baldo, 2012). Collaboration and networking can help SMEs to overcome some of the inherent difficulties, such as limited size, information asymmetry, incompetence and so on, so it is essential to set a standard in SMEs Networks (Mijatovic, 2014).

The previous literature makes significant contribution to the corporate governance structure in SMEs, most of the scholars argue that different governance mechanisms have different characteristics (Rediker and Seth, 1995). However, there is very limited literature which concentrates on Macau SMEs. We should notice the research gaps from previous studies, and aim at SMEs in Macau at a time when many focus on the gaming and hospitality industry. First, one inevitable problem is that data on small businesses are not publicly available, mainly because most of these firms are closely held, and governance issues are more complicated than that of in large (Cowling, 2003). Second, it remains unanswered that whether or not the corporate governance structure in western countries would also operate to a similar efficiency in Eastern context such as Asian countries and districts. Thus, it is necessary to analyze firstly the different business context in a given region, and then discover the current situation of corporate governance in its SMEs. Third, in this study, we specifically choose Macau as the target context because of the two reasons: a) SMEs have always been
one of the most critical business models in Macau, even though the largest industries (e.g.,
gambling and tourism) often draw more attention; and b) comparing to the large portion of
SMEs in Macau area, there is a lack of literature, which interferes with both business growth
and theory development.

Thus, targeting at these research gaps, this study aims at stemming from western theories in
corporate governance efficiency and developing an appropriate model specifically for Macau
SMEs. Also, we focus on providing relevant solutions to challenges faced stemming from by
Macau SMEs, under globalization background.

**Definition to Macau SMEs**

According to *Provisions on the Standards for Small and Medium Sized Enterprises* in China,
number of employees, annual turnover, and market capitalization are the most important
indexes to define SMEs. For manufacturing industry, the number of employees in medium
sized enterprises is between 300 and 2000, the number in small sized enterprises is under 300.
For retail industry, the number of employees in medium sized enterprises is between 100 and
500, the number in small sized enterprises is under 500. For accommodation and restaurants,
the number of employees in medium-sized enterprises is between 400 and 800, the number in
small sized enterprises is under 400. Taking relevant factors as consideration, we define
Macau SMEs on the basis of the number of employees, annual turnover, and market
capitalization, with two aspects (manufacturing industry and non- manufacturing industry).
Table 1. The Classification of Macau SMEs

<table>
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<th>Manufacturing Industry</th>
<th>Non-Manufacturing Industry</th>
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<tbody>
<tr>
<td><strong>Number of employees</strong></td>
<td>100 or below</td>
<td>50 or below</td>
</tr>
<tr>
<td><strong>Annual Turnover</strong></td>
<td>MOP$ 10,000,000 or below</td>
<td>MOP$ 5,000,000 or below</td>
</tr>
<tr>
<td><strong>Market Capitalization</strong></td>
<td>MOP$ 3,000,000 or below</td>
<td>MOP$ 1,000,000 or below</td>
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Source: The Statistics and Census Service (DSEC) of Macau

In accordance with data from Statistics and Census Service (DSEC), the definition to Macau SMEs is that, for manufacturing industry, the number of employees is 100 or below, annual turnover is MOP$ 10,000,000 or below, total assets is MOP$ 3,000,000 or below; for non-manufacturing industry, the number of employees is 50 or below, turnover is MOP$ 10,000,000 or below, total assets is MOP$ 3,000,000 or below, shown in Table 1.

Characteristics of Macau SMEs

**Small business scale**

Family firms constitute a relatively high proportion in Macau SMEs. Since the shareholders of the firms are mostly family members, they operate the business in a flexible manner. The small scale of business determines that the management must be decentralized as to improve production efficiency.
**External dependence**

SMEs are regarded as the important parts of Macau economy, with the characteristic of export-oriented and labor-intensive. The mode of production depends on build to order (BTO), with the strong dependence on the external. The imports of raw materials to SMEs are mainly from Chinese mainland and the exports aim to Chinese mainland, the United States, the European Union, Asia Pacific Region, and Portuguese-speaking countries.

**Labor-intensive**

The productions of textiles, leatherwear and footwear in SMEs show the characteristic of labor-intensive. The enterprises which closely relate to the people’s livelihood demand more labors to complete the work. However, the total amount of local labor forces cannot meet the requirement of market. In the labor intensive enterprises, shortage of labor resources is a serious problem.

**A variety of organizational forms of enterprise**

From the development process of enterprises in Macau, SMEs have witnessed three kinds of enterprises: *Sole Proprietorship, Partnership and Company* (Guo, 2010). In the previous years, most of the businessmen tended to choose *Sole Proprietorship* and *Partnership*. Yet recently, it should be noted that *Company* has become increasingly popular as the business organization form.
Importance of Improving Corporate Governance in Macau SMEs

Stimulate region economy

The definition of corporate governance can be found as the exercise of power over corporate entities (Tricker, 1997). The improved corporate governance helps the development of Macau SMEs, and in turn, stimulates the regional economy. The integration of western and Chinese cultures, especially the contacts with Portuguese-speaking countries, shows the characteristic of culture background in Macau. Certain import and export products are exempt from customs duties, with less complicated taxation system and lower rate of taxation. The advantages provide the international free trade port more business opportunities, comparing to other cities in mainland China and other districts (Guo, 2013). Thus, it has considerable practical significance to improve the efficiency of the corporate governance in SMEs. On the one hand, it will promote the development of enterprises themselves; on the other hand, the economy in Macau will also be actively impacted by such improvement.

Multi-dimensional benefit

Well-developed corporate governance will benefit the shareholders, society, economy, and so on. Both the SMEs and governments should make great efforts to promote the corporate governance in Macau SMEs. The UK and the U.S.A. are market-oriented ones, with highly decentralized equity and efficient capital market in such external corporate governance structure. By contrast, Germany and Japan have internal corporate governance structure. The Japanese example shows how capital acquisition patterns influence the working of corporate
control mechanisms (Walsh & Seward, 1990). In terms of Macau, it is necessary to establish a mode of corporate governance which is proper to local situation.

**Goals of Corporate Governance Improvement in Macau SMEs**

According to the Organization for Economic Co-operation and Development (OECD), the principles of corporate governance are designed as: 1) Rights and equitable treatment of shareholders; 2) Interests of other stakeholders; 3) Role and responsibilities of the board; 4) Integrity and ethical behavior; 5) Disclosure and transparency (OECD publishing, 2004). Compared to large enterprises, the relatively smaller scale leads to distinct corporate governance in SMEs. In consideration of the business environment in Macau, we set the goals for corporate governance in SMEs as the following three aspects.

*Improve corporate governance structure*

Corporate governance is obviously related to the protection of shareholders’ interests through developing the use of firm governance devices (Johnson & Greening, 1999; Shleifer & Vishny, 1997; Short et al., 1999). Family-oriented management still dominates the corporate governance in Macau SMEs. Although this is beneficial to internal control of SMEs, the excessive centralization of business risk and relevant disadvantages cannot be omitted either.

According to Figure 1, it shows the number of new incorporations with less registered capital is bigger, than that with more registered capital. The new SMEs even the micro-enterprises (with registered capital less than MOP$ 50, 000) grow steadily year by year. Thus, by
regulating operation mechanism and establishing proper internal control, the improvement of corporate governance structure should be regarded as the main principle. A good corporate governance structure is capable of improving the overall performance of Macau SMEs in order to prepare for various opportunities and challenges in the future.

Figure 1. The Evolution of New Incorporations in 2010-2014

![Graph showing the evolution of new incorporations in Macau from 2010 to 2014.](image)

Source: The Statistics and Census Service (DSEC) of Macau

**Increase the efficiency of corporate governance**

Firstly, influenced by the market and public policies, corporate governance structure in SMEs is different from large enterprises and joint stock enterprise. SMEs are more sensitive to
environmental changes, because the lack of financing channels and information asymmetry will negatively affect the result of corporate governance in SMEs. Secondly, most of the SMEs in their initial stages of business are managed by spouses, siblings or with other family members. Family members control the ownership of enterprises as well as the management decision making. They are reluctant to employ professional managers owing to a lack of trust. The main reason is that the activities of managers depend on their own interests rather than the owners’ interests (Walsh & Seward, 1990). Consequently, the poor quantity of professional managers is one of the factor that impacts the efficacy of corporate governance in Macau SMEs.

**Balance the interests of corporate governance**

The owners’ interest are threefold: (a) to make profit to maxima compatible with a predictable risk, (b) to use those profits generously and equitably for the owners, and (c) to sustain market conditions that are satisfied by the investors (Walsh & Seward, 1990). It is necessary to allow all kinds of stakeholders to participate in the business management of enterprises, through appropriate formal channels, and then share the development achievements of SMEs. Thus, the remaining issue is how to realize the maximum interest of the owners in Macau SMEs.

**THEORETICAL BACKGROUND AND RESEARCH MODEL DESIGN**

The theory of corporate governance has been transferred from “shareholder-oriented” to “stakeholders” since 1960s. In Germany, national laws grant the workers certain rights to
participate in corporate governance. In view of this, the stakeholders of Macau SMEs include shareholders, creditors, employees, management, consumers, suppliers, government etc. The representatives of the stakeholders are encouraged to be involved in decision-making process. However, since different stakeholders have different goals, conflicts of interest are inevitable, which have brought the difficult position to the stakeholder theory. This contradiction will reduce the efficiency of corporate governance in SMEs (Sun, 2012). Thus, provided that balancing the powers among the stakeholders, the condition will effectively improve the participatory governance.

**Corporate Governance Structure in Macau SMEs**

In consideration of the large quantity of SMEs, the improved corporate governance will play an important function to economic prosperity. Little specific legislations for SMEs in Macau, the relevant rules and regulation provide in *Macau Commercial Code*. The research on governance structures in other regions makes it clear to understand both the function of internal and external corporate control mechanisms (Walsh & Seward, 1990). We also follow the classification of corporate governance structure in Macau SMEs into internal and external.

**Relevant Patterns in Other Countries and Regions**

In the early stage of nineteen-ninety, the model of Japanese corporate governance was brought into focus, in the context of economic recession in Japan. Japanese corporate governance structure was dominated and encouraged by government, which integrated with culture (Li,
2011). Unlike Italian SMEs which have relatively more alternative financial institution instead of banks, the main bank system plays an important role in corporate governance in Japanese SMEs. The enterprises primarily rely on banks, which is the direct consequence of the support by Japanese government. The second type is insider control. In Japan, there is seldom external corporate control market (Sheard, 1989). Cross-shareholding promotes the shareholders to control business. On the one hand, it limits the restrain from shareholders to managers. On the other hand, it presses the managers to protect the interests of shareholders. All of above differ from taking the market monitoring as external supervision in the United States.

Further arguments on the efficiency of internal and external control mechanisms can be obtained by exploring corporate governance structures and monitoring among different countries (Walsh & Seward, 1990). As a result, the different patterns offer different experience of firms operating, which provides extended perspectives on corporate governance of Macau SMEs.

**Research Model: Challenges for Corporate Governance in Macau SMEs**

Based on the district economy status and the frameworks adopted by other countries, we develop a research model that illustrates the four main challenges faced by Macau SMEs at this stage, and then explore a five-point solution in order to tackle each of the challenge.
Problematic corporate governance structure

Strictly speaking, few SMEs has formal organizational structure in Macau. The possible reasons are as follows: 1) before the sovereignty over Macau transferred back to China, the Portugal government managed business affairs neglectfully, and less standardized management system in SMEs, which lead to the lack of corporate governance in respective of modern commercial law; 2) during the Portuguese government governed Macau, most of the laws in Macau were in Portuguese, which caused the language barrier between the local Chinese and the application of laws. As a result, customs and rules in Hong Kong supported business organizations in Macau; 3) limited by the small number of workers in SMEs at the initial stage, the business organization had to face the deficiency in all kinds of resources, so it is difficult to form formal organizational structure for corporate governance. In addition, short of modern management concepts, constitutes an important factor to hinder the development of corporate governance.

Proposition 1: The corporate governance efficiency in Macau SMEs is negatively influenced by problematic governance structure.

Limited financing channels

In the past, one of the governance problems in Macau SMEs is that financing channels for these business organizations are narrow. Most of the initial capitals for SMEs are from family members or friends; in addition, owing to the trusting relationship between banks and SMEs, a number of SMEs cannot get appropriate credit support. The financing channels for Macau
SMEs are limited, owing to the reasons of lower credit ratings, higher credit costs, less mortgages, and poorer financial management. Banks are reluctant to provide loans to SMEs, compared to large ones. Parts of the SMEs go bankrupt due to financial difficulties. Take the year 2013 as an example, the total dissolution of companies is 515, more than half of the dissolved one, their amount of capital is less than MOP$ 50,000 separately.

**Proposition 2:** The corporate governance efficiency in Macau SMEs is negatively influenced by limited financing channels.

**Improper integration of ownership and management**

The compositions of the internal governance structure of SMEs are general meeting, board of directors, and managers, which form the balance of power and responsibility. Since the ownership and management are usually considered as a whole, seldom do the owners authorize the agents

We believe that the integration of the powers leads to confusion of ownership and management. According to the degree of concentration of ownership, and then distinguish the governance characteristics of fewer ownership more control. Of course, the most advantage of this kind of structure is effective decision. Because the interests and concerns of business for ownership and managers are harmonious, which ensure the coherent and efficient enterprise decision-making process and execution. This kind of structure reflects the efficiency of
family-control governance. However, since the internal governance primarily rely on family members and relatives, it is not easy to apply principal-agent relationship. The majority controls not only the ownership, but also takes advantage of social resources to build and maintain relationships, which result in the high integration of decision-making, management and supervision.

**Proposition 3:** The corporate governance efficiency in Macau SMEs is negatively influenced by improper integration of ownership and management.

**Incompatible relationships among stakeholders**

The stakeholder theory focuses on all possible related parties. Stakeholder management has become the central theme of business forms and society (Carroll, 1989). The research gap discovered from previous literature is that different authors take different criteria to define stakeholders (Donaldson, & Preston). In order to protect stakeholders’ interests, the SMEs should carry out common governance. Therefore, the stakeholder theory provides broad thinking and theoretical foundation for the research of corporate governance (Li, 2011). We argue that the individuals and organizations which may affect SMEs include: shareholders, board of directors, employees, creditors, banks, suppliers, government etc., shown in Figure 2. So far, SMEs have been treated and supported by government positively, which shows great encouragement for them.
Proposition 4: The corporate governance efficiency in Macau SMEs is negatively influenced by incompatible relationship among stakeholders.

Research Model: Legal Strategy and Relevant Solutions

In this section, we develop and illustrate a five-point solution system in order to resolve relating challenges discussed in the previous section. To certain degree, the development of Macau SMEs contributes to the local economy, so it is also significant to improve the corporate governance in Macau SMEs. According to traditional theory of corporate governance, corporate governance in Macau SMEs can be divided into internal governance and external governance. Thus, we had better improve the corporate governance in Macau SMEs from the two aspects: internal governance and external governance with five-point solution. As the research model, Figure 3 shows the theoretical model of challenge-solution in Macau SMEs.
Figure 3. Theoretical Model of Challenge-Solution in Macau SMEs

Challenges

P1  Problematic Corporate Governance
P2  Limited Financing Channels
P3  Improper Integration of Ownership and Management
P4  Incompatible Relationships among Stakeholders

Internal Governance

P5  Coordinate Relationship among Shareholders, Board of Directors and Board of Supervisors
P6  Encourage Employee Involvement

External Governance

P7  Optimize Market and Policy Environment
P8  Increase Financial Support for SMEs
P9  Enhance Loans Assistance to SMEs

Solutions
Internal Governance in SMEs

*Coordinate relationships among shareholders, board of directors and board of supervisors*

Article 214 (1) in *Macau Commercial Code* provides that: the organs of commercial companies are: a) the general meeting; b) the administration; c) the company secretary; d) the supervisory board or single supervisor (Zhao, 2009). In view of the limited scale, a part of SMEs in Macau fail to meet minimum standards to set up company secretary, the supervisory board or single supervisor. The setting of one company secretary and one supervisory board or single supervisor is compulsory in any of the following situations ruled in Article 214 (2): a) have 10 or more shareholders; b) issue bonds; c) have the form of a public company; d) have an amount of company capital, balance sheet value or income volume in excess of a limit stated by *portaria of the Governor* (Zhao, 2009). Therefore, as shown in Figure 4, there are two basic frameworks for internal governance in SMEs: meet the requirement in Framework (A) but not meet the requirement in Framework (B). Businessmen in SMEs should set up the organs of company in accordance with the enterprises’ actual situations.
Coordinate the corporate governance structure, to form a scientific allocation with checks and balance, and to improve the efficiency of decision making. The relevant legal relationship of contracts could be regarded as the core of modern enterprises.

**Proposition 5:** coordinate relationships among shareholders, board of directors and board of supervisors are able to increase corporate governance efficiency in Macau SMEs.

**Encourage employee involvement**

As an important approach, employee involvement has been concerned to the development of corporate governance. If the representatives of employees have access to participate in the
daily management of enterprise, it will benefit for promoting the cohesion of the company.

Employee involvement at least includes the right to know, to supervise, and to make decisions and so no. From above, employee involvement in Western countries provides valuable experiences to corporate governance in Macau SMEs. And then, a proper compensation incentive mechanism for employee involvement may directly produce the benefits to company. How to apply the successful experiences from the Western to local SEMs should be concerned. All efforts made for the compensation incentive mechanism should be in accord with cultural diversity in Macau, what’s more, fully reflecting the local characteristics. Thus, creating an environment in which employees have a positive impact on business management, is the goal of employee involvement.

**Proposition 6**: encouraging employee involvement is able to increase corporate governance efficiency in Macau SMEs.

**External Governance in SMEs**

**Optimization of market and policy environment**

For efficiency improvement of external corporate governance in Macau SMEs, we should focus on the two aspects of market environment and social environment. In terms of market environment, there are capital market, manager market, production market and labor market, which are directly relevant to the destiny of local SMEs. The allocation of control rights of Macau SMEs corporate governance depends on the market. In addition to the market
environment, the social environment also forms an important part of external governance, as shown in Figure 5. Public opinion, laws, macro policy and financing, which made the effective integration to the enterprises and society.

Figure 5. The Composition of External Cooperate Governance

Proposition 7: systematic optimization of market and policy environment is able to increase corporate governance efficiency in Macau SMEs.

Increase financial support for SMEs

In order to help the growth of SMEs, the Macau government has made some financial schemes since 2003. After the revisions of 2006, 2009 and 2012, the schemes render better service for Macau SMEs. In accordance with the schemes, local SMEs have been granted the right to obtain financial support from banks. The schemes include SME Credit guarantee Scheme, SME Credit Guarantee Scheme Designated for Special Projects. Because the Macau government acts as the credit guarantor for SMEs in these schemes, a better security has been formed for the business development of SMEs. Besides, the local government should provide
preferential taxation policies to for the interests of SMEs. On the one hand, as an efficient financial support, preferential taxation policies reduce the investment risk of SMEs, on the other hand, preferential taxation policies as affect positively the corporate governance of Macau SMEs. Under this context, the financial market for corporate control provides an external control mechanism, which the interests of the shareholders can be well served.

**Proposition 8:** increasing financial support channels is able to increase corporate governance efficiency in Macau SMEs.

**Enhance loans assistance to SMEs**

The corporate performance of SMEs are influenced by the relationships between bank and corporate governance (Pinto, Augusto, & Gama, 2010). Debt sources of SMEs’ capitals are provided primarily through banks in Macau, and applicants who meet the requirements set by Macau government will get interest subsidization. The Interest Subsidized Scheme on Bank Loans to Enterprises is based on the reformation to SMEs, as one of the most importance factor to influence external corporate governance, capital market for enterprises should be focused on seriously. Since through subsidizing the interest of bank loans, the local enterprises will have more opportunities to invest and develop the business. The local government actively supplies financial support, and the amount of funds increase every year, according to the application data of SMEs, and the qualified ones which get the loans assistance.
**Proposition 9:** enhancement of loan assistance is able to increase corporate governance efficiency in Macau SMEs.

**DISCUSSION**

This study proposes a challenge-solution model targeting at improving the corporate governance of Macau SMEs. There are several theoretical contribution, which lie in these three aspects. First, it applies agency theory to corporate governance of SMEs in Macau, which explains the reasons for the owners of SMEs are often reluctant to entrust professional managers. According to agency theory, principals should take the risks and responsibilities brought by the agents. Especially in such circumstances where there are different goals from principals and agents, conflict of interests in corporate governance may be caused accordingly. Based on this theory, equity ownership affects managers’ risk-taking propensity (Eisenhardt, 1989). Thus, reconciling the relationship between shareholders and board of directors will improve the efficiency of corporate governance in Macau SMEs.

Second, it integrates stakeholder theory and agency theory in building a broader picture of understanding Macau SMEs. Well-developed corporate structure needs cooperation from all the stakeholders. Except for the agency relationship, we should also focus on the performance of stakeholders of Macau SMEs, which complied with stakeholder theory. The importance of stakeholder theory for corporation has been accepted not only in academic areas but also in business world (Donaldson & Preston, 1995). The purpose of this article is to point out the stakeholders characteristics of Macau SMEs, and to clarify its significance in an overall
perspective. In addition, the actual application of stakeholder theory combined with agency theory offers meaningful insights in building the proposed theoretical model.

Third, this paper provides a theoretical model for corporate governance in Macau SMEs. We take four challenges as the factors (P1, P2, P3, and P4) negatively influence the corporate governance efficiency. And in order to improve the efficiency of corporate governance, we explore a five-point solution (P5, P6, P7, P8 and P9), in perspective of internal and external governance.

CONCLUSION

As the world’s largest gambling center, Macau is quite vulnerable to the external economic environment. Since the global economy shows slower growth recently, gambling revenue has fallen for nine consecutive months. In addition to Casinos, we should not ignore that the basic business units which means SMEs have close connection with Macau economy. The study to Macau SMEs is full of practical and theoretical meanings. Our discussion to the efficiencies of internal and external corporate governance represents the kind of work that can apply the corporate governance theory to Macau SMEs. This is particularly important as the choice of corporate governance in Macau, and the general logic is supported by our illustration. It’s obvious that improved and efficient corporate governance will play an active role to foster the diversification of economic activities in Macau, meanwhile, SMEs will also be directly benefited from the positive corporate governance. Firstly, there are certain difficulties in some
aspects for the governance, yet, upon the great support by Macau government and well
coordination from internal and external of enterprises, SMEs can overcome the challenges in
the globalization process. Secondly, in order to regulate the structure of corporate governance,
as well as to cooperate with the support from government, improvement measures that learned
from international experience of corporate governance should be in compliance with the local
conditions. Moreover, a large number of SMEs in Macau will be beneficial from the improved
corporate governance practices. Thirdly, provided by agency theory and stakeholder theory,
we build a research model to better illustrate the strategy and mechanism design for
improving corporate governance in Macau SMEs. Thus, this paper has practical significance
for Macau business. Our understanding of corporate governance is still in its adolescence. An
empirical research synthesis between the internal and external factors should bring this
understanding to maturity.
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