

China – An Entrepreneurial Perspective

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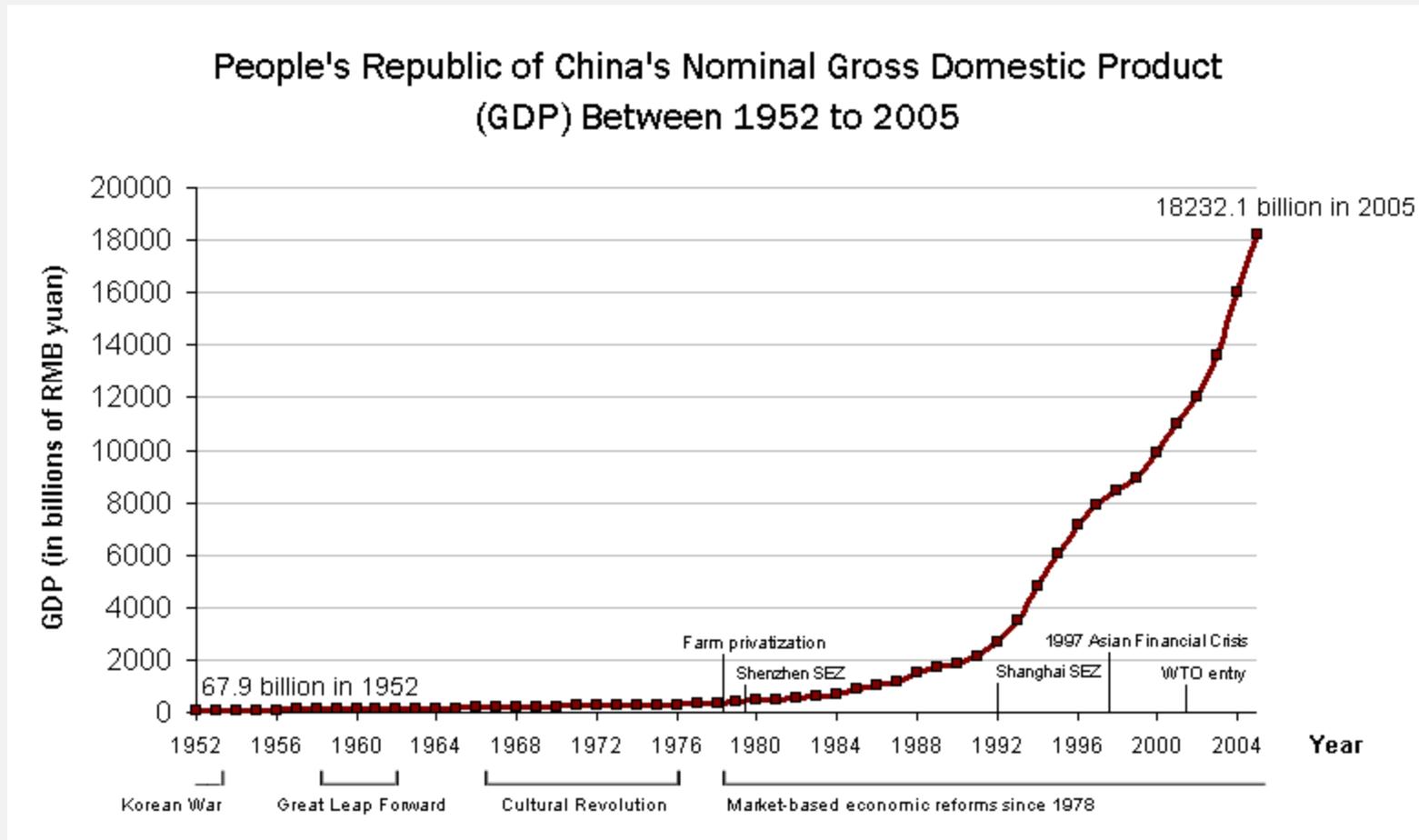


Some of the major changes we have seen

- China has liberalized its politics, regulatory framework, and economic system.
- Chinese economic reforms called "*Socialism with Chinese characteristics*" in the People's Republic of China (PRC)
 - was started in December 1978 by reformists within the Communist Party of China (CPC) led by Deng Xiaoping.
- The first stage, in the late 1970s and early 1980s, involved the de-collectivization of agriculture, the opening up of the country to foreign investment, and **permission for entrepreneurs** to start businesses. However, most industry remained state-owned.
- The second stage of reform, in the late 1980s and 1990s, involved the privatization and contracting out of much state-owned industry and the lifting of price controls, protectionist policies, and regulations, although state monopolies in sectors such as banking and petroleum remained.
- In 2015, Chinese growth slowed appreciably causing the government to undertake economic stimulus programs.

China

- China (http://en.wikipedia.org/wiki/Chinese_economic_reform)



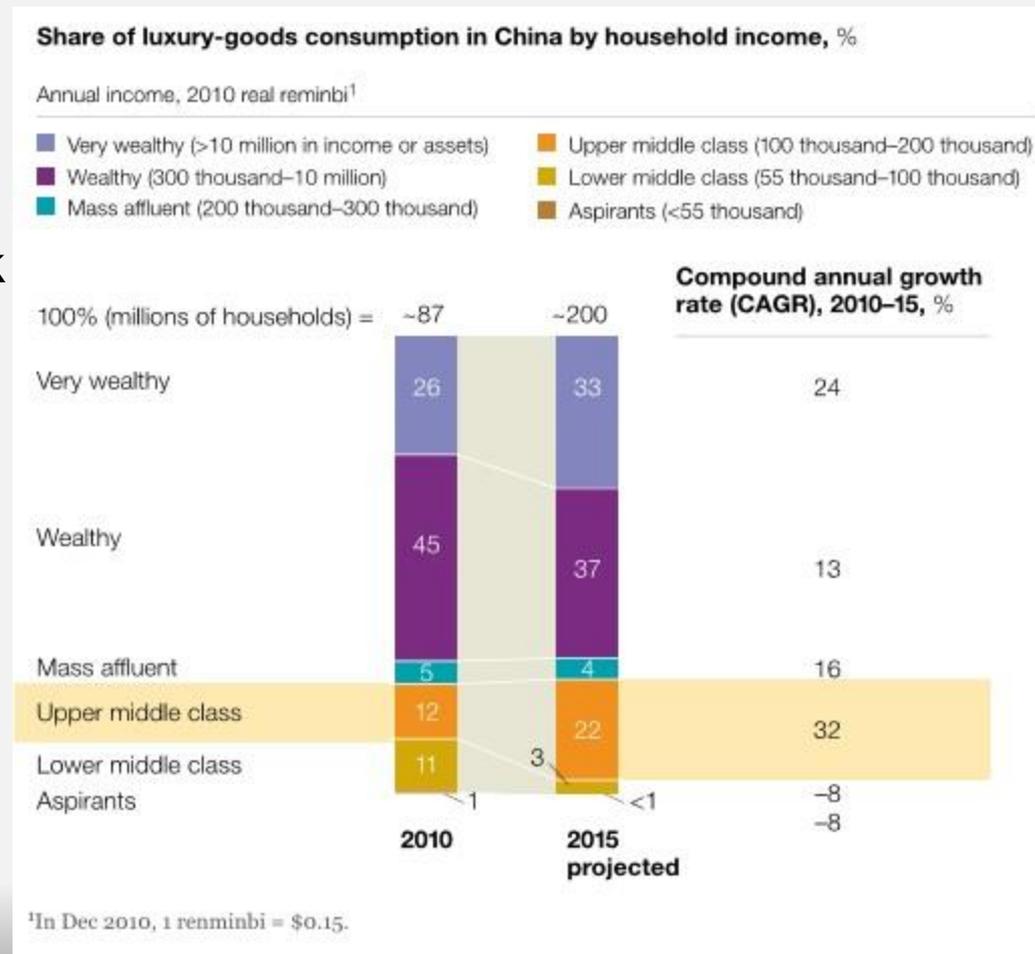
McKinsey & Co, reports in 2013

- By 2022 more than 75% of China urban consumers will earn between \$9000 and \$34,000.
 - That would put them between Brazil and Italy in average income.
 - In 2000 that was 4% and in 2012 it was 68%
- Upper middle class -\$17,000-\$34,000 will be 54% of urban households and 56% of urban consumption.
 - In 2012 that was 14%
 - <http://www.foodnavigator-usa.com/Manufacturers/Red-Bull-targets-China-for-expansion-UPDATED>
- China will account for about 20 percent, or 180 billion renminbi (\$27 billion), of global luxury sales in 2015
 - http://www.mckinsey.com/insights/marketing_sales/tapping_chinas_luxury_goods_market
- References
 - http://www.mckinsey.com/insights/asia-pacific/forecasting_china
 - http://www.mckinsey.com/insights/marketing_sales/understanding_chinas_wealthy

McKinsey & Co Projections in 2011

(http://www.mckinsey.com/insights/marketing_sales/tapping_chinas_luxury-goods_market)

- Chinese consumers have a preference for internationally well known brands.
- The luxury market is growing very rapidly.
- Fourth largest concentration of wealthy
- Top 1% earn more than \$80k

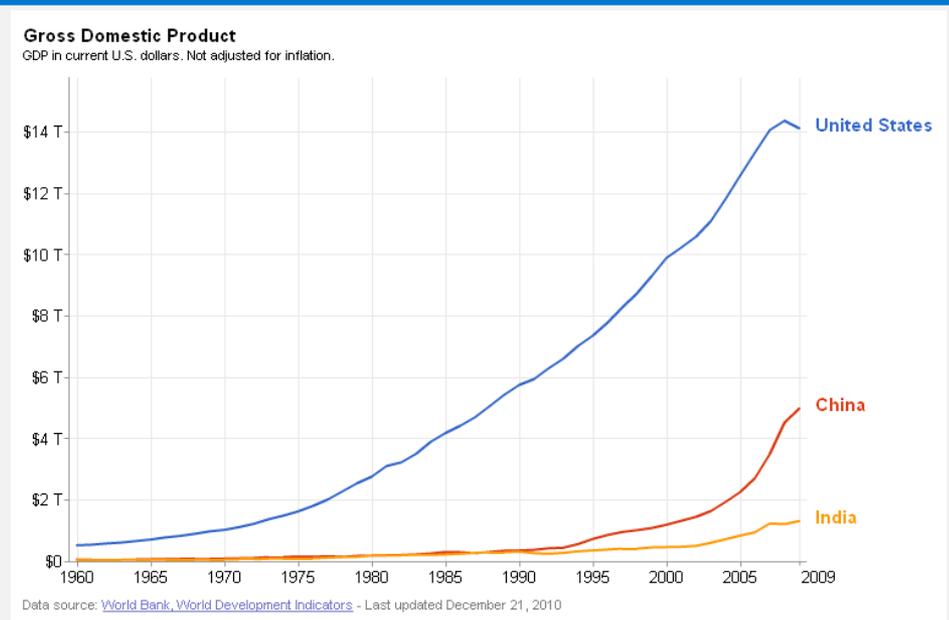
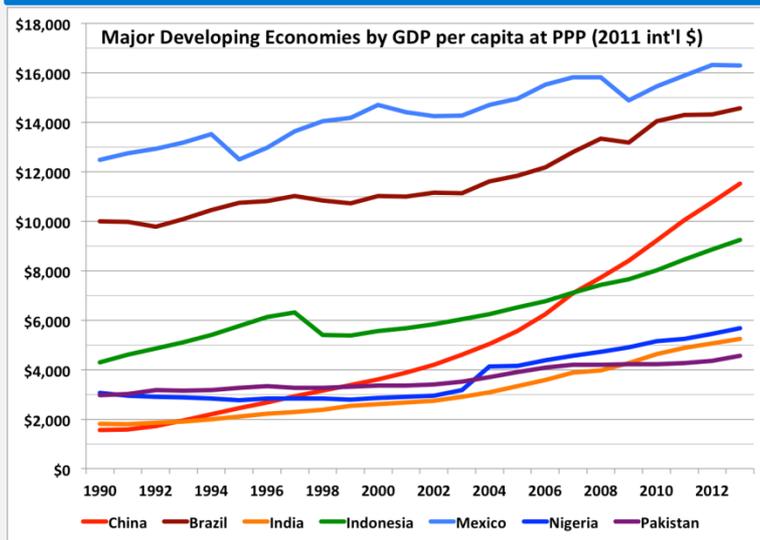


McKinsey & Co Projections in 2011

(http://www.mckinsey.com/insights/marketing_sales/tapping_chinas_luxury-goods_market)

- Rapid urbanization and growing wealth beyond China's largest cities are creating a number of geographic markets with sizable pools of luxury-goods consumers.
- China's four richest cities—Shanghai, Beijing, Guangzhou, and Shenzhen—account for about 30 percent of all wealthy consumers; the top ten cities are home to some 50 percent of them.
 - http://www.mckinsey.com/insights/marketing_sales/understanding_chinas_wealthy
- More small cities will become large enough to justify the presence of stores catering to them; we expect luxury sales in urban areas such as Qingdao and Wuxi, for instance, to triple over the next five years.
- By 2015, consumption in such cities will approach today's levels in Hangzhou and Nanjing—now two of China's most developed luxury-goods markets—and luxury consumption could pass 500 million renminbi in more than 60 cities, compared with 30 today.
- But the luxury-goods market will remain concentrated in the top 36, which will account for 74 percent of the market's growth and 76 percent of total luxury sales by 2015.

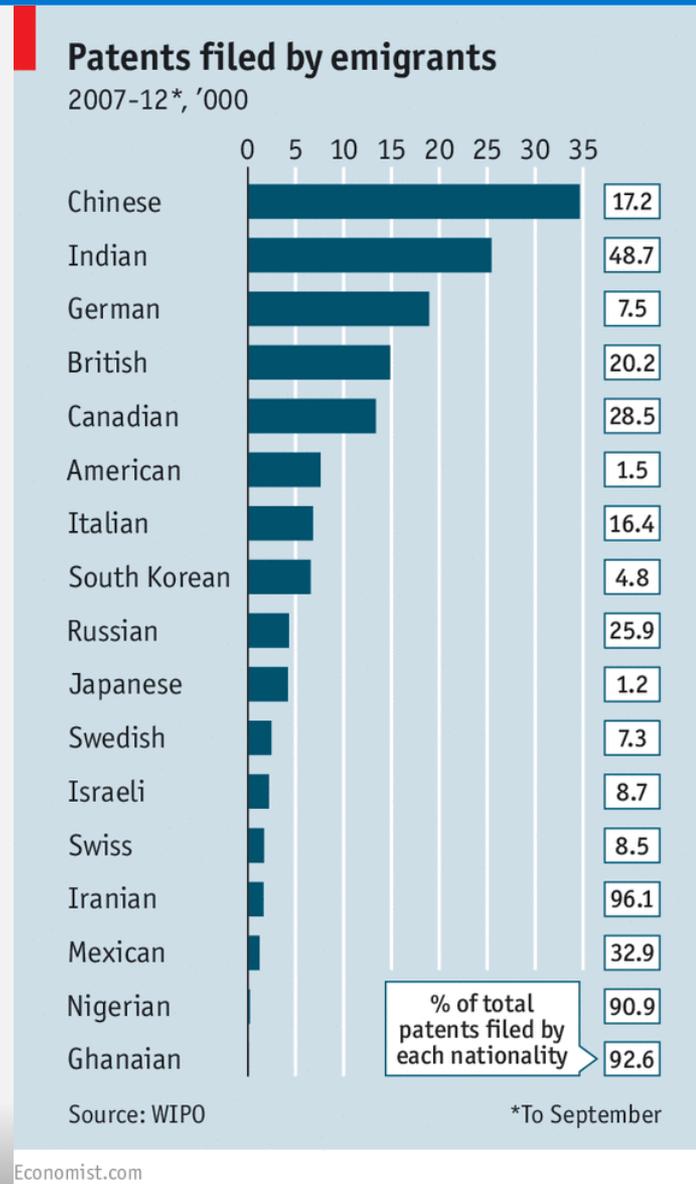
Growth in Economies varies by country



In 1974, China's GDP was about 280 B CNY
 In 2014, China's GDP was 63,646 B CNY or \$ 10,361 B US.
 This is a growth of 22,700 %

- "Graph of Major Developing Economies by Real GDP per capita at PPP 1990-2013" by CircleAdrian - Created on Excel from World Bank World Development Indicators 2014 data. Licensed under CC BY-SA 3.0 via Wikimedia Commons - http://commons.wikimedia.org/wiki/File:Graph_of_Major_Developing_Economies_by_Real_GDP_per_capita_at_PPP_1990-2013.png#/media/File:Graph_of_Major_Developing_Economies_by_Real_GDP_per_capita_at_PPP_1990-2013.png
- <http://www.theamericanconservative.com/articles/how-social-darwinism-made-modern-china-248/>

Overseas Chinese are very active



Entrepreneurship in China is seen as a paradox

By most accounts, China is one of the most entrepreneurial countries on earth. According to the widely cited Global Entrepreneurship Monitor (GEM), published by Babson College, on a range of dimensions, such as fear of failures and entrepreneurial intentions, China ranks quite favorably among the group of nations surveyed by the GEM. China is not yet an innovative economy, in the opinion of GEM researchers, but it is an efficiency-driven economy that is a cut above factor-driven economies that are a norm among developing countries.

That said, there are two puzzling issues. One is that most of the analysts—outside of China and even inside the country—do not associate China’s economic success with entrepreneurship. Most commentators credit the government, foreign direct investment and massive infrastructural construction as the reasons why the Chinese economy has surged forward. Private sector development, if it is mentioned at all, is often viewed as an afterthought—something that happened as a result of Chinese economic success rather than the cause of it. The other puzzle is why Chinese entrepreneurship should be so vibrant in the first place. Is it not the case that this is still, at least nominally, a communist country? Is it not also true that the rule of law, market competition, and its business environment are not viewed as “friendly” to private entrepreneurs and businesses? If, as the thinking goes, communism can go hand-in-hand with vibrant entrepreneurship, why do we need capitalistic institutions—with all of their historical baggage, operational arcanery, and legal complications—at all?

- <http://www.worldfinancialreview.com/?p=2782> (2010)

Entrepreneurship in China –a personal anecdote

- I first entered China in 1983 as part of a Physics delegation that was part of the process of enabling the CUSPEA program –The Chinese U.S. Physics Examination and Application that brought hundreds (915) of Chinese graduate students to the U.S. to study physics.
- There were very few cars. Bicycles dominated the streets. Dress was uniform in blue polyester suits for both men and women. Fashion was not to be seen anywhere. There was no sign whatsoever of entrepreneurial activity.
- I traveled to China many times in the interim and was amazed at the dramatic changes on each visit.
- In June of 1990 during the first anniversary of the Tiananmen protests, I made another visit to China. This time I was contacted by a group of young Chinese Entrepreneurs and invited out for a night on the town so that we could talk entrepreneurship and enjoy our fellowship.

Entrepreneurship in China –a personal anecdote -continued

- They picked me up in a BMW and drove me to a part of town that I had walked through in the past. It had been a very primitive looking group of hutongs, but now the banks of the river were lined with sidewalk cafes and music was coming from each one. The BMW's, Audis, and Buicks were lined up on the street. The men wore business casual and the women wore the latest fashions. It could have been an evening in Paris.
- There I met a collection of Chinese entrepreneurs. Many of them had come to the US to study and often had worked in Silicon Valley, Boston and other hotbeds of US Entrepreneurship.
- I asked one young woman entrepreneur to tell me what had brought her back to China after a successful career in start-up in California. “I think there is more opportunity here now,” she replied.
- Change came quickly in China!



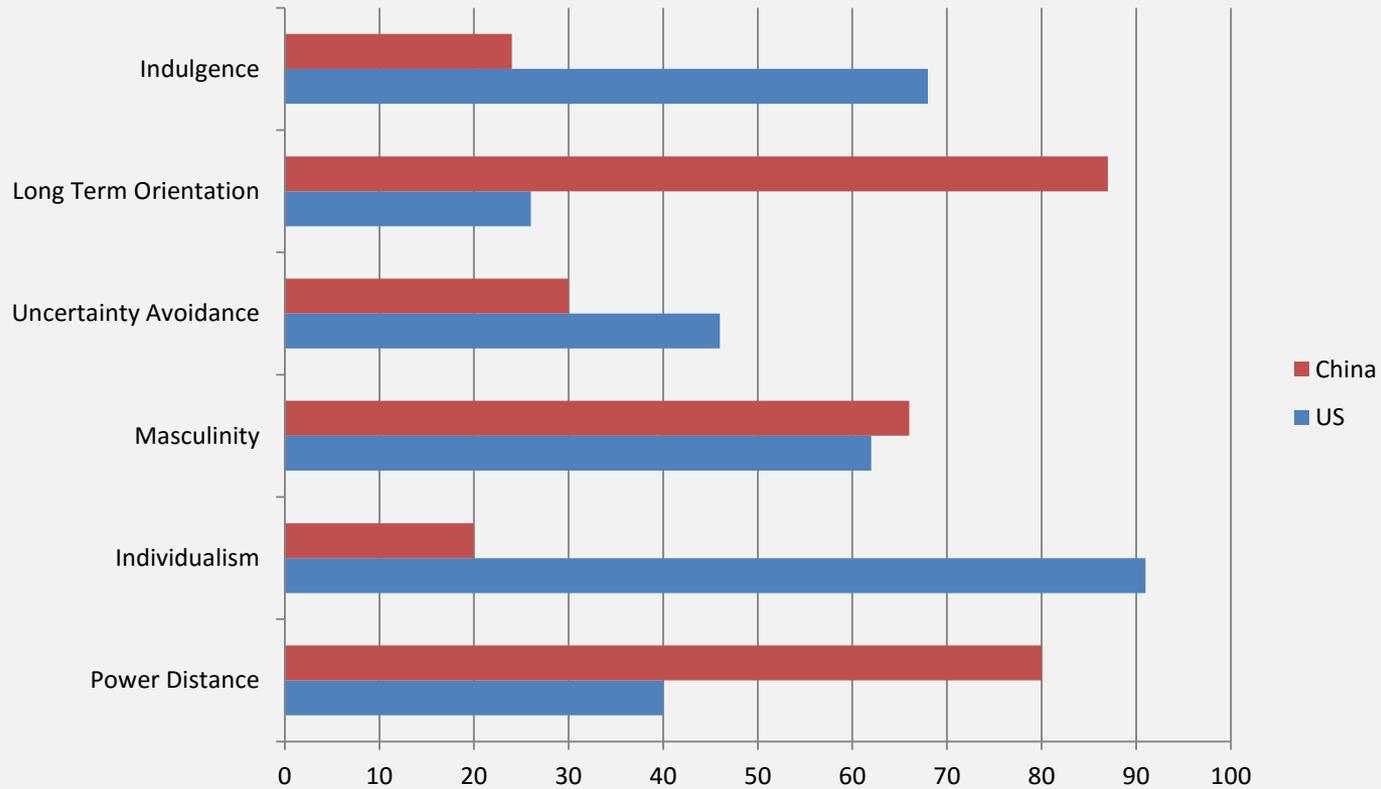
Hofstede's 6 Cultural Dimensions -China

- “These cultural dimensions are deeply embedded in a country’s culture and are difficult to understand unless you are born and raised there. The Chinese culture needs to be studied and taken into consideration before entering any binding contracts. Not understanding these cultural dimensions can be damaging to any relationship you are trying to build with the Chinese.”
 - <https://alexnstone.wordpress.com/2012/01/14/hofstedes-5-cultural-dimensions-for-china/>
 - <http://geert-hofstede.com/united-states.html>
 - <http://geert-hofstede.com/china.html>
- Power Distance (PDI) -China 80 vs US 40
 - – Power distance is the extent to which less powerful people in an organization will accept and expect power to be distributed differently. China ranks **80** on PDI which is very high. This means there is a lot of power distance between subordinates and superiors, but that it is accepted and normal.
- Individualism (IDV) -China 20 vs US 91
 - – This is whether or not people think with the mentality of “I” or “We.” The American culture is very “I” focused, meaning that we focus more on furthering ourselves and careers versus furthering our department or group. On the other hand, China ranks **20** on IDV, meaning that they are highly collectivistic and think as a group versus individually. This can be seen with the high amount of in-groups and out-groups

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- **Masculinity/Femininity (MAS) -China 66 vs US 62**
 - This is the first dimension where the Americans and the Chinese rank similarly. China ranks **66** for this dimension, meaning they are very driven by successful, competition, and achievements. The Chinese will often put work before family or leisurely activities. This dimension can be seen in the fact that Chinese workers will leave their families to go work at factories for 11 months out of the year, proving how important work truly is to them.
 - **Uncertainty Avoidance (UAI) – -China 30 vs US 46**
 - This is the second dimension where Americans and Chinese rank similarly as well. China ranks **30**, meaning they accept ambiguous situations and are not deterred by them. It may seem like China has a lot of rules and regulations in place to avoid ambiguous or uncertain situations, however they are willing to bend and changes the rules as situations require it. The Chinese language is also very ambiguous; the Chinese characters are hard to interpret or understand if it is not your native language.

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- Long-term/Short-term Orientation (LTO) -China 87 vs US 26
 - The Chinese rank extremely high on long term orientation at **87**, meaning they focus on persistence and perseverance, and that they will dedicate however much time is required to achieve their goals. This is seen in the very time consuming Chinese negotiation process, the time required to build trust and long-term relationships, and their focus on long term results versus short term goals
 - Indulgence -China 24 vs US 68
 - This dimension is defined as the extent to which people try to control their desires and impulses, based on the way they were raised. Relatively weak control is called “Indulgence” and relatively strong control is called “Restraint”. Cultures can, therefore, be described as Indulgent or Restrained.
 - China is a Restrained society as can be seen in its low score of 24 in this dimension. Societies with a low score in this dimension have a tendency to cynicism and pessimism. Also, in contrast to Indulgent societies, Restrained societies do not put much emphasis on leisure time and control the gratification of their desires. People with this orientation have the perception that their actions are Restrained by social norms and feel that indulging themselves is somewhat wrong.

China and the US – a Graphical Comparison



Foreign Direct Investment -FDI

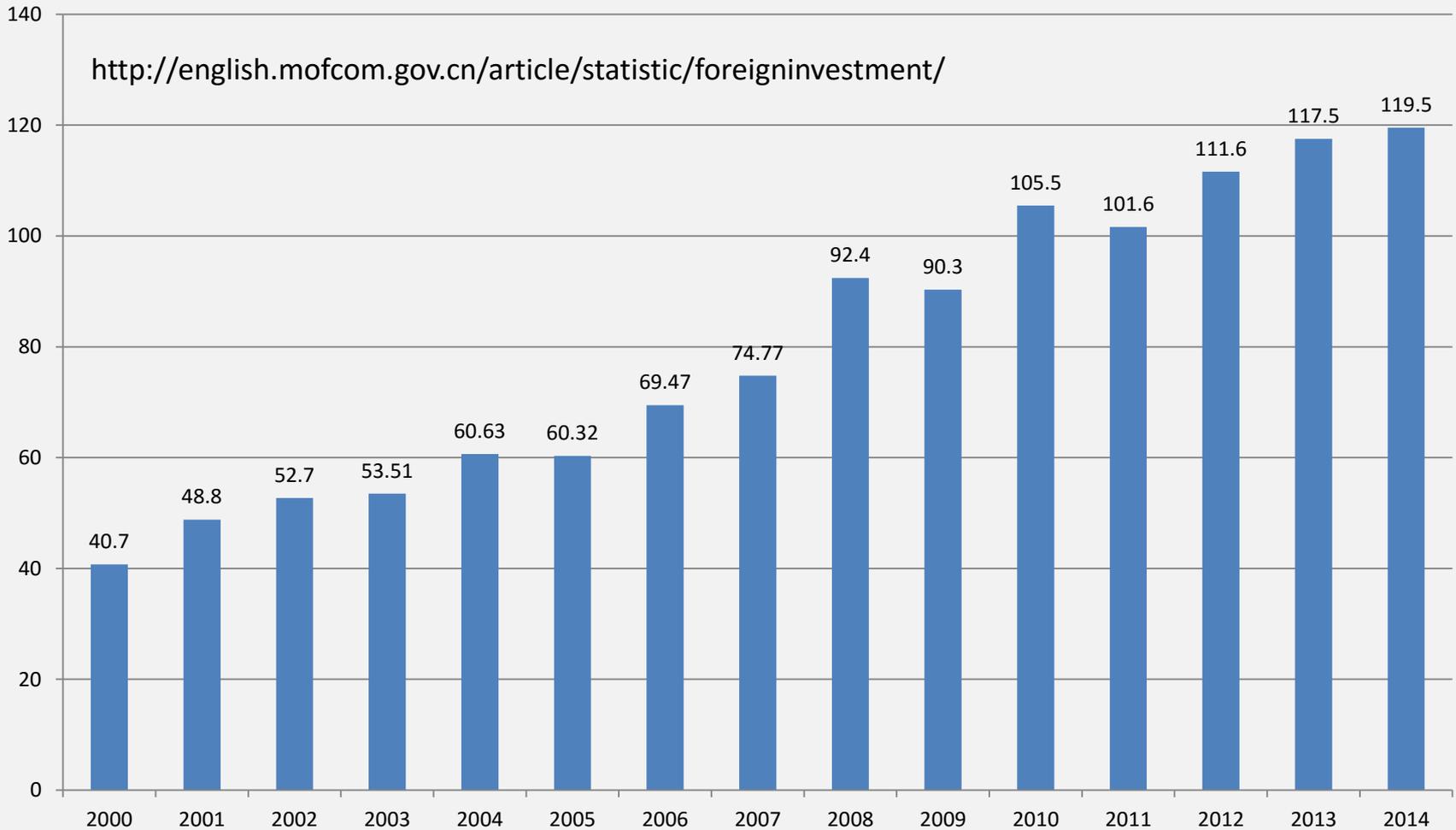
- China surpassed the United States in FDI in 2014
 - <http://www.bbc.com/news/business-31052566>

Top destinations for foreign direct investment in 2014

China	\$128bn
Hong Kong	\$111bn
US	\$86bn
Singapore	\$81bn
Brazil	\$62bn
UK	\$61bn
Canada	\$53bn
Australia	\$49bn
Netherlands	\$42bn
Luxembourg	\$36bn

Growth in FDI into China

China FDI (\$ B US)

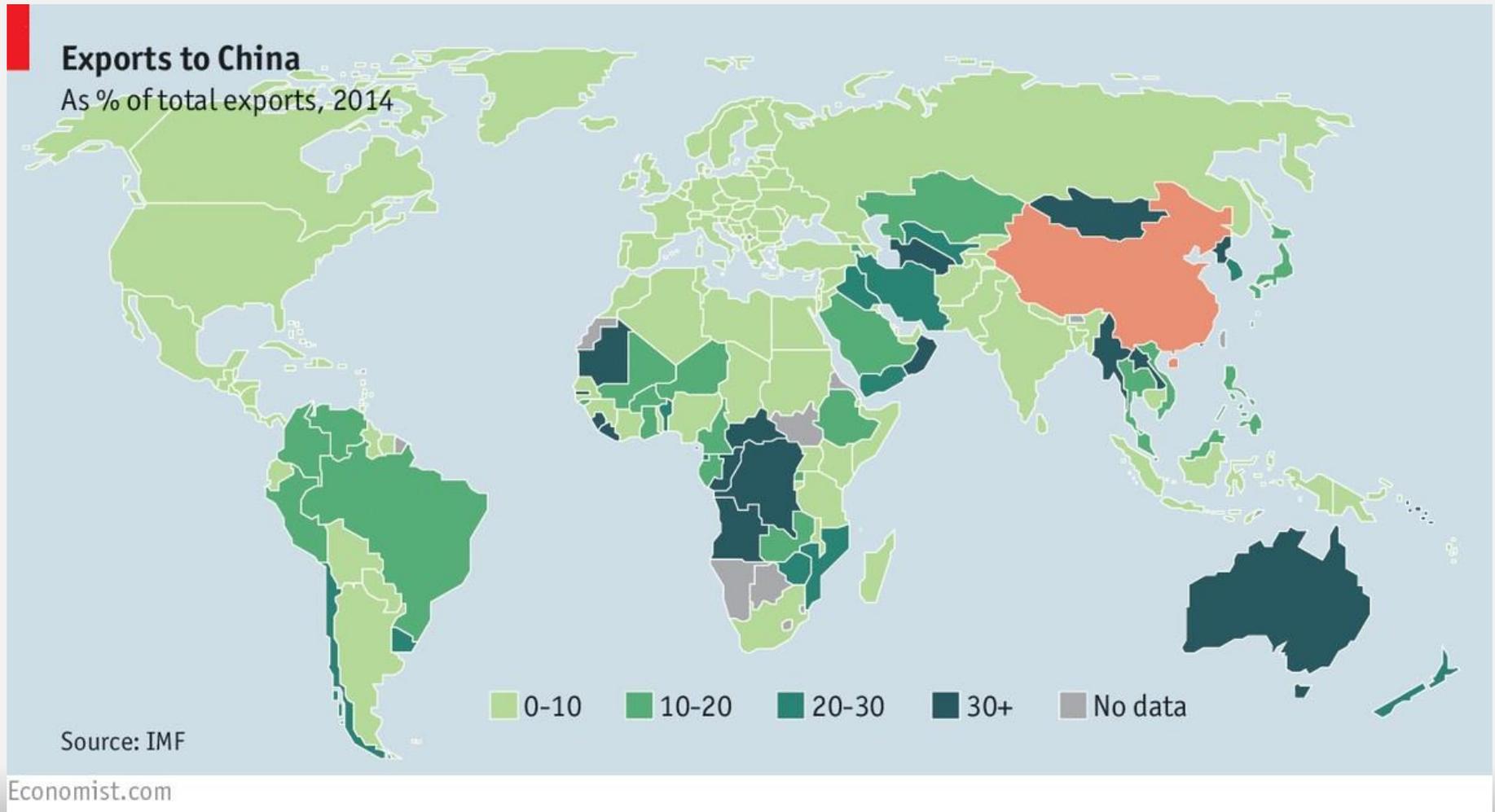


Investing in China

- China presently constitutes the largest FDI absorption territory, and one of the major sources of outward FDI in the world since its open-door policy began in 1979.
- Many foreign investors are eager to gain a foothold in this populous market.
- However, doing business in China is complicated and can be particularly difficult. Foreign investors can be confused and irritated by the long negotiation process, government hierarchy, and the distinctive practices that they meet in China (Davies, 1995).
- Instead, foreign investors depend on personal connections (*guanxi*) with regional authorities, bureaucracies and individuals in China to safeguard and enhance their business interests.
- Therefore, in addition to the advantages firms possess, both western and overseas Chinese firms strive to establish close connections, *guanxi*, with Chinese government/partners in order to gain an edge over competitors.

Exporting to China

- China has become a strong consumer
 - <http://www.economist.com/node/21662581>



China has poured more into investment than consumption



Economist.com

<http://www.economist.com/node/21662581>

Guanxi as an Advantage in the Chinese Market

- *Guanxi* is an important resource for individuals and firms in China to induce cooperation and govern relationships efficiently.
- *Guanxiwang* (Yang, 1994) is the network of these continuing relationships used to secure favors in personal and organizational relations.
- The underlying premise is that Chinese firms utilize *guanxi* to manage organizational interdependence, and to mitigate institutional disadvantages, structural weaknesses, and other environmental threats (Park & Luo, 2001).
- With *guanxi*, one is an “insider”: negotiations proceed smoothly, and much can be accomplished. Without it, one is an “outsider” with little chance of success.

Guanxi as an Advantage in the Chinese Market

- In Chinese culture, *guanxi*, or connections, have historically been critical to facilitating business (Tsang, 1998).
- The art of *guanxi* is essential for obtaining scarce resources as well as dealing with the bureaucratic maze in China.
- In the business arena, there is a well-accepted “motto” among non-Chinese investors in China: “Whom you know counts more than what you know.”

- The Chinese word *guanxi* is two syllables *guan* and *xi*.
 - The Chinese meaning of “*guan*” is either “to connect” or “a gate/pass that can be closed”
 - *Xi* means to tie up and extend into relationships.
- To sum up, *guanxi* means to “doing favors for and maintaining a relationship with someone you recognized”.
- It can be written with traditional characters (often used in Taiwan) or simplified characters (most often used in China).

Traditional Chinese

關係

Simplified Chinese

关系

- *Guanxi* refers to the concept of drawing on connections or networks in order to secure favors in personal or business relations.
- It is pivotal at all levels of societal functioning and in all kinds of dealings in the oriental country.
- *Guanxi* literally binds millions of Chinese firms into a social and business web. No company can go far unless it has extensive *guanxi* (Campbell 1987, Shenkar 1990).
- In fact, a new term has arisen in China: *Guanxihu*. This term now applied to specially connected firms, refers to the bond between *guanxi* members that leads them to give highly preferential treatment to other members of their network (Pearce & Robinson, 2000).

- *Guanxi*, *renqing* (human feelings) and *mianzi* (face), are regarded as key building blocks of the Chinese culture.
- *Renqing* (人-情 *rénqíng/jen-ch'ing*), unpaid obligations to the other party as a result of invoking the *guanxi* relationship, is a form of social capital that provides leverage in interpersonal exchanges of favors (Yang, 1994).
- The person's face (*mianzi* -面子, *miànzi/mien-tzu*) is also a key component in the dynamics of *guanxi* because one must maintain a certain level of prestige to cultivate and expand a viable network of *guanxi* connections (Redding & Ng, 1982; Yeung & Tung, 1996). *Mianzi* is an intangible form of social currency and personal status. It provides the leverage one needs to successfully expand and manipulate a *guanxi* network.

Legal relationships and Guanxi

- Until recently, the Chinese legal system was weak and Guanxi governed many business relationships.
 - Under a weak legal system in China, *guanxi* networks can be used as substitutes for institutional support such as obtaining scarce resources, mitigating various forms of governmental interference, and protecting property rights.
 - It compensates for systematic inefficiency and institutional weaknesses. In other words, *guanxi* connection is a very useful means of dealing with the Chinese bureaucratic maze because it balances the awkward Chinese bureaucracy by giving individuals a way to circumvent rules through the activation of personal relations.
 - The formal bureaucratic rules often inhibit business dealings, while *guanxi* facilitates them.
 - Hence, *guanxi* improves efficiency, saves time and eases the procurement of necessary production resources (e.g., government approvals, utilities and local suppliers of labor and materials)
 - Developing, expanding, and maintaining one's *guanxi* network has become a form of social investment.
- In recent years the legal system has become more robust and, especially for large projects, guanxi is not as effective.
- Since China entered the WTO on 11 December 2001, legal systems have been enhanced and brought into conformity with the WTO rules.

Accession to the WTO

- These changes were difficult steps for China and conflicted with its prior economic strategy. Accession meant that China would engage in global competition according to rules that it did not make. China's admission was "an enormous multilateral achievement" that marked a clear commitment towards multilateralism.
 - <http://www.economist.com/blogs/schumpeter/2011/12/money-talks-december-5th-2011>
- When China joined the WTO, it agreed to considerably harsher conditions than other developing countries. After China joined the World Trade Organization (WTO), the service sector was considerably liberalized and foreign investment was allowed; restrictions on retail, wholesale and distribution ended. Banking, financial services, insurance and telecommunications were also opened up to foreign investment.
 - Bransetter, Lee (2008), "China's embrace of globalization", in Brandt, Loren; Rawski, G. Thomas, China's Great Transformation, Cambridge, UK: Cambridge University Press, p. 655-659

More than ten years in the WTO

CHINA'S efforts to join the World Trade Organisation (WTO) dragged on for 15 years, long enough to “turn black hair white”, as Zhu Rongji, China's former prime minister, put it. (His own hair remained Politburo-black throughout.) Even after membership was granted, ten years ago this week, Mr Zhu expected many “headaches”, including the loss of customs duties and the distress of farmers exposed to foreign competition.

Yet the bet paid off for China. It has blossomed into the world's greatest exporter and second-biggest importer. The marriage of foreign know-how, Chinese labour and the open, global market has succeeded beyond anyone's predictions.

It is instead China's trading partners who now contemplate its WTO membership with furrowed brows (see article). They have a variety of complaints: that China exports too much, swamping their markets with cheap manufactured goods, subsidised by an undervalued currency; that it hoards essential inputs, such as rare earths, for its own firms; and that it still skews its own market against foreign companies, in some cases by being slow to implement WTO rules (notably on piracy), in others by suddenly imposing unwritten rules that are unfavourable or unknowable to foreigners. The meddling state lets multinationals in, only to squeeze them dry of their valuable technologies and then push them out.

- <http://www.economist.com/node/21541408>

Shanghai Stock Exchange –always a wild ride.

SSE Composite Index (000001.SS) ★ Watchlist
3,121.09 +37.50(+1.22%) Shanghai - As of 10:02pm EDT

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+ Indicator + Comparison 1d 5d 1m 3m 6m YTD 1y 2y 5y 10y Max Linear Go To Symbol



China –The Opportunity Continues

- China remains one of the best places for an entrepreneur.
- How to participate?
 - Fit into the value chain of a company like Apple, Boeing, Hewlett Packard or the many other global manufacturing companies.
 - McNeill engineering –Champ is an outstanding example of this. They manufacture cleats and golf accessories in China and the US for sale to shoe manufacturers (mostly manufacturing in China) and to the public in the US.
 - Manufacture in China for sale in the US.
 - Buy products in China for resale in the US.
 - Sell products in China that have been made in the US.