



# Entrepreneurship in China: An overview

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## David Ahlstrom

The Chinese University of Hong Kong, Hong Kong

## Zhujun Ding

Hang Seng Management College, Hong Kong

### Abstract

This article offers an overview of entrepreneurship in China to complement this special issue of *International Small Business Journal*: ‘Exploring Entrepreneurial Activity and Small Business Issues in the Chinese Economy’. A broad review of entrepreneurship research is provided and linked to the context of research in China with several principal topics summarised. These include an examination of recent research on entrepreneurial firms in China, the attributes of Chinese entrepreneurs and the challenges they face. Finally, future research avenues are suggested.

### Keywords

China, entrepreneurs, entrepreneurship, growth, new ventures

### Introduction

For much of the past century, entrepreneurship and China were seldom mentioned together. Although the Chinese diaspora had a history of entrepreneurship around the Pacific rim, generally speaking, the same was not true in mainland China (Ahlstrom et al., 2004; Pan, 1990). The old examination system, a strict licensing regime limiting rewards to inventors and widespread upheaval all hindered the development of entrepreneurship in imperial China (Balazs, 1964; Landes, 1998). Periods of warfare and related upheaval in the 20th century further impeded the development of entrepreneurship and small business (Harding, 1987). In the 1950s, the People’s Republic of China collectivised agriculture and nationalised industry; what had remained of the small and medium-sized enterprise (SME) sector from republican China was virtually eliminated (Harding, 1987; Rawski, 1989).

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### Corresponding author:

David Ahlstrom, Department of Management, The Chinese University of Hong Kong, Cheng Yu Tung Building, 8/F, Shatin, NT 00852, Hong Kong.  
Email: ahlstrom@baf.cuhk.edu.hk

During the 1960s, development efforts in China (as in many countries) were geared toward the expansion of heavy industry, using elements of the Soviet central planning model (Harding, 1987; Naughton, 1995). Correspondingly, research in economics and the social sciences generally was unconcerned with entrepreneurship and its kindred small business sector (e.g. Cooper, 2010; Nasar, 2012).<sup>1</sup> For example, in development economics, Kaldor (1966) argued that the failure of firms to achieve scale and specialisation hindered their development and national industrialisation. In an influential review in the *Journal of Economic Literature*, Nathaniel Leff (1979) argued that often, the level of entrepreneurship was not a constraint on the pace of development in countries. Even today, in spite of the attention that entrepreneurs have garnered in research and popular culture, entrepreneurship still rates only a few mentions in development economics (e.g. Perkins et al., 2013; Rodrik and Rosenzweig, 2010), although more in mainstream economics (Baumol et al., 2009), management (e.g. Bruton et al., 2008; Du et al., 2013; Ireland et al., 2003; Lu et al., 2013; Zahra et al., 2006) and finance (e.g. Cumming and Suret, 2011).

In spite of the uneven attention afforded to entrepreneurship, many are convinced that the answer to economic growth and social development, including job creation, is to be found in innovative entrepreneurship (Phelps, 2013). Both management and finance scholars and those studying entrepreneurship attest to its importance in driving economic growth and social development (e.g. Ahlstrom, 2010; Audretsch et al., 2006; Butler et al., 2004), and the alleviation of poverty (Bruton et al., 2013). *The Economist* magazine concurs in describing entrepreneurship as ‘an idea whose time has come’ (2009a: 6).

Although debates continue about the best types of entrepreneurship and the degree to which it matters (Wong et al., 2005), it has proven to be particularly important in developing countries such as China, where new venture creation and the SME sector have fuelled a significant portion of China’s growth (Huang, 2008). How entrepreneurs navigate China’s challenging environment is a very important question, particularly in terms of the institutional regime (Chen et al., 2012; Kazanjian et al., 2002; Peng, 2006). Financing and venture capital are particularly influential, informing opportunities and incentives within the environment that shape the entrepreneur’s ability to manage new venture creation (Li, 2006; Zhang, 2013). Yet, only recently has the entrepreneurship literature begun to pay attention to these issues in China (e.g. Yang and Li, 2008). This special issue of *International Small Business Journal* (ISBJ) addresses this by examining entrepreneurship in China; this overview contributes to the special issue by providing a brief introduction to entrepreneurship research and its application to China.<sup>2</sup>

## Background

Entrepreneurship was once a backwater for researchers and consultants, as macroeconomics and traditional factors of production garnered the most attention (Cooper, 2010; Galbraith, 1967; Rodrik and Rosenzweig, 2010). Joseph Schumpeter (1934[1911]) was one of the few who argued that the key to competitiveness was not lower prices or more scale, but new ideas and combinations of resources. Rather, work in firm laboratories and by entrepreneurs led to creative destruction, renewal and economic growth, although innovation with associated new venture creation was regularly resisted by entrenched societal interests (Ogilvie, 2011; Schumpeter, 1942).

More recently, researchers and policymakers have rediscovered Schumpeter’s thesis regarding the important role that entrepreneurs play in creating new product markets, companies, wealth and jobs (McCraw, 2010; Wong et al., 2005). Correspondingly, research has identified entrepreneurship’s importance to job creation (Phelps, 2013). In the late 1970s, David Birch (1979) suggested that in an eight-year period ending in 1976, businesses with fewer than 20 workers created four

times as many new jobs as companies with more than 500 employees, thereby opening up a whole new field of research in entrepreneurship and firm type (particularly fast growth firms) and employment ([Abzug et al., 2000](#); [Haltiwanger et al., 2011](#); [Medoff and Birch, 1994](#)).

## Entrepreneurship in China

In much of the pre-industrial world, sovereigns or local rulers held claim to all property in their lands, including new inventions ([Rosenberg and Birdzell, 1986](#)). As a result, innovations were regularly confiscated and held by local nobles or the monarch, often with very limited compensation ([Finley, 1965](#)). This was also true in imperial China ([Balazs, 1964](#)). Thus, it was common for people in China with assets to avoid acquiring conspicuous capital or concentrating resources in high-profile projects ([Balazs, 1964](#); [Rosenberg and Birdzell, 1986](#)). This made it challenging for potential proprietors in China to develop and grow their businesses and workshops significantly, and it also made it difficult to concentrate wealth to create funding for major investments required by industry and infrastructure. In addition to the dearth of property rights, pre-industrial imperial China reserved its biggest rewards for those who did well in imperial examinations. These were devoted heavily to the Confucian texts, other classics and calligraphy ([Ho, 1962](#)). Successful candidates entered the government hierarchy and high-status groups which gave them access to rents associated with government positions. Meanwhile, although they may have gained success in commerce, others outside of the government had less access to government favouritism, and frequently were unable to achieve high social standing ([Balazs, 1964](#)).

Entrepreneurship did experience a flowering in republican China in the first decades of the 20th century ([Rawski, 1989](#)), but the Chinese Communist Party's accession to power in 1949 led to transformation of the nascent market economy into a socialist one strongly influenced by the Soviet model, whereby enterprises had to seek approval to do virtually everything ([Reynolds, 1982](#)). Managers had to obtain authorisation from their superiors before they could make expenditure greater than 50 yuan (\$10) ([Liu and Wang, 1984](#)). Entrepreneurship was essentially legally suppressed ([Harding, 1987](#)). With the economy in very poor shape, the new premier, Deng Xiaoping, launched China's Four Modernisations in 1978. Soon, Deng's popular reforms were extended to households, so that small businesses could supply much-needed local goods; these reforms created an impetus for the rapid development of township and village enterprises, many of which were, in actuality, private companies ([Huang, 2008](#)).

## Economic development and employment

Entrepreneurship has generated significant economic growth and job creation in China ([Huang, 2008](#); *The Economist*, 2011). Over the last 35 years, the entrepreneurial sector has grown rapidly from almost zero to more than six million registered private businesses, and this may be a conservative estimate ([Chen, 2006](#)). Enterprises that are not majority-owned by the state recently accounted for well over half of industrial output ([Huang, 2008](#)), and are contributing an increasing share of gross domestic product (GDP), recently at about 70 percent (*The Economist*, 2011). These new ventures have made a major difference in terms of human welfare in China (*The Economist*, 2009a; [Huang, 2008](#)). Since the start of China's economic reforms, the economy has grown on average at approximately eight percent annually ([Yueh, 2013](#)). This has led to a tenfold growth in GDP, with an emerging middle class which has grown from 174 million in the mid-1990s to a remarkable 806 million in 2009, elevating hundreds of millions out of poverty (*The Economist*, 2009b). Research is accumulating slowly on examining the entrepreneurship development process in China, and how those lessons can be applied elsewhere ([Chen et al., 2012](#); [Yueh, 2013](#)).

## Who are China's entrepreneurs?

China's new entrepreneurs tend to be younger and well-educated, with an average age of 31 and nearly 44 percent in the 25–34 age group. 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 percent between 18 and 34 and less than one-quarter falling into the older 45–64 category (Xavier et al., 2013). Education levels are also an important characteristic of entrepreneurs in China. The survey shows that bachelor degree holders account for nearly 32 percent, community college or equivalent for about 27 percent, secondary school about 27 percent, secondary school or below 9 percent, while master's degree and above accounts for the remaining 4.4 percent (Yang and Zhang, 2012). About 80 percent of entrepreneurs have prior work experience. Another important phenomenon is the role of migrant entrepreneurs, who often maintain strong social ties to their home community and transfer business and technological know-how, information exchange and remittances. Overseas returnee entrepreneurs are usually highly-educated individuals such as scientists and engineers trained in developed countries who return to China to start technology ventures (Wright et al., 2008).

Although there is considerable criticism of research on entrepreneurial personalities and related attributes (e.g. [Littunen, 2000](#); [Shane and Nicolaou, 2013](#)), some characteristics and behaviours are associated with entrepreneurs. For example, risk-tolerance and an aptitude for problem solving seems to be common among entrepreneurs ([Sarasvathy, 2008](#); [Van Praag and Cramer, 2001](#)). Similar research on entrepreneur attributes has started to emerge slowly in China. [Tan \(2001\)](#) argued that entrepreneurs in private firms tend to be more risk-taking, innovative and proactive than managers in state-owned enterprises in responding to the changing institutional environments. Additionally, being female, older or a member of the Chinese Communist Party all significantly reduce the probability of becoming an entrepreneur.

## Entrepreneurship and financing

Within the entrepreneurship ecosystem, financial capital is one of the necessary resources required for enterprises to form and subsequently operate. Compared with more developed economies, private enterprises, especially SMEs, face significant constraints in accessing finance from the banking sector (*The Economist*, 2011). The nature of the capital structure of start-up ventures is quite important to their success ([Cassar, 2004](#)) For example, it has been argued that both the level and the sources of capital can play a critical role in the start-up's success ([Cooper et al., 1994](#); [Florin, 2005](#)).

A critical challenge faced by Chinese entrepreneurs has been their limited access to credit. It is estimated that very few of China's millions of SMEs obtain formal financing ([Cong, 2009](#)). Examining the source of start-up capital for businesses in ethnic Chinese communities in East Asia is an important topic that is garnering additional research (as in this special issue; see also Newman et al., 2012). For example, Newman and colleagues (2012) found that firm size, firm age, profitability and incorporation are significantly related to the leverage of Chinese SMEs, although asset structure was related only weakly to capital structure, possibly reflecting the higher importance of social capital in China. In order to facilitate the development of venture capital, the Chinese government promulgated policies in the 1980s and 1990s to attract and encourage external investors. In 1999, China's Ministry of Science and Technology officially launched the Technical Innovation Fund for Small and Medium-sized Enterprises, partly in response to new policies from the government on technology development. By 2010, the Chinese venture capital industry had 720 venture capital enterprises established, with an average fund size of RMB330m (Shen, 2011). The

substantially different institutional environment in China, compared to that in the USA or Europe, suggests that there are different models of venture funding in China that adjust to the local institutional regime ([Ahlstrom et al., 2007](#)).

## The challenges of China's institutional regime

As institutional theory suggests, the beliefs, goals and actions of individuals and groups, particularly working in an organisational setting, are shaped by various environmental influences ([Scott, 2014](#)) in a subtle but pervasive way. Generally speaking, private firms in China have grown regardless of the arguably poor applicable legal and financial mechanisms through the use of informal institutions such as social capital substituting for more formal rules and laws ([Allen et al., 2005](#); [Newman et al., 2012](#)). However, institutions from macro level (policy and regulation) to micro level (individual characteristics and attitude) both constrain and enable entrepreneurial endeavours ([Baumol, 1990](#); [Chen et al., 2012](#); [Coase and Wang, 2012](#)). The gradual weakening of state control over the economy in China has changed the institutional and incentive regime, allowing the emergence of a generation of entrepreneurs that navigate the difficult institutional landscape effectively ([Bruton et al., 2010](#)).

Ease of doing business in China remains a problem. According to the World Bank Doing Business Report 2013 (World Bank, 2012), China was ranked 91 out of 181 countries (where a higher ranking indicates that the regulatory environment is more conducive to the starting and operation of new firms). The report states that it takes Chinese entrepreneurs on average 13 procedures and around 33 days to start a business, versus five procedures and 12 days in the OECD. Although Chinese entrepreneurs are able to navigate China's institutional environment, stronger property rights and less government interference in the economy would be advantageous ([Young et al., 2008](#)).

Commitment to entrepreneurship in China also has been growing, albeit unevenly, in recent years ([Ahlstrom et al., 2008](#); [Huang, 2010](#)). Research needs to define the concepts and processes needed for researchers to conduct large sample studies of entrepreneurship in China. For example, one such interesting line of research is whether venture capitalists will determine the location of initial public offerings, and how they can facilitate Chinese firms' relocation to countries with a superior institutional environment, if need be ([Cumming et al., 2009](#)). Innovative research such as this combines the constructs of incentives and institutions with the decisions and actions of entrepreneurs, employing theory from finance and institutional theory.

## Conclusion

This overview of entrepreneurship in China suggests that although market transition in China in general remains at a relatively early stage, a significant body of research and experience has accumulated on entrepreneurship, firm strategies and growth ([Bruton et al., 2001, 2008](#); [Hitt et al., 2004](#)). Much understanding has been built through dogged study by a dedicated worldwide network of scholars, although more research is needed in these and other areas ([Yang and Li, 2008](#)). The Chinese context includes a specific set of institutional arrangements and a set of cultural understandings, both embedded in the distinct history of Chinese societies ([Haley et al., 2009](#); [Young et al., 2004](#)). Unpacking these institutional and cultural arrangements and related incentives is essential to understanding entrepreneurship in China and transferring that experience to other developing countries. Research is required to explore how to remove the obstacles and improve the incentives for entrepreneurs to flourish ([Lerner, 2009](#)). China represents a valuable research site in this regard, and the research in this special issue is an important step in this direction.

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## Notes

1. The work of Joseph Schumpeter is a notable exception, though Schumpeter started to give more attention to larger firms and their research and development in his later work (McCraw, 2010; Schumpeter, 1939, 1942).
2. See Beck (2009), Leung and White (2004) and Yang and Li (2008) for a more exhaustive review.

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## Author biographies

David Ahlstrom is a Professor of management at The Chinese University of Hong Kong. His research focuses on innovation and new ventures, managing in Asia and management and organizational history. He has published numerous articles in journals such as *Strategic Management Journal*, *Academy of Management Review*, *Journal of International Business Studies*, *Organization Science*, *Journal of Business Venturing* and *Journal of World Business*. His work has also appeared on multiple occasions in the *Wall Street Journal*, and he guest edited two special issues of *Entrepreneurship: Theory and Practice*.

Zhujun Ding is an Assistant Professor at the Hang Seng Management College in Hong Kong. Her research interests include entrepreneurship, firm strategy and international business. She has published several articles in leading journals including *Asia Pacific Journal of Management*. She also won the Best Paper Award from a recent Academy of Management Annual Meeting in the Entrepreneurship Division.