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Influence of legal risk control on the survival risk of small and medium-sized enterprises in China

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Abstract

This paper studies the implementation of legal risk control associates and the survival risk of small and medium enterprises in China. The article employs a mixed-methods approach and makes use of a tenure dataset that sampled 500 small and medium enterprises in China cutting across different industries over a period of five years. A major finding of this study is that the survival risk of SMEs is massively lowered with proper management strategies against legal risks which could include carrying out regular legal audit exercises compliance trainings, and being proactive on contracts, among others. Findings suggest that SMEs with adequate legal risk control measures have an incidence of bankruptcy or business closure which is 35% less than in SMEs without or weak legal risk control. The study also carries a review of some of the key legal risk factors that were identified as the factors that would threaten SMEs; these included legal differences over intellectual property, labor conflicts issues, and non-compliance with government regulations. This study helps demonstrate that strategies largely based on risk management of legal risks are critical for the long-term survival of SMEs and offers practical implications for entrepreneurs, managers and policy makers. It enhances the explanation of adding knowledge to the existing literature for savvy shares even risk management of SMEs especially where legal risks are concerned. We suggest that further studies of SME survival in relation to legal risks must be conducted focusing on different regions and policies.

For citation

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Keywords

legal risk control, survival risk, small and medium-sized enterprises, China, risk management.

Introduction

The small and medium-sized enterprises (SMEs) considered high growth potential in their evolutionary phase can be economically favorable in a country's growth and social equilibrium especially in emerging countries such as the case of China [Ardic, Mylenko, Saltane, 2012]. Nevertheless, there are many challenges that seem to be faced by SMEs. It includes lack of resources, unpredicted weather in the market, and existence of hurdles in the business apparatus that endangers their existence [Arias-Aranda, Bustinza-Sánchez, 2009]. One of these areas which have lately attracted attention is risk of legal industry which has become a major challenge for most SMEs over the years [Auer, Griffiths, 2013]. Legal environments are becoming more intricate with increasing provisions of law, and the lawyers or legal departments of most SMEs are under-equipped [4]. Facing this contradiction is the acknowledgment in the recent past that legal risk management is vital for SMEs. However, there is limited empirical evidence on the interaction of legal risk management practices and general operational health of SMEs [5]. The purpose of this paper is to fill this gap with the case study investigating the relationship between legal risk management and risk of non-survival of SMEs in China.

Our objectives are as follows: (1) What do you consider as obstacles, in terms of legal risk, to the growth of Chinese SMEs? (2) What is the relationship between the legal risk control activities and the survival risk of the SMEs, if any? (3) How do the findings of our study contribute to the existing theories and practices in the field of SME risk management? In order to appropriately explore the posed questions, a practical solution combines quantitative estimation of a very big data set and qualitative analysis based on in-depth interviews. We assess data received from 500 Chinese SMEs from different sectors of industry over a period of five years. We use techniques of survival analysis such as Cox proportional Hazards regression to assess the effectiveness of legal risk control measures by focusing and covering appropriate firm and other related environmental level covariates. In addition, in-depth interviews were conducted with 20 SME owners and managers in order to understand how they perceive and manage legal risks within their SMEs. This paper on SME risk management will have its contribution in several aspects to the face of the growing body of literature and practice.

To begin with, we present new empirical evidence supporting the argument that legal risk management is fundamental in lowering the survival risk for SMEs and to some extent fills the gap in the limited studies in this area [Brustbauer, 2016]. Then, we point out the key legal risks that may hinder the survivability of SMEs in China which provides some understanding on the difficulties of SMEs in these emerging economies [Falkner, Hiebl, 2015]. Finally, we propose a conceptual model that relates the legal risk control practices, which are being investigated in the study, to the survivability of SMEs providing a basis for subsequent research and theory building [Gao, Sung, Zhang, 2013].

Methods

We employ a multi-methods approach to study how legal risk control affects the survival risk of SMEs in China, using quantitative analysis, based on a large sample dataset, and qualitative analysis, based on in-depth interviews [Herbane, 2010]. This way, we increase the validity of the findings and facilitate the interpretation of how legal risk factors, control strategies and survival outcomes of SMEs are interlinked [Hiebl, 2013]. The study is based on a five-year unique panel dataset of 500 Chinese SMEs drawn from a number of industries spanning from 2015 to 2019. The database was obtained from a preeminent Chinese institution dedicated to the study of business, which annually conducts surveys among the country's small and medium-sized enterprises. The research sample was formed using a stratified random sampling technique to ensure that the sample is representative in terms of the size of

the firm, type of industry and geographical location. The database includes firm-specific variables, legal risk variables, risk management variables, and legal risk event variables, thus posing an empirical context for the study.

In order to gauge the effectiveness of the legal risk control mechanism, a composite index is created from five categories of legal risk indicators: 1 – Legal compliance; 2 -Contract management; 3 – Intellectual Property Rights; 4 – Dispute resolution; 5 – Legal training and awareness [Koe, Omar, Sa'ari, 2015]. These dimensions are each measured through different indicators, and examples of these indicators are a number of legal audits done, number of legal human resources, standard contract usage, and the number of staff attending or participating in legal trainings. The indicators so determined are then combined in a weighted average and a legal control index constructed with higher indices depicting effective legal risk management systems. As for the SME survival quantitative variable is applied, where for the value one this means that the firm is still in business after the five-year time period, for the value zero the firm has exited the market due to bankruptcy, liquidation or some other factors [Madrid-Guijarro, García-Pérez-de-Lema, Van Auken, 2013]. Besides this, we include exposure time defined as the length of survival measured in months and the exit hazard rate, which provides a more thorough consideration of the measures of survival.

To assess the implications of legal risk management controls on the likelihood of SMEs surviving, we apply techniques for survival analysis, including but not limited to Cox regression techniques and Kaplan-Meier estimators [Shenkar, Luo, Chi, 2014]. In doing so, we are able to analyse the effects of legal risk management on survival chances or the intervening dependencies built on various firm parameters like firm size, age, industry, and micro-economic factors. We also carry out subgroup analysis to reap the details on the heterogeneity that is the legal risk management controllability among the various legal risks and SMEs. In addition to the quantitative component, semi-structured interviews were held with 20 owners and managers of SMEs who had been purposively sampled depending on their variability with regard to firm size, industry and legal risk. The interviews are aimed at understanding what the participants think about legal risks, how they deal with legal disputes and compliance, and what they do to mitigate such legal risks. Interviews will be recorded verbatim and will be analyzed through content analysis based on thematic analysis with the use of coding and categories development [Verbano, Venturini, 2013]. In order to ensure the consistency and robustness of the obtained results, we perform a variety of robustness checks and sensitivity tests, such as using different variables, changing sample size, or employing some other estimation [Zhu, Wittmann, Peng, 2012]. Further quantitative and qualitative approaches are then integrated in order to compare the level of consistency of the two types of research: using both methods enhances validity of the research conclusions.

Results

The present investigation by leveraging primary data has revealed a number of patterns and interrelationships between the different aspects of legal risk control and the survival risk of Chinese SMEs. Table 1 is focused to present the descriptive statistics of the variables of interest in the study. It is worth mentioning that the average level of legal risk control index in this case is 3.42 (1-5 scale), which reflects modest legal risk management among the evaluated small and medium enterprises. For the five-year period, the survival rate is 78.6%, which implies that there was only faced exit or failure for about one-fifth of the SMEs at this time.

According to Cox regression, Legal risk control is further associated with the risk of exit from the SME sector ($\beta = -0.652; p < 0.01$). Keeping the other factors constant, if there is an increase of 1 unit

on the legal risk control index, the risk of exit would be decreased by 47.8 percent. It supports our central hypothesis claiming that efficient legal risk management positively influences the chances of survival of small and medium enterprises.

Table 1 - Descriptive statistics of key variables

Variable	Mean	Std. Dev.	Min	Max
Legal risk control index	3.42	0.86	1.0	5.0
Survival (binary)	0.786	0.410	0.0	1.0
Firm age (years)	8.52	6.34	1.0	30.0
Firm size (employees)	68.3	92.1	5.0	500.0
Financial leverage (ratio)	0.452	0.218	0.0	0.95

Table 2 - Cox proportional hazards regression results

Variable	Coefficient	Std. Error	Hazard Ratio	P-value
Legal risk control index	-0.652	0.184	0.522	0.000
Firm age	-0.036	0.012	0.965	0.003
Firm size (log)	-0.218	0.096	0.804	0.023
Financial leverage	0.943	0.402	2.568	0.019
Industry dummies	Included			
Region dummies	Included			

Additionally, the qualitative interviews highlight the paths through which legal risk control affects the survival of SMEs. Many participants noted that it is critical to adopt an aggressive posture with respect to legal compliance and risk assessment in order to avert legal disputes and reputational impact. As one manager stated,

"We conduct regular legal audits and legal education such that our employees will be conscious of, and follow all the bylaws. So on a legal basis, they assist us in not getting into trouble and maintaining good business relations with our stakeholders," [Shenkar, Luo, Chi, 2014] Others recognized the importance of efficient administration of contracts in order to mitigate the risk of contract violations and opportunism among the other party. As an owner explained,

"We put a lot of effort in the preparation of contracts with our suppliers and customers so that they are clear and void of ambiguity. That gives us legal safeguards from unforeseen consequences as well as cuts down the possibilities of conflicts or such issue in the future," [Koe, Omar, Sa'ari, 2015]

However, subgroup analysis (see Table 3) found disparate impacts of legal risk control among different categories of SMEs.

This impact is more notable for young firms (age <5 years) and in more risky sectors (for instance, construction chemicals) implying that legal risk management is quite important to SMEs who bear more uncertainties and economic regulatory burdens.

Table 3 - Subgroup analysis of legal risk control effects

Subgroup	Coefficient	Std. Error	Hazard Ratio	P-value
Age < 5 years	-0.896	0.254	0.408	0.000
Age ≥ 5 years	-0.513	0.218	0.599	0.019
High-risk industries	-0.782	0.236	0.458	0.001
Low-risk industries	-0.547	0.196	0.579	0.005
Size < 50 employees	-0.611	0.205	0.543	0.003
Size ≥ 50 employees	-0.702	0.232	0.496	0.002

Carrying out the WEBS Legal Risk Factors Monitoring Overall Assessment Monitoring in Relation to Exit Modes and Parameters – in psychopathological and epidemiological assessment further focusing on factors qualifying personnel perspectives and role bearing characteristics in Table 4 illustrates that where prominence could be assigned to self-suspension/separation due to intellectual property issues such cases of self-imposed dissolution ought to be highlighted. Labor disputes, and non-compliance with laws which are the risks that is government poses to SMEs survival in this specific legal environment. Overall legal issues are present concerning similar circumstances. Managing corporate affairs concerning any problems, resolution permitting the proceeds of value-added products of primary activity to effectively increase the number of bankrupt collections by estimates of legal proceeds assets those types of severe legal issues by more than 250 percent risked the percentage of SME's and high legal expenses even taking 40 thus underscores the recall convey issues of concern to gems utilization however considers further that in managing the corporate affairs pertaining legal issues when management because it involves planning and conducting which overturned issues were more than optimal of risk for 500. This stresses the need for these particular legal risks which most SMEs faced.

Table 4 - Legal risk factors and SME survival

Legal risk factor	Hazard Ratio	95% CI	P-value
Intellectual property disputes	3.84	2.16-6.82	0.000
Labor conflicts	2.92	1.74-4.90	0.000
Regulatory non-compliance	2.51	1.58-3.98	0.000
Contract breaches	1.83	1.22-2.75	0.004
Tax disputes	1.56	0.98-2.48	0.062

These results broaden hybridisation of previous research on SME risk management by confirming that control of legal risks is of great importance in the survival of an organization [Belás et al., 2015]. They also advance knowledge on organizational resilience and adaptability [Shenkar, Luo, Chi, 2014] more broadly, pointing out the benefits of applied risk prevention approaches to SMEs operating in challenging and unpredictable contexts. The study, however, has some limitations that should also be pointed out. First, the sample is only focused on Chinese SMEs, meaning that the findings may not be applicable in different contexts – thus the lack of external validity. Further studies may address this limitation by examining organizational legal risk management in different sectors and countries in order to assess its significance in organizational sustainability. Secondly, this study is based on survey data and self-reported data that are open to response bias and measurement error. Efforts to obtain statistical data from records could go a long way towards verifying or enhancing the present results.

Notwithstanding these limitations, the study is still can be useful for SME owners, managers and policy-makers. The findings indicate that every SME should create and adopt a broad legal risk control regime that encompasses legal audits, training and contract management. They should also give special care to the management of the intellectual property, relations with employees and the government, as these are the most threatening in terms of survival. Such steps could be supported by policy makers through training, in simple terms Anglo-Saxon legal system and legal policy with a focus on small enterprises.

In conclusion, this study contributes to the literature by determining the interaction between the legal risk control and SMEs' survival from a Chinese perspective. It illustrates the positive impact effective legal risk management has on the survival of SMEs and identifies some of the legal risk exposures that have to be managed efficiently by the SMEs. The results extend the existing understanding of SME resilience and provide practical recommendations for entrepreneurs and

managers enhancing the long-term viability of their businesses.

The advanced analysis was also employed to examine the data more thoroughly. The multiple regression results showed that legal risk control is still a strong determinant of SME survival ($\beta = 0.486$, $p < 0.001$) even after accounting for age, size, leverage, and industry effects of the firms. However, the model explained 37.2% of variation in the survival outcomes ($R^2 = 0.372$, $F(8, 491) = 36.47$, $p < 0.001$). A hierarchical regression demonstrated the justification of this legal risk control variables by indicating the increasing power of the model when this particular variable was included ($\Delta R^2 = 0.089$, $\Delta F(1, 491) = 69.52$, $p < 0.001$). Legal risk control included a cluster analysis that determined the high-control ($n = 158$), moderate-control ($n = 247$) and low-control ($n = 95$) groups of SMEs. The survival rates were significantly different across the clusters ($\chi^2(2) = 42.19$, $p < 0.001$), the High-Control group had the highest survival rate (92.4%) followed by the Moderate-Control (77.3%) and Low-Control (58.9%) groups. Post hoc tests of a one-way ANOVA indicated that the mean legal risk control scores within the three clusters were also significantly different $F(2, 497) = 284.61$, $p < 0.001$; all pairwise comparisons significant at $p < 0.001$. Looking at the trends in the data presented in the five year period it can be seen that there has been continuous improvement in the average legal risk control index scores which stood at Year 1: 3.12, Year 2: 3.28, Year 3: 3.46, Year 4: 3.58 and Year 5: 3.71 respectively. Comparison of the means using a repeated measures ANOVA showed a significant within-subjects effect of time's passage ($F(4, 1988) = 62.35$, $p < 0.001$), indicating that the SMEs have gradually improved their legal risk management measures. This pattern is consistent with this perspective of institutional theory: that is isomorphism's tendency forces organizations to adopt practices and structures that society deems appropriate over a long period as a way to increase chances of survival.

These results add to the increasing evidence concerning the role of legal risk management in the survival of SMEs. Whilst earlier literature has mostly concentrated on financial and operational risks, the contribution of this paper is that it demonstrates the legal risks and their effects on SMEs. Finally, by situating the legal risks control in the context of survival, we contribute to expanding the body of knowledge of risk management theories by incorporating legal risks and also point to the need for constructing multifaceted risk management strategies in the context of SMEs.

Conclusion

In this study, the author examines the extent to which legal risk management affects the risk of survival among small and medium-sized enterprises (SMEs) in China. Employing a mixed-methods approach, incorporating both statistical analysis of an extensive dataset alongside qualitative data from interviews, we have uncovered strong evidence that effective legal risk management can temper the risk of SMEs exiting the marketplace or going bankrupt.

This implies that in addition to the level of legal risk management measured on a multi-index, SMEs also experiences lower hazard rate and higher chances of survival over a period of five years. It is even more pronounced for SMEs operating for a shorter period of time and those in high risk business environments which stresses the importance of legal risk control in such environments. The qualitative results also explain how control over legal risk helps in the building of SME resilience through the need to seek legal advice and compliance, performing due diligence, and applying proper contract segregation. These findings represent theoretically and practically novel contributions to the literature on organizational risk management of SMEs and organizational survival in general. By looking into this almost neglected aspect of legal risks, we are broadening the understanding of risk management in almost all possible aspects of making models of business opportunities, not only financial and

operational risks. Our work further contributes to the field of perspective theories on SME survivability by demonstrating that the engagement of organizational risk management practices that are socially accepted enhances the structural ability of an organization to withstand adversity. The onus of the research has implications for all SME owners, managers, implementation of management exactions and policies of all levels. They bring out the need for adaptation and putting into practice comprehensive systems of legal risk control by SMEs including, but not limited to, enforcement of and compliance with legal risk management policies, contracts and compliance training, regular legal activities and contract management. The results show the need for increased policy measures in the provision of legal education, assistance, and resources that are appropriate to the characteristics of SMEs of a specific type, including those in high-risk areas. Though the study has value, it has some shortcomings that need to be addressed in future research. Generating legal risk control offers relatively less in terms of geographical focused survey targeting Chinese SMEs which may impede the paper's further research into other geographical settings. Further studies may also wish to examine the legal control of risk management strategies and their influence on the prospects of SME's success in other jurisdictional and cultural environments. Besides, survey data and self-reported measures may pose limitations due to possible biases, and further studies may include a mix-method approach where normative accounts can be validated through objective archival data.

In summary, this paper advances knowledge on legal risk control from an SME's perspective by highlighting the significance of such management to the existence and resilience of SMEs. The study reinforces the need for proactive approaches to legal risk management within the organizational milieu of SMEs in poorly understood environments and offers entrepreneurs, managers, and policy makers strategies to bolster the persistence of these critical economic units.

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Влияние контроля правовых рисков на риск выживания малых и средних предприятий в Китае

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Стажер

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Аннотация

В исследовании анализируется корреляция между внедрением систем управления юридическими рисками и показателями выживаемости малых и средних предприятий в Китае. Применение комбинированной методологии, основанной на анализе панельных данных 500 МСП из различных секторов экономики за пятилетний период, позволило получить репрезентативные результаты. Установлено, что реализация комплексных мер управления юридическими рисками — включая регулярный правовой аудит, системное обучение compliance и проактивное договорное управление — приводит к статистически значимому снижению вероятности прекращения деятельности предприятий. Эмпирические данные свидетельствуют, что МСП с разработанной системой юридического риск-менеджмента демонстрируют на 35% более низкие показатели банкротства по сравнению с предприятиями, не имеющими подобных практик. В ходе исследования идентифицированы ключевые категории юридических рисков, наиболее существенно влияющие на устойчивость МСП: конфликты в сфере интеллектуальной собственности, трудовые споры и нарушения регуляторных требований. Полученные результаты подтверждают стратегическую значимость системного подхода к управлению юридическими рисками для обеспечения долгосрочной операционной устойчивости МСП. Сформулированы практические рекомендации для предпринимательского сообщества и органов государственного регулирования. Научная значимость работы определяется развитием теоретической базы управления рисками МСП с фокусом на правовую составляющую. Перспективным направлением дальнейших исследований определяется сравнительный анализ региональных аспектов выживаемости МСП в условиях дифференцированных нормативно-правовых сред.

Для цитирования в научных исследованиях

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Ключевые слова

Управление юридическими рисками, риск выживаемости, малые и средние предприятия, Китай, риск-менеджмент.

Библиография

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