

A CASE STUDY OF PROGRESS AND CHALLENGES OF ENTREPRENEURSHIP IN CHINA

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1. Introduction

The People's Republic of China (PRC) enjoys a growth rate that has averaged around 8% annually for over three decades. Recently founded private enterprises are increasingly an important part of that steady economic development as there are estimated to be about ten million such enterprises in China supplying a majority of the country's employment (China News, 2013; Huang, 2008). Moreover, there is evidence that private small and medium-sized enterprises (SMEs) played an important role in China's economic growth during a number of decades in the twentieth century as well (Huang, 2011; Rawski, 1989).

Yet in spite of that growth, entrepreneurship has not typically been a focus of researchers as much attention has been paid to the reforming state sector or to China's economic upheavals during the past century (Ahlstrom & Wang, 2010; Huang, 2010; Steinfeld, 1998). Although the Chinese diaspora had a long history of entrepreneurship around Southeast Asia, or the "South Seas" as it is often rendered in Chinese writings (Ahlstrom, Young, Ng, & Chan, 2004; Huang, 2005; Pan, 1990), the same cannot be said of Mainland China (Seagrave, 2010; Tung & Chung, 2010). The old examination system, a lack of institutional protection for property rights, limited availability of artisanal technologies that form the basis for many new products (Mokyr, 2002), a strict licensing regime and other cultural factors (Greif & Tabellini, 2010) that limited rewards to entrepreneurs likely hindered entrepreneurship in imperial China, much the way certain institutional factors such as the power of the guilds and the overemphasis on classical

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education was thought to have checked European growth before 1820 Europe (Balazs, 1964; Greenblatt, 2011; Landes, 1998; Ogilvie, 2011).¹ In particular, the many years of war and upheaval in the twentieth century, and the ascension of the Chinese Communist Party (CCP) in 1949 (and subsequent introduction of the Soviet economic model) stifled entrepreneurship and small business in China while other countries were experiencing much postwar growth (Harding, 1987).

In the decade of the 1950s, the People's Republic of China (PRC) collectivized agriculture and nationalized industry; small business and entrepreneurial activities were shut down. Many business and property owners were punished or imprisoned. Major industrial sectors such as film and garments were able to pull up stakes and move out of Mainland China to Hong Kong and Southeast Asia. By the end of the 1950s, the SME sector that had developed smartly in

Republican China virtually ceased to exist (Barone, 2004; Harding, 1987; Rawski, 1989).

The trend in 1960s China (as in many countries) was not only the collectivization of farms and small businesses but also the expansion of heavy industry using many elements of the Soviet central planning model, which further served to stifle entrepreneurship (Barone, 2004; Harding, 1987; Naughton, 1995). Economic and industrial development were thought to be largely based on scale and scope economies and capital accumulation (Galbraith, 1967; Naim, 2013; van Zanden, 2009). In China, this model of centralized agriculture and scale production was aggressively pursued as nearly all firms had their assets assigned to the government; scale and cost minimization were the order of the day (Harding, 1987).² Penalties for "profiteering" were quite strict; people were jailed for minor commercial infractions such as selling a few stalks of sugar cane on the street (Ahlstrom, Bruton, & Lui, 2000). Correspondingly, research in economics and generally the social sciences was not particularly concerned with entrepreneurship and its kindred, small business, particularly in the decades after the Second World War in spite of its apparent importance in earlier economic growth (e.g., Leff, 1979; McCloskey, 2013; Nasar, 2012; Schumpeter, 1934).³ For example, in the development economics field, Kaldor (1966) argued that the failure of firms in achieving scale economies and specialization was key to hindering firm development and national industrialization. In a subsequent influential review in

the *Journal of Economic Literature*, Nathaniel Leff (1979) added that the level of entrepreneurship was often not a constraint on the pace of development in countries.

In spite of the increasing attention directed at entrepreneurs in the popular culture in recent years, entrepreneurship still rates only a few mentions in development economics studies (e.g., Perkins, Radelet, Lindauer, & Block, 2013; Rodrik & Rosenzweig, 2010), though more recently several economists (Baumol & Strom, 2007; Baumol, Litan, & Schramm, 2009; Lerner, 2009, 2012; McCloskey, 2010), management scholars (Bruton, Ahlstrom, & Obloj, 2008; Du, Guariglia, & Newman, 2013; Ireland, Hitt, & Sirmon, 2003; Peng, 2001; Zahra, Sapienza, & Davidsson, 2006), historians (Landes, 1998; Pomeranz, 2001), and finance scholars (e.g., Cumming, Fleming, & Schwienbacher, 2009; Cumming & Suret, 2011; Levine, 2005) among others have started to draw more attention to the significance of entrepreneurship, new ventures, and the supporting institutions in general that contribute to economic growth and development (Aghion & Durlauf, 2005; Ahlstrom, 2010). Economics underlies the importance of entrepreneurship as it is thought to drive growth and development (e.g., Audretsch, Keilbach, & Lehmann, 2006; Autio & Fu, 2014; Baumol et al., 2009; Altiwanger, Jarmin, & Miranda, 2010; Wong, Ho, & Autio, 2005), and alleviates poverty (Bhagwati & Panagariya, 2013; Bruton, Ahlstrom, & Si, 2015; Bruton, Ketchen, & Ireland, 2013).

Both management and finance scholars attest to entrepreneurship's importance in driving economic growth, social development, and prosperity (Ahlstrom, 2010; Allen, Qian, & Qian, 2005; Butler, Ko, & Chamornmarn, 2004; Bruton et al., 2008; Levine, 2005; Phelps, 2013). *The Economist* magazine (2009a: supplement p. 6) concurs in describing entrepreneurship as "an idea whose time has come."

The growth opportunities provided by China's entrepreneurs and the particular challenges they face has led to important questions about how to encourage productive entrepreneurship, as opposed to its less productive forms (Baumol, 1990; Baumol et al., 2009; Young, Ahlstrom, Bruton, & Rubanik, 2011). Research in management and sociology to economics and finance generally agree that the institutions and incentives in the society matter a great deal

inencouraging entrepreneurship. How firms navigate China's challenging environment, given the unpredictable nature of its transition economy, is a very important question particularly in terms of the institutional regime there (Ahlstrom et al., 2000; Kazanjian, Drazin, & Glynn, 2002; Peng, 2006). Financing, venture capital, and other factors such as shadow banking are also important to entrepreneurs in China, and particularly impact the opportunities and incentives provided by the environment that help (or hinder) the entrepreneur's ability to create and grow new firms (Li, 2006; Zhang, 2013). Yet to date, the entrepreneurship literature has only recently started paying attention to these issues in China (e.g., Li, 2006; Wang, Ahlstrom, Nair, & Hang, 2008; Yang & Li, 2008). This chapter provides some background on key topics with respect to entrepreneurship and its application and research in China and suggests several topics for future research.⁴

2. Background

Entrepreneurship is generally regarded as a creative process whereby an entrepreneur causes changes in a market or economic system through provision of an innovative product or business model often in response to a valuable, enacted economic opportunity (Alvarez & Barney, 2013; Kirzner, 1973; Sarasvathy, 2008). As noted earlier, entrepreneurship was once a backwater area of study for academic researchers and consultants (Ahlstrom & Ding, 2014). Attention was typically directed toward the traditional factors of production labor and capital and on the price mechanism (Ahlstrom, 2014).

German economist Werner Sombart (1913) and Austrian economist Joseph Schumpeter (1934, 1942) were among the few who argued that the key to development and growth was often not lower prices or more scale in production or added capital but the creation of credit, innovation, and new ventures. This required creative destruction, that is, innovations and new ventures that may render the old system, or part of it, obsolete, but will provide more in terms of welfare gain to the society in terms of new products and ventures, as well as jobs, productivity, and growth (McCloskey, 2013; Phelps, 2013).

Such creative destruction of an older order has almost become Schumpeter's trademark, though the first use of the term "creative destruction" in economics probably should be attributed to Sombart (1913). Both maintained that the simple accumulation of capital is not the heart of economic growth. In discussing the importance of innovation, as opposed to mere capital accumulation, Schumpeter noted: "Add successively as many mail coaches as you please, you will never get a railway thereby" (Schumpeter, 1934, p. 64). More recently, researchers and policymakers have rediscovered Schumpeter's thesis regarding the important role entrepreneurs and their technologies play in creating new ventures, product markets, and growth (Acemoglu, 2009; Baumol et al., 2009; Haltiwanger et al., 2010; McCloskey, 2010). Empirical research extended the foundation laid by Schumpeter and further clarified the importance of entrepreneurship to an economy through innovation and new ventures thus leading to job creation (Aghion, Akcigit, & Howitt, 2005; Ahlstrom, 2010; McCloskey, 2013; Phelps, 2013; von Tunzelmann & Wang, 2007). Though it had long been thought that big companies created the most jobs (Galbraith, 1967), in the late 1970s, MIT researcher David Birch (1979) discovered that in an eight-year period ending in 1976, firms with fewer than 20 workers created four times as many new jobs as did companies with over 500 employees.

His report, titled *The Job Generation Process*, demonstrated the need to study job creation at the firm level, thereby opening up a whole new field of research in employment and entrepreneurship (Abzug, Simonoff, & Ahlstrom, 2000; Birch, 1979; Shane, 2008).

5 Later research (Medoff & Birch, 1994) confirmed that not all small firms created jobs, rather often it was young firms (sometimes small, but certainly growing) that did much of job creation. They called these firms "gazelles"—companies that with at least \$100,000 in revenue were able to grow 20% or more per year for four years. In one period studied in the early 1990s, gazelle firms accounted for nearly two thirds of the net new jobs in the economy (Medoff & Birch, 1994).

Recent data from John Haltiwanger and colleagues (2010) also show how (usually) young growth firms account for significant net job creation, which in turn is important for national income and economic growth (McCloskey, 2013).

3. Entrepreneurship in China

In much of the preindustrial world, sovereigns or local rulers held claim to all property in their lands, including new inventions (Rosenberg & Birdzell, 1986). As a result, subjects' property could be confiscated on the order of the sovereign. This could include innovations, which were regularly appropriated and utilized (or simply held) by local nobles or the monarch, often with limited compensation (Finley, 1965). A similar institutional structure existed in Imperial China (Balazs, 1964). As a result, it was common for people in China with assets to avoid acquiring conspicuous capital or concentrating resources in investments that might attract attention (Balazs, 1964; Rosenberg & Birdzell, 1986). This made it challenging for Chinese proprietors to significantly develop and grow their workshops and businesses, and also made it difficult to concentrate wealth to create funding for major investments required by industry.

In addition to the dearth of property rights, which worked to limit entrepreneurship, preindustrial Imperial China also reserved its biggest rewards for those who did well in the imperial examinations, much as classical education and examinations in Europe (Greenblatt,

2011). These exams were devoted primarily to the Confucian texts, other classics, and calligraphy (Ho, 1962). Successful candidates often entered the government hierarchy and high society, which gave them access to rents associated with many government positions.

Others outside of the government, though they may have gained success in commerce, had much less access to government favoritism and were often unable to achieve high social standing (Balazs, 1964). Institutional rules favored the scholar-official who could devote much time to exam preparation and were weighted against the creation of new firms and products by entrepreneurs.

Entrepreneurship was to experience a small flowering in Republican China in the first decades of the twentieth century (Rawski, 1989). However with the CCP's accession to power in

1949, China's nascent market economy was transformed into a socialist one governed by a system of central planning with largestate-owned enterprises (SOEs) and collective agricultural units. The state determined the allocation of most economic inputs and outputs, and maintained a monopoly over production and distribution (Reynolds, 1982). At that time, enterprises had to seek approval for doing virtually everything from the higher departments, which were separated from frontline production. In many factories, managers had to obtain authorization from their superiors before they could make expenditures greater than 50 Yuan—about ten dollars at that time (Liu & Wang, 1984).

Under the planned economy, management systems emphasized production, cost control, and filling needed quotas (Naughton, 1995). With the *danwei* system implemented at that time, enterprises provided housing and benefits to employees, such as childcare, schools, clinics, shops, services, post offices, and so on. The *danwei* acted as the first step in a multitiered hierarchy linking each individual with the central Communist Party infrastructure. The

“Iron Rice Bowl” of lifetime employment also restricted the ability of individuals to operate outside of the system. Entrepreneurship was suppressed both legally and by the de facto restrictions of the *danwei* system. Although some artisans continued to quietly work outside of the system, they often did so at the risk of arrest and punishment (Ahlstrom et al., 2000). What entrepreneurship did exist was on a small scale in the form of the black market and underground economy, often unproductive rent-seeking activity to take advantage of the perennial inefficiencies and shortages in the economy (Harding, 1987).

As China stabilized after the end of the Cultural Revolution, the new leader Deng Xiaoping launched China's Four Modernizations reform program in 1978 to improve the moribund economy and stimulate much needed economic growth. The first step was to decollectivize agriculture so farmers, after producing their annual grain quotas, could raise other crops, fish, or livestock to sell outside of the country's formal economic plan (Harding, 1987). Deng's popular agricultural reforms were soon extended beyond farms to households so small businesses could be set up to supply much needed local goods such as bricks and other building materials.

The rural reforms created the impetus for the rapid development of township and village enterprises (TVEs), many of which were actually private, entrepreneurial firms (Huang, 2008). TVEs had the flexibility to switch their production to goods needed by the local markets, which led to growth, and the development of a solid entrepreneurial sector during the early reform period of the 1980s, which was the impetus behind China's impressive and steady economic growth (Huang, 2010).

4. Economic Development and Employment

Chinese economic reforms have fundamentally transformed its economy and society (Ahlstrom & Bruton, 2010). This sustained economic liberalization, perceived as providing valuable opportunities for many individuals and existing economic units, has given birth to a new diversity in organizational forms and to a plurality of property ownership types (Boisot & Child, 1988, 1996; Huang, 2008). Along with the flourishing of private and small businesses,

China's entrepreneurs have been unleashed in almost every corner of Chinese society and have begun to make a significant contribution to economic development (Dana, 1999; Huang, 2010). After more than three decades of sustained market transition, domestic entrepreneurial organizations, including private startups, joint ventures, and other new ventures, have emerged as one of the most important driving forces behind China's rapid economic growth and development (*The Economist*, 2011; Naughton, 2007; Yueh, 2013). This has led to an increase in magnitude in GDP with a concomitant improvement in real per capita income. In China, the middle class has grown from 174 million in the mid-1990s to a remarkable 806 million just 15 years later (*The Economist*, 2009b).

Entrepreneurship has also facilitated the transition of China's institutional regime and its ability to gradually develop in the planned economy (Naughton, 1995, 2007). From the time of Deng's initial reforms, the entrepreneurial sector grew rapidly from almost zero to over six million registered private businesses by the end of June 2008, recording an annual growth rate of over 10% in 2000–2007 and over 19% in 2000–2005. Enterprises not majority-owned by the state not long ago accounted for well over half of industrial output (Huang, 2008) and are contributing an increasing share of GDP—recently at about 70% (*The Economist*, 2011).

The vigorous growth of private businesses, together with the development of the investment markets, has led to the formation of an entrepreneurial ecosystem in China. For example, entrepreneurship has led to growth and development and improved job opportunities for millions of China's citizens. Research is slowly accumulating on examining the entrepreneurship development process in China and to identify similarities (and distinctive factors) in China's entrepreneurial environment compared to that in the more developed economies; however more research is needed in several areas (Ahlstrom, Nair, Young, & Wang, 2006; Anderson & Lee, 2008; Djankov, McLiesh, & Ramalho, 2006; Yang, 2007; Yang & Li, 2008; Yu & Stough, 2006).

5. China's Entrepreneurs

In the early reform period, entrepreneurs tended to disguise themselves and their businesses due to China's previous political suppression of private enterprise (Ahlstrom, Bruton, & Yeh, 2008; Tsang, 1996). However, in recent years, with the widely disseminated entrepreneurial stories and successful IPOs of many startups, more and more people in China have pursued entrepreneurial aspirations (*The Economist*, 2009a). The Chinese Panel Study of Entrepreneurial Dynamics (CPSED)⁶ survey has recently revealed some important facts on Chinese nascent entrepreneurs: Male entrepreneurs account for about two-thirds of all nascent entrepreneurs; they tend to be younger and well-educated; they are in the average age of 31; and nearly 44% are in the age group 25–34. This result is largely consistent with findings from the Global Entrepreneurship Monitor (GEM) 2012 report, which found that China has a high proportion of young entrepreneurs, with 57% between 18 and 34 years of age, and less than one quarter falling in the older age group of 45–64 (Xavier, Kelley, Kew, Herrington, & Vorderwülbecke, 2013). This is younger than the average age of entrepreneurs in the United States, where the highest rate of self-employment and business ownership is found among people between the ages of 45 and 64 (Shane, 2008, p. 44).

Education levels are also an important characteristic of nascent entrepreneurs in China. The survey results show that those with bachelor's degrees account for nearly 32%, community college or equivalent accounts for about 27%, high school also represents about 27%, junior high school or below accounts for about 9%, while master's degree and above accounts for the remaining 4.4% (Yang & Zhang, 2012). Prior working experience is regarded as important

humancapital for entrepreneurs; about 80% of the entrepreneurs have priorworking experience, within which about 39% claim related industryexperience. Nascent entrepreneurs start up their company to pursueattractive market opportunities, which comes from their resourceand capability, and from systematic research (Carter, Gartner, &Reynolds, 1996). According to the CPSED data, when Chinese peopledecide to start their own business, the priorities they usually haveare beginning to save money to invest in the startup, developingfinancial projections, and beginning to collect information on prospectivecustomers.

Another important phenomenon is the role of migrant entrepreneurs. Migrant entrepreneurs often maintain strong social ties to theirhomeland community, with positive benefits such as the transfer ofbusiness and technological know-how, information exchange, andremittances. In the United States for example, migrant entrepreneursaccount for more than half-million jobs (Hohn, 2012). More andmore overseas-returnee entrepreneurs are often highly educated individualssuch as scientists and engineers trained in developed countrieswho return to China to start up a new venture with technologicknow-how or scientific expertise (Wright, Liu, Buck, & Filatotchev,2008). This is a clear indication of the impact that migrants orreturnee entrepreneurs can have on entrepreneurial development andgrowth. Particularly in developing economies such as that of China, returning migrant entrepreneurs may be better equipped to overcomeobstacles and start businesses (Saxenian, 2006).

There is research on entrepreneurial personalities and relatedattributes (e.g., Littunen, 2000) and indeed on some characteristicsand behaviors that seem common to entrepreneurs everywhere, including China. For example, the willingness to find a way tomake something work rather than saying it cannot work is a commonbehavioral characteristic of entrepreneurs (Sarasvathy, 2008). Entrepreneurs are also thought to be more tolerant of risk in general (Van Praag & Cramer, 2001). Similar research on entrepreneur attributeshas slowly started to emerge in China as well. For instance, Tan (2001) argued that entrepreneurs in private firms tend to be more risk-taking, innovative, and proactive than managers in SOEsin responding to the changing institutional environments. Otherstudies emphasized that the propensity to engage in entrepreneurialactivities is a function of individual cognition (Brush & Chaganti, 1996; Busenitz & Lau, 1996). Lau and Busenitz (2001) tested amodel of entrepreneurial cognition among small business owners

in China. They found that not only are entrepreneurs' commitment, need for achievement, and social environment important, but an understanding of the transition environments has a direct impact on firm growth intentions.

Research on entrepreneur attributes has also been conducted in China. For instance, Tan (2001) argued that entrepreneurs in private firms tend to be more risk-taking, innovative, and proactive than managers in SOEs in responding to the changing institutional environments. Some studies emphasized that the propensity to engage in entrepreneurial activities is a function of individual cognitions (Brush & Chaganti, 1996; Busenitz & Lau, 1996). Lau and

Busenitz (2001) tested a model of entrepreneurial cognition among small business owners in China and found that not only are entrepreneurs' commitment, need for achievement, and social environment important in terms of firm-growth intentions, but so also is a clear understanding of the transition environment in which they are based.

Though more research is needed in the areas of entrepreneurial characteristics and behavior, early research suggests that Chinese entrepreneurs share a lot of common characteristics with entrepreneurs in Western countries. For example, as in the West, social networks, a healthy attitude to risk, and an inclination to work hard are all characteristics associated with entrepreneurs in China (Forbes, 1999; Krueger, 1993; Krueger & Brazeal, 1994). But there are also notable differences; being female, older, or a member of the CCP all significantly reduces the probability of becoming an entrepreneur.

These traits are not dissimilar to entrepreneurs elsewhere (Djankov et al., 2006).

The person-centric approach, however, is thought by some to be problematic because it puts too much emphasis on individual roles in entrepreneurship and does not consider variations in the opportunities that different people may identify or otherwise develop (Gartner, 1990; Shane & Venkataraman, 2000). In contrast to this approach, researchers began to focus on entrepreneurial individuals interacting with their environments and, more importantly, on their cognitive processes in discovering, enacting, and developing opportunities (Alvarez & Barney, 2013;

Sarasvathy, 2008; Shook, Priem, & McGee, 2003). Legitimacy building, for example, is a particular enactment activity that is crucial to entrepreneurship in China and other developing economies (Ahlstrom et al., 2008; Tsang, 1996)

Entrepreneurship and Financing

Within the entrepreneurship ecosystem, financial capital is one of the necessary resources required for enterprises to form and subsequently operate. The nature of the capital structure of startup ventures is quite important to their success (Cassar, 2004). For example, it has been argued that both the level and the sources of startup capital can play a critical role in the success of the firm (Cooper, Gimeno-Gascon, & Woo, 1994; Florin, 2005). The amount of capital needed has been widely examined, and it is generally acknowledged that its absence helps to explain the liability of newness that impacts new firms so negatively (Aldrich, 1999; Marlow & Patton, 2005). But the source of the capital also impacts the success of the venture (Cassar, 2004; Christensen & Raynor, 2003). Additional research has recently emerged on this important topic (Du et al., forthcoming; Newman, Gunnessee, & Hilton, 2012). Compared with more developed economies, private enterprises; especially SMEs face significant constraints in accessing financing from the banking sector (*The Economist*, 2011). While the source of capital has been recognized as having a significant role in the success of a venture, the topic of why entrepreneurs seek out different sources is yet to be examined in detail. Examining the source of startup capital for businesses in ethnic Chinese communities in East Asia is an important research topic that is garnering additional research (and is addressed in a Special Issue of *ISBJ*, 2014, issue 6).

A key institutional challenge faced by Chinese entrepreneurs has been their limited access to credit. It is estimated that recently, of the 40 million SMEs in China, very few could obtain loans from banks or other formal financing (Cong, 2009). Entrepreneurs mainly rely on their own savings or borrow money from family and friends.

However, other financial channels are emerging and developing in China, such as venture capitalists, private equity investors, and business angels, as well as numerous informal and gray market channels (*The Economist*, 2009a, 2011; Zhang, 2013).

The theoretical principles underlying the capital structure and financing choices of entrepreneurs can be generally described either in terms of a static trade-off choice or pecking-order framework (Cassar, 2004). Both frameworks predict differences in explicit and implicit financing costs, and consequently, the use of financing for different firms. A static trade-off choice encompasses several aspects including the exposure of the firm to bankruptcy and agency costs against the tax benefits associated with debt use. On the other hand, Myers and Majluf (1984) also provide a pecking-order theory of capital structure choice created by the presence of information asymmetries between the firm and its potential financiers. Asset structure has generally been found to be a key determinant of capital structure in most SME studies, but research by Newman and colleagues (2012) found that firm size, firm age, profitability, and incorporation are significantly related to the leverage of Chinese SMEs. However, contrary to what they hypothesized, asset structure was found, at best, to be weakly related to capital structure. This is somewhat surprising given that asset structure has generally been found to be a key determinant of capital structure in most SME studies; in China, intangible assets such as social capital are likely to be relatively more important and valuable, which would account for that result (Bruton, Ahlstrom, & Wan, 2001; Newman et al., 2012). To facilitate the development of venture capital (VCs) industries in China, the government and related institutions gradually launched policies and agencies starting in the early 1980s. During the 1980s, private equity professionals' pioneering efforts to enter the

China market began. Jardine Fleming, Sung Hung Kai, & Co., and American International Group were among the pioneers. In 1985, the first Chinese VC institution, China New Technology Venture Capital Company, was established with the official approval of the State Council. At the same time, in the 1980s, a few pioneering private equity professionals (e.g., Jardine Fleming, Sung Hung Kai, and the American International Group) entered the China market (Bruton & Ahlstrom, 2003). Early investments tended to be in property and tourism (Bruton, Dattani, Fung, Chow, & Ahlstrom, 1999).

However, the pace of China's economic reforms did not encourage a significant number of firms to enter the market until 1992.

In 1999, China's Ministry of Science and Technology (MOST) officially launched a fund called "Technical Innovation Fund for Small and Medium-sized Enterprises" partly in response to new policies from the government on technology development. Also in 1999, the "Opinions on Establishing a Venture Investment Mechanism" was introduced jointly by the Ministry of Science and Technology, the State Development Planning Commission, the State Economic and Trade Commission, the People's Bank of China, the Ministry of Finance, the State Administration of Taxation, and the China Securities Regulatory Commission.

To get an overview of the development of VC investment, in 2002, the Ministry of Science and Technology, the Ministry of Commerce, and the China Development Bank jointly launched the first "National Annual Survey of Venture Capital Investment."

In 2011, the Ministry of Science and Technology, the Ministry of Finance, the State-Owned Assets Supervision and Administration Commission of the State Council, one bank and three commissions in the government (the general headquarters of People's Bank of China, China Securities Regulatory Commission, China Insurance Regulatory Commission, China Banking Regulatory Commission), and the State Administration of Taxation jointly issued "Opinions on Promoting the Integration of Science and Finance and Accelerating the Implementation of Independent Innovation Strategy." With continuous policy improvement and the emergence of entrepreneurial opportunities, a number of venture investors sprang up in the first decades of the twenty-first century. In 2010, for example, the major source of capital for Chinese VC investment was unlisted companies, which accounted for one-third of the total, while the total amount of capital from government-supported and state-owned investment institutions took up nearly 40% of the total (Shen, 2011). Moreover, in 2010, the world economy recovered and the VC industry started to grow steadily. By 2010, the Chinese VC industry was experiencing significant growth with 720 VC invested enterprises (fund) already established, increasing by 144 and 25% compared with 2009; the total amount of VC managing fund reached 240.66 billion RMB, increasing by 49.9%. The average fund size stood at 330 million RMB, increasing by 20.1% compared with 2009 (Shen, 2011).

While early venture funded investments in China tended to focus principally on property development and tourism, newer work has been in high-technology sectors. By the end of 2010, the cumulative investment of Chinese VC institutions has covered 8,693 projects, in which hi-tech enterprise (projects) investment took up about 60%; total cumulative investment stood at nearly 150 billion RMB, in which high technology projects investment took up over half.

Forms of capital in the Chinese VC industry demonstrate distinct features that have emerged in recent years. First, the government (at all levels) has increased the amount of government-guided funds available to support the development of new ventures. Second, VC institutions show a trend to collaborate in their investment and thus perhaps shape a VC network with distinctive characteristics (Allen et al., 2005; Bruton & Ahlstrom, 2003). Also, the substantially different social environment in China compared to that in United States or Europe suggests lead researchers to consider that VCs may have a different model of investment in order to adjust to the local institutional requests in China (Ahlstrom, Bruton, & Yeh, 2007; Bruton & Ahlstrom, 2003; Peng, 2000, 2006).

7. The Challenges of China's Institutional Regime

The basic requirements, such as a country's macroeconomic stability, institutions, infrastructure, health and primary education, and certain cultural characteristics such as thrift and long-term orientation are the underlying fundamental conditions required for a well-functioning business environment (Acemoglu & Robinson, 2012).

As institutional theory holds, the beliefs, goals, and actions of individuals and groups, particularly working in an organizational setting, are strongly influenced by various environmental institutions (Scott, 2008), and their role in doing this is subtle but pervasive (Boisot & Child, 1996). Generally speaking, the private firms in China grow fast regardless of the arguably poor applicable legal and financial mechanisms through informal institutions such as social capital substituting for more formal rules and laws (Allen et al., 2005; Newman et al., 2012).

However, a holistic view of the development of entrepreneurship in China, it suggests the efficacy of institutional reform there (Peng, 2003, 2006). The enabling and constraining characteristics of institutions exist from the macro-level (policy and regulation) down to micro-level (individual characteristics and attitude) and may also suggest incentives, all of which impact entrepreneurial endeavors (Bruton & Ahlstrom, 2003; Coase & Wang, 2012; North, 1990).

The gradual lessening of the state's control over the economy in China has changed the institutional and incentive regime, allowing the emergence of a generation of entrepreneurs. These entrepreneurs have been able to navigate the difficult institutional landscape and have transformed the economy into one increasingly driven by competition, innovation, and productivity.

Researchers also have stressed the importance of Chinese culture, in general, and Confucianism, in particular, as a key explanation for this putatively unique business system in East Asia. Confucian capitalism is thought to impact the economies of East Asia because of its complex network organization and compatibility with modern virtual organizations (Ahlstrom et al., 2004; Bond & Hofstede, 1990).

Confucianism places emphasis on social capital and networking, which is of vital importance in the current competitive landscape (Chen, 2001; DeBary, 1988). In this view, Chinese managers, who have a widely noted cultural tendency to rely on informal ties and personal connections to achieve organizational goals, fit well within this regional trading economy, and possibly the increasingly global world economy. However, Boisot and Child (1996), Peng (1997), and Peng and Heath (1996) argue that, in addition to cultural influences, institutional imperatives during the transition may further necessitate the extensive reliance on personalized exchange relationships, a (cultural) reliance that may wither over time.

However, the ease of doing business in China is still a challenge for entrepreneur. According to the World Bank Doing Business Report 2013, China was recently ranked 91 out of 181 countries for the overall ease of doing business. A higher ranking on the ease of doing business

index means the regulatory environment is more conducive to the starting and operation of a local firm. On average, the report states it takes Chinese entrepreneurs 13 procedures and around 33 days to start a business, while it takes entrepreneurs in OECD countries about 5 procedures and 12 days to get a new business registered. Property rights have been more formally recognized with the introduction of the Law on Property Rights in

2007, though problems with intellectual property certainly still exist (Atherton, 2008; Clissold, 2006). Although Chinese entrepreneurs have gradually evolved methods to manage China's institutional environment, many would likely argue that stronger property rights and less government interference in the economy would be preferable in future reforms (Ahlstrom et al., 2000)

8. Discussion and Future Research

The Chinese context includes a specific set of institutional arrangements and cultural understandings, both embedded in the distinct history of Chinese and Overseas Chinese societies (Ahlstrom & Wang, 2010; Haley, Haley, & Tan, 2009). The institutional arrangements involve the state—its laws, economic system, and political organization—and the more formal aspects of the societies of China and Southeast Asia. The cultural understandings include the values, beliefs, scripts, and practices that are associated with Chinese culture and Chinese business (Lal, 2006; Li, Schulze, & Li, 2009).

Commitment to entrepreneurship in China has been growing, albeit unevenly in recent years, sometimes in reaction to numerous problems raised in the management practitioner and consulting literature in terms of problems entrepreneurs have with financing, increased interference from various government entities within China, and government emphasis on large SOEs (Ahlstrom et al., 2008; Bruton, Ahlstrom, & Lu, 2009; Huang, 2008, 2010; Yueh,

2013). Research needs to provide good definitions and identify the process of entrepreneurship in China to better set the groundwork for the needed large-sample studies and meta-analyses. For example, intriguing research by MIT economist Yasheng Huang (2008) has shown that many

TVEs that were once thought to be SOEs were actually privately controlled and managed. It will be helpful to understand more about the performance of these organizations as well as the many joint ventures and contract manufacturers in China and to have an improved classification system of organizations in China (Bruton et al., 2008; Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004).

Constraints on private enterprise continue to exist in China, most notably the tedious procedures to register a new venture (World Bank Group, 2012), the difficulties of securing resources such as proper financing or exit options (Chen & Wang, 2009; *The Economist*,

2011), and challenges in building legitimacy for the private sector (Ahlstrom et al., 2008; Young et al., 2011). This often leaves informal and shadow financing as entrepreneurs' main financing options (Cong, 2009; Zhang, 2013). The problems that entrepreneurs have

in obtaining financing, avoiding government interference, or just sidestepping China's apparent favoritism toward SOEs in recent years may have hindered the development of the entrepreneurial private sector, which though substantial in number has still not produced many large firms over the past 35 years (Huang, 2008, 2010). Research on how Chinese startups strive to achieve growth and build their own brand names and secure financing needs to be expanded, particularly through the use of careful analytic case studies and process research (Huang, 2005; Yin, 2013). Although economic liberalization in China has provided significant opportunities to entrepreneurs and small businesses, it is still incomplete and involves many perplexities that could constrain the development and growth of Chinese entrepreneurship (Huang, 2010; Zapalska & Edwards, 2001). In the initial stage of reform, the non-state sector has been assigned only a supplementary role in the dominant public economy. This status has led to discrimination against small entrepreneurial firms when obtaining factor inputs, accounting partly for their vulnerability to interventions by local governments (Ahlstrom et al., 2008; Tsang, 1994). In order to thrive and grow, entrepreneurial firms were often forced to collude with local governments or other major constituents holding valuable resources (Ahlstrom et al., 2008; Tsang, 1996). Entrepreneurial firms can also promote their image by sharing ownership with foreign firms

(Chen, Ding, & Wu, forthcoming). In addition, China's transition economy, which is generally characterized by weak capital Market structures, limited legal protection for property rights, and high institutional uncertainty, creates an environment in which entrepreneurship may present patterns that are different from its counterparts in more advanced economies (Ahlstrom & Bruton, 2002; Allen et al., 2005). Research on entrepreneurship in China needs to continue to identify the process of entrepreneurship and the attributes of successful entrepreneurs in China.

It has been argued that China's SOEs are the engine driving China's growth and improved industrial performance (e.g., Ralston, Terpstra-Tong, Terpstra, Wang, & Egri, 2006). This reinforces the belief in some quarters that China's SOEs are exemplary performers and a model for developing countries (Halper, 2010). The government owns the biggest companies and as the economy grows smartly, the large SOEs in major industries, such as energy production and distribution, finance, and communications, is growing steadily.

Yet, China's state-controlled entities are not particularly profitable or effective resource allocators (Hsieh & Klenow, 2009). Indeed recent work suggests that average return on equity for companies owned by the state is barely 4%, despite the benefit of cheap financing and other benefits such as inexpensive land provided by the government or government-controlled banks. Private firms in China are thought to be much better performers, though data are patchy, as financial records are difficult to get for many firms (Driffield & Du, 2007; *The Economist*, 2011; Huang, 2008). Additional research is needed to understand more about the performance of entrepreneurial firms, particularly in an environment wherein their legitimacy is not entirely certain and more attention (in some parts of the country) is given to SOEs.

Finally, the lack of capital continues to be one of the biggest problems for China's entrepreneurs and other smaller private firms, and a key topic for future research. Not enough financing comes from the big, state-owned banks, and SMEs in China have limited access to capital markets, though China's government has recently laid down a policy goal to increase small firms' access to finance (*The Economist*, 2011). Loans to SMEs comprise 4% or less of the total made by three of the country's four largest banks, according to informal reports from government banking

officials. Still, a few other smaller institutions have begun to emerge. Zhejiang Tailong Commercial Bank, a privately-owned lender, has grown smartly at 40% a year by making small loans averaging about \$75,000. It displays the same entrepreneurial spirit as its clientele; employing workers in two shifts to maintain office hours of 7:30 a.m. to 7:30 p.m., seven days a week. But this type of small-loan bank is still an exception in China (*The Economist*, 2011). Researchers in banking and finance or microlending could find this to be an interesting research topic, particularly using novel research sites in China's smaller provinces.

Future research needs to continue to identify the sources of financing available to entrepreneurs. According to research by China's central bank, 57% of Wenzhou's enterprises and a remarkable 89% of Wenzhou's population have borrowed outside of China's banking system, often paying very high interest rates (*The Economist*, 2011).

The informal financing system in parts of China differs significantly from private equity firms in the West as the Chinese partnership often do not raise funds before seeking investments. Investments are often located and then partnerships are formed immediately after to fund the investment or new venture (*The Economist*, 2011). Although some research has been done on VC and private equity in China, the less formal portions of these systems require much more research (Broadman, 1999; Bruton et al., 1999; Newman et al., 2012); the shadow banking sector similarly remains under-researched (Zhang, 2013). This is particularly true for the entrepreneurial hotbeds in provinces such as Zhejiang and Guangdong, where studies are needed to better determine the contribution of financing options such as private equity or VC for the development of the SME sector (Newman et al., 2012). One such interesting line of research, for example, is whether venture capitalists will impact the location of the IPO chosen by entrepreneurial firms and how venture capitalists can facilitate Chinese firms' relocation to countries with a superior institutional environment (Cumming et al., 2009). Relocation to the United States can yield much greater returns to Asia-Pacific VCs than investing in companies already based in the United States (Cumming et al., 2009). Innovative research such as this combines the major impelling factors of incentives and institutions with respect to the decisions and actions of entrepreneurs employing finance and institutional theory. More rigorous cross-disciplinary research, such as the work done

by Cumming and his colleagues, is needed on the important topic of entrepreneurship and SMEs in China.

9. Conclusion

In this chapter, a review of several historical, institutional, economic, and social factors that impact entrepreneurship in China was provided.

In addition, we sought to provide an overview of some of the current research regarding the characteristics of entrepreneurs, the financing of new ventures, the social impact including job creation and wealth growth, migrant workers, and the challenges of the institutional regime. Our overview of entrepreneurship in China also suggests that, although the market transition in China in general is still at a relatively early stage, especially regarding the reemergence of entrepreneurship, a significant body of scholarship has been accumulated through the dogged work of a global network of scholars (Lu, Au, Peng, & Xu, 2013; Yang & Li, 2008). Research on similar, successful economies at different stages of development such as that of Taiwan or Hong Kong will also be helpful in better understanding entrepreneurship and firm performance in China (Ahlstrom & Wang, 2010; Liu, Wang, Zhao & Ahlstrom, 2013; Studwell, 2014).

This research has contributed significantly to our comprehension of entrepreneurship in emerging economies, though certainly more research is needed in these areas (Bruton et al., 2008).

Understanding these institutional and cultural arrangements in their contemporary and regional manifestations is essential to comprehending entrepreneurship in China, answering questions regarding how entrepreneurs in China navigate the challenging business environment and contribute to China's economic growth and reform.

Chinese consumers are becoming better educated and more demanding of information (Zhao, Gu, Yue, & Ahlstrom, 2013), which further facilitates firms' product development and marketing, while increasing global competition compels firms to compete with foreign counterparts even in the domestic Chinese market. These changes coupled with China's institutional reforms, such as

improvements in the rule of law, have made the environment considerably more competitive, though entrepreneur-friendly over the past three decades, and opened up several avenues for research on this vital topic.

Notes

1. Imperial China refers to the period of Chinese history before 1912; and the Republican period refers to 1912–1949.
2. The Great Leap Forward of 1958–1961 in China held some exceptions as numerous small-scale collective enterprises were created in industries such as steel where backyard steel furnaces were unsuccessfully experimented with. This absorbed many agricultural labor inputs and tools, particularly in rural China, which subsequently led to a severe famine (Yang, 2008).
3. The work of Joseph Schumpeter in economics is a notable exception, though Schumpeter started to give more attention to larger firms and their research and development in the years around and after the Second World War (McCraw, 2010). Schumpeter drew on some earlier and contemporaneous work by German economist Werner Sombart (1913), who also discussed the notion of creative destruction largely at the economy level.
4. This overview is by no means exhaustive. Several very good and complementary reviews of entrepreneurship and small business in China and other parts of the developing world cover more ground and provide interested readers with additional information on entrepreneurship research (e.g., Au, Craig, & Ramachandran, 2011; Beck, 2009; Leung & White, 2004; Li, 2006; Lu, Au, Peng, & Xu, 2013; Shane, 2008; Yang & Li, 2008)
5. The first textbooks devoted to entrepreneurship started to appear around this time in the 1970s including the seminal text by Jeffrey Timmons, which has gone through multiple editions (e.g., Timmons & Spinelli, 2008)
6. The Chinese Panel Study of Entrepreneurial Dynamics (CPSED), modeled on the US-PSED (Reynolds & Curtin, 2010), is a longitudinal study tracking individuals who are in the process of starting new businesses.

CPSED data were collected from eight major provincial capital cities in the four main regions of China, using random digit dialing. Sampling in these cities can capture the characteristics of nascent entrepreneurship in each region and give a good coverage of a large country such as China (Zhang, Yang, Au, & Reynolds, 2010). The longitudinal design helps researchers to

identify nascent entrepreneurs and track their progress (Castrogiovanni, 1996; Delmar & Shane, 2004; Smith, Locke, & Barry, 1990).

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