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Key Issues and Challenges

Edited by Douglas Cumming, Michael Firth, Wenxuan Hou, and Edward Lee

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Introduction

Douglas Cumming, Michael Firth, Wenxuan Hou, and Edward Lee

China's economic reforms have been ongoing for more than 30 years and the fruits of this move toward a free market system are becoming increasingly apparent. Initially, the reforms concentrated on improving the efficiency of state owned enterprises (SOEs), and the SOEs were reorganized with corporate structures and mandates to be profit making. At the same time, markets developed and competition became keener. Later, reforms focused on developing new industries. It was soon apparent, however, that the corporatized SOEs were not well-suited to developing completely new technologies and new forms of doing business. China's government therefore began encouraging individuals to start up new business ventures. The government decided to tap the innate entrepreurial spirit that lies within people, a spirit that had been long suppressed under the centralized state planning system in place since the 1950s.

The government sees the development of a vibrant private sector as a vital necessity to achieve their objectives of modernizing the economy, increasing Gross National Product (GNP) and employment, and delivering innovative and high technology products and services. To help foster the development of the private sector, the government opened up the banking sector and formal and informal financial markets were developed to help finance the business plans of entrepreneurs. China's growth as an economic power, where it is set to overtake the United States in terms of GNP in the next few years, is largely down to the performance of the private sector.

China's new entrepreneurs operate in traditional industries, where they have overhauled the way these businesses operate, as well as in new industries. These "new to China" industries include property, building, and construction, which cater to people's desire to own their homes, and footwear, clothing, retailing, and electronic goods, which supply both the domestic and export markets. Perhaps the most visible entrepreneurs are those in the telecommunications, Internet, and e-commerce sectors. Jack Ma is one of the best known of China's new entrepreneurs and he built his fortune in e-commerce. His company, Alibaba, was the largest initial public offering (IPO) in history when it listed on the NYSE in September 2014, and this event brought great exposure to China's entrepreneur-led businesses.

Scholars have recently turned their attention to documenting and analyzing the rise of entrepreneurs and private sector business in China. However, this research has thus far been published in a wide array of specialist journals and magazines that are not easily accessible to an international audience. With this in mind, we have put together this book, which has contributions written by leading experts on entrepreneurial activity in China. We believe our book will be thought-provoking and highly informative for all those with an interest in detailed accounts of entrepreneurial development in China.

Chapter one "Entrepreneurship in China: Progress and Challenges" by David Ahlstrom and Zhujun Ding provides an overview of entrepreneurship in China. It reviews the historical development of the entrepreneurial class and traces the important political decisions that allowed and encouraged private sector businesses. The roles of institutional and social factors in entrepreneurship is carefully laid out. The chapter also provides an excellent review of historical and current research into entrepreneurship research in China, which runs the gamut from theory, to experimental, to archival approaches and draws on the disciplines of economics, finance, management, and sociology. The chapter provides an excellent coverage of where we are in terms of research and is essential reading for those who want to work in this area.

Chapter two "Overcoming the Innovation Challenge: Examining the Determinants of New Product Innovation in Chinese SMEs by Alex Newman, Yanyan Gao, and Jinghuai Zheng examines the financing of research and development (R&D) in small and medium-sized firms. Based on a comprehensive questionnaire survey of

1439 Shanghai-based industrial firms, the authors found that internally conducted R&D is more efficient than externally conducted R&D. Efficiency is measured by turning R&D into new product sales. One reason for this finding is that really promising R&D is kept in-house to avoid information leakage to competitors. R&D that is farmed out to other firms is less likely to lead to saleable products. Another important finding from the research is that internal funding and tax credits are more directly linked to successful product innovation than are external financing sources and government subsidies. Raising external finance through bank loans is often a short-term solution and this is not conducive to financing long-term R&D. Moreover, the detailed disclosures needed to borrow money and sell new shares will lead to a leakage of information on research ideas, which will lead to fewer successes.

Our understanding of the financing of entrepreneurial businesses in China is further enhanced in chapter three where Mingzhi Liu, Yulin Shi, and Zhenyu Wu investigate the activities and performance of angel investors. In their chapter "Angel Investors' Affiliations and Investment Returns in China," the authors examine the financial returns to angel investors in China. Angel investors are private individuals who invest in startup firms as opposed to venture capital firms, which raise funds from clients and invest in later stage entrepreneurial firms. Not surprisingly, the authors find that the returns to angel investors are extremely variable. However, on average, the returns are positive, which is to be expected if angel investors are to survive in the longer term. Some of the angel investors are affiliated with venture capital funds but the benefits from doing so are unclear. The authors show that the returns to angel investors from investing in a firm are reduced when a venture capital fund also invests in the firm although this negative effect is reduced (and can become positive) if the venture capitalist investment is high (above RMB 70 million). This complex relationship between angel investors and venture capitalists has not been documented before and highlights the importance of investor-type in the outside financing of entrepreneurial businesses.

In chapter four, "Corporate Governance and Corporate Social Responsibility Disclosure: Evidence from China," Naqiong Tong explores the association between corporate governance and corporate social responsibility (CSR) disclosures. CSR has garnered more interest in recent years because of widely reported environmental and workplace disasters associated with firms. Firms have attempted to reduce the direct or inferred reputational damage from these scandals by increasing information on CSR. Using recent data from listed firms in China, the author finds that the quality of CSR disclosures is better in firms with a larger board size and a higher proportion of independent directors. Other noticeable associations are that firms with greater management shareholdings, a dominant controlling shareholder, and a more diversified set of large stockholders have greater CSR disclosures. Overall, firms with more elaborate systems of checks and balances, as manifested in their corporate governance structures, are more likely to have detailed CSR disclosures. This may indicate that these firms care more about the environment, customers, and their employees although the authors do not claim they have proved such a causal link.

Chapter five by Hongyan Yang, Ting Ren, and Massimiliano Sassone, "Foreign Direct Investment, Institutional Environment and the Establishment of Private Economy in China," examines the effects of foreign direct investment (FDI) on the growth of the private sector using provincial level data. Prior research has identified at least two possible outcomes of FDI on the domestic private sector. One possible outcome is that FDI generates positive spillover effects for the domestic private sector economy. This is based on knowledge transfer from foreign firms to local firms. Knowledge transfer includes technology as well as labor skills. The transfers are made to the domestic private sector as a whole as well as to domestic firms in the supply chain. In contrast, FDI could have negative spillovers including crowding out effects where local firms are forced out of business. Here, the potential beneficial effects of knowledge spillovers do not materialize as the knowledge/technology gap between foreign firms and local firms is so great that knowledge transfer becomes well-nigh impossible. With this as a background, the authors use government statistics to show that FDI has generally had positive effects on the domestic private sector in terms of the number of establishments and the number of employees in the private sector. This evidence suggests a very positive role for FDI.

In chapter six, Chenglong Zhang examines the importance of networks in explaining the success of small high technology firms. His chapter "How China's Technological Small and Microtechnology enterprises' Network Embeddedness Impacts Performance: The Mediated Effect of Entrepreneurial Opportunity" reports the results from a survey of small high technology firms that asked questions about their use of networks. Dividing entrepreneurial opportunity into three types, discovery, creating, and imagining, the author shows that these factors play an influential role in the relation between embeddedness and performance.

In chapter seven, Shasha Wu, Ting Ren, and Hongyan Yang examine the venture capital industry in China. "Fund Ownership, Investment Preference, and Performance: The Venture Capital Industry in China" details the rise of the venture capital industry from its beginnings in the 1990s through to the present time. While many of the early venture capital (VC) firms were financed by foreigners, China-funded VC firms quickly arrived on the scene and a natural question is whether there are differences in the investments made by the foreign VC firms and domestic VC firms. While foreign VC firms have a long history of investment, Chinese VC firms should have more local knowledge and may have better political connections. Thus, there could be differences in investment styles and financial performance between the two types of VC firms. The authors address these issues in fine detail. They find that foreign VC firms are more adventurous in terms of financing nontraditional industries (including IT) and startup entrepreneurial ventures. Foreign VC firms have earned better returns than domestic VC firms and they are more likely to exit their investments through merging with, or being acquired by, other firms and by making IPOs in overseas markets. While these differences have been quite pronounced, there is some evidence that the strategies used by foreign and domestic VC firms are becoming closer.

The detailed and insightful contributions herein highlight the high quality of research on entrepreneurship in China. As the editors of this Palgrave MacMillan book on Developments in Chinese Entrepreneurship, we not only learned a great deal from reading all of these chapters, but we also immensely enjoyed corresponding with each of the authors. We are extremely grateful for their timely and excellent contributions.