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The Development of Entrepreneurship in China
The Influence of Institutions on Entrepreneurship

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LIST OF ABBREVIATIONS

APR	The annual percentage rate
CBRC	China Banking Regulatory Commission
CCTV	Chinese Center Television
CIT	The Center for Information Technology
CCP	Chinese Communist Party
e.g.	exempli gratia (for example)
et al.	et alia (and others)
etc.	et cetera (and other things, or and so on)
EPZ	Export Processing Zones
FIE	Foreign Investment Enterprise
FDI	Foreign Direct Investment
GEM	The Global Entrepreneurship Monitor
GDP	Gross Domestic Product
HR	Human Resources
IEA	Information Engineering Academy
IPO	Initial Public Stock Offering
IPD	Integrated Product Development
ISO	International Organization for Standardization
i.e.	id est (that means)
ibid.	ibidem (some sources as preceding parenthetical note)
LDCs	Less Developed Countries
LCD	Liquid Crystal Display
LCM	Liquid Crystal Module
OECD	Organization for Economy and Co-operation Development
OEM	Original Equipment Manufacture
PBOC	People's Bank of China
PRC	People's Republic of China
PLA	People's Liberation Army
PDT	Product Development Team
SOE	State-owned Enterprise
SME	Small-and-Medium-Sized Enterprise
SEZ	Special Economic Zone
SSEZ	Shenzhen Special Economic Zone
U.S.	United States
WTO	World Trade Organization

INTRODUCTION

1. Statement of the Problems

The role of entrepreneurship in the world economy has changed drastically over the last half century. During the Post-World War II era, the importance of entrepreneurship and small businesses seemed to fade. In the early and mid 20th century, the exploitation of economies of scale and scope was thought to be at the heart of modern economies (Teece 1993, p.199). Small businesses were considered to be a vanishing breed. This thinking has changed in recent years. By the 1980s evidence mounted to demonstrate that this move away from large firms toward small, predominantly young firms was a sea-change, and not just a temporary aberration (Wennekers 2002, 1899).

In the late 20th century, entrepreneurship re-emerged as a key agenda item of economic policy makers across Europe, both for specific nations as well as for the European Union as a whole (Brock and Evans 1989, p.7). Audretsch and Thurik labels this new economic period, which is based less on the traditional inputs of natural resources, labor and capital, and more on the input of knowledge and ideas, as the “entrepreneurial economy”(Audretsch and Thurik 2001,p.267). The United States has achieved its highest economic performances by fostering and promoting entrepreneurial activity. According to Kuratko and Hodgetts (Kuratko and Hodgetts 2004, p.30), the most important part of their study is that new entrepreneurial companies have been blossoming while large companies have been transforming into small business and in the meantime thousands of small firms have been founded in the U.S.A.

In the developing countries, micro-entrepreneurship has created more opportunities for poor people to find jobs. And China’s economy is growing quickly, averaging 8.35 percent expansion for most of the 1990s. However, so many researchers argue that China lacks the essential environment for the development of entrepreneurship. In earlier entrepreneurship research, it is widely believed among social scientists that a lack of entrepreneurial resources is a major cause of economic stagnation in Less Developed Countries (LDCs). For example, China has long been regarded as one of

the poorer countries in the world. In 1978 China was still in the throes of the Cultural Revolution chaos and in the grip of a central planned economy. Business scholars in recent years argue that sound financial and legal systems are vital to economic growth, so how did the Chinese entrepreneurs manage to start-up and become so successful? Apart from the perplexing Chinese entrepreneurship research, there is a popular logic among studies of China, for instance, that a democratic political system is a prerequisite for successful economic development. Furthermore, questions were raised, such as, “Are there any qualified entrepreneurs in China?” or “Why does China have a lack of entrepreneurs?”

Table 1 Number of days required to Start a Business and Entrepreneurship Rates in Selected Countries (2005)

	Number of days required to start a business	Young businesses entrepreneurship rate	Opportunity nascent entrepreneurship rate	Necessity nascent entrepreneurship rate
Australia	2	4.66	4.99	0.49
Canada	3	3.59	4.90	0.69
United States	5	5.23	7.16	1.06
Singapore	6	3.67	3.08	0.54
France	8	0.68	1.46	1.10
United Kingdom	18	2.92	2.00	0.29
Switzerland	20	3.71	2.28	0.16
Germany	24	2.71	1.91	0.67
Japan	31	1.14	0.86	0.16
Thailand	33	13.06	6.40	1.23
South Africa	38	1.74	1.89	1.14
China	48	9.40	3.67	1.16

Sources: World Bank Doing Business Global Entrepreneurship Monitor cite in Andre van Stel, David Storey and Toy Thurik (2006) “The Effect of Business Regulations on Nascent and Young Business Entrepreneurship” p.8

The global entrepreneurship monitor (GEM) research program is an annual assessment of the national level of entrepreneurial activity. The GEM was initiated in 1999 with 10 member countries, and expanded to 21 countries in 2000. In 2005 the number of the countries had reached 39 and the program covers both developed and developing countries. China entered the program in 2002. The collected data on both opportunity entrepreneurship and necessity entrepreneurship show higher levels in

developing countries than in developed countries. Table 1.1 shows the number of days required to start a business and the entrepreneurship rates in 2005 in different countries. The young business entrepreneurship rate is defined as the percent of the adult population that is the owner/manager of a business that is less than 42 months old (Stel, Storey and Thurik 2006), and the nascent entrepreneurship rate is defined as the percent of adult population that is actively involved in starting a new venture (Reynolds, 2002).

As indicated in Table 1.1, the collected data on both opportunity entrepreneurship and necessity entrepreneurship by the GEM show higher levels in developing countries than that in developed countries. The young business entrepreneurship rate in the selected twelve countries ranges from below 3 percent in Japan, France, South Africa, United Kingdom and Germany to rates of over 5 percent in the United States, China and Thailand. Among them China and Thailand reached the highest rates, 9.4 percent and 13.06 percent respectively.

Leff (1979) conducts entrepreneurship research on LDCs. He argues that the problem of the supply available for entrepreneurship in LDCs seems to have been “solved.” Leff (1979) suggests that it has become clear that economic development in most current LDCs can proceed without having to wait for a psycho-cultural transformation in order to increase the supply of entrepreneurs. In 2002 a conference named “The Future of Chinese Management” was held at Wharton West Campus in San Francisco. In the conference Professor Franklin Allen and his colleagues argued that “Imposing Western models of economic growth, without understanding their effect on the informal sector, could be harmful to China and other developing nations.” Since the late 1980s, China has demonstrated sustained high rates of real output growth, especially in the manufacturing sectors where entrepreneurship constraints had been expected to be more severe. Entrepreneurship research discloses abundant evidence that the supply of entrepreneurship turns out to be highly responsive to economic incentives even in cultures and societies about which social scientists are pessimistic. This indicates the exaggeration of earlier theoretical concerns that the lack of entrepreneurial capacity would be a serious barrier for the research on the development of entrepreneurship in China.

In the context of China, a popular but transient behavior of an entrepreneur is the

practice of taking advantage of gaps in both markets and institutional structures. Seen in this light, entrepreneurship is everywhere in China's economic life. For instance, a local official sits at a company's board of directors meeting; several university lecturers are partners with a consultancy company and a group of retired or laid off factory workers run a car servicing shop. However that is only a part of the profile on Chinese entrepreneurs. Entrepreneurship research has been studied extensively in the United States and other developed countries. However, such studies in developing countries are rare. China is one of them.

2. Purpose of the Study and Approach

2.1 Purpose of the Study and the Research Questions

Scholars have analyzed the influence between entrepreneurship and institution, the impact of socio-cultural networking and the development of entrepreneurship. Yang (Yang 2007, p.5) suggested that in the research on China's entrepreneurship we are short of ideas that theorize the relationship between entrepreneurship and institutional changes in the Chinese emerging economy. In my view, we lack analysis which could reveal the dynamic power for the initiative activities and its inner logic in entrepreneurship development in China. Therefore, my thinking has become focused on the interaction between institutions (formal and informal institutions) and entrepreneurship while studying the various business models in China. The two phenomena, institutional transformation and the development of entrepreneurship, has appeared together during the economic reform since the end of 1978.

Hence, the main goals of this study are to enrich the entrepreneurship literature by examining a specific aspect of the institutional environment, which includes the political environment, the economic environment and the socio-cultural environment, and discover how the entrepreneurial models have evolved in different institutional environments in China. This research has three objectives: (1) To describe the trajectory of entrepreneurial models. In so doing, this research should provide the insight into the entrepreneurial models by analyzing the dynamic power to improve entrepreneurial development in the then current institutional environment, and what is the impact of institutions on the transformation of business models. (2) To discover how the entrepreneurs make use of the resources and opportunities to

develop their business plan, the study focuses on some case studies, in particular the grass-roots entrepreneurs' stories that occurred in the 1980s to 1990s, and examines how informal institutions were produced and how the informal institutions transformed into formal institutions to improve the institutional environment. (3) The main purpose is to develop a comprehensive theoretical framework to illustrate the nexus of the three issues, such as informal institution (core values of culture and social capital), the development of entrepreneurship and the institutions, which work as a whole to impact on the distinctive qualities of entrepreneurship in China. My task is to find out how the interaction works.

The study focuses on the following questions in particular:

- 1) How do the institutions impact on the entrepreneurial activity in different regions in China? Also what are the benefits of institutions with regard to the regional entrepreneurial models? And what are the barriers and how do the barriers of institutions hinder the regional entrepreneurial development?
- 2) How the organizations and their structural variety come into existence in response to the incentives that a given institutional system offers?
- 3) How do the entrepreneurs make use of formal and informal institutional rules to benefit their entrepreneurial activity? How do entrepreneurs find the opportunities to start-up in the ill-functioning institutional environment of the 1980s?
- 4) How do institutional innovations occur in the process of entrepreneurship?
- 5) What is the counterforce of the development of entrepreneurship for the informal institutions? How can cultural diversity in entrepreneurship be promoted?

2.2 The Introduction of the Interaction of Social Capital/Culture, Institutions and Entrepreneurship

In order to answer the research questions, this study attempts to discover the relationship between institutions and entrepreneurship, a choice must be made between the number of relevant questions and aspects if comparison and synergy are to be possible. In Chinese entrepreneurship we lack convincing research on the basis of Chinese social structure and Chinese culture; in particular China is a country with its own social and economic institutional environment and varied regional cultures. Allen and his assistants (Informal, 2003) argued that entrepreneurship relies on

factors such as cultural norms and economic competition to promote good corporate governance, and depends more on bonds or trust and reputation for financing rather than traditional Western sources of capital. What is the motivation to combine such kinds of “informal” sectors? A study sponsored by the OECD states that “there is no unique set of causes” (OECD, 2000) and points to the conclusion that technological, economic, institutional and cultural factors all play a part in explaining the decline and revival of self-employment, i.e., the role of entrepreneurship, in individual countries (Sander Wennekers, Lorraine M. Uhlaner and Roy Thurik 2002).

Unfortunately, so far the business side of entrepreneurship is still kept apart from its institutional side; we need theoretical frameworks that seriously incorporate them both as essential components of a single process. This section discusses the triangle framework, which is to be specifically used for this study in order to analyze the relationships between the formal and informal institutional framework, the social capital/culture and the development of entrepreneurship. The detailed introduction and discussion on the theoretical literature is in the following subsection.

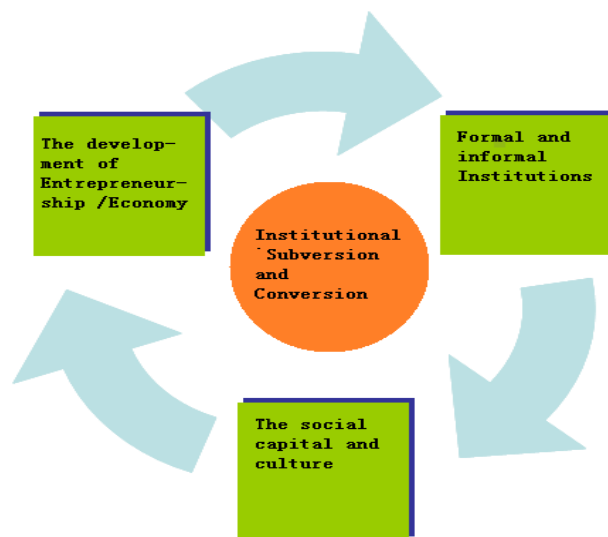


Figure 1: A Framework on the Interaction of Social Capital/Culture, Institutions and Entrepreneurship

Here the three points of the framework will be discussed: Firstly, entrepreneurship research should not be completely divorced from life, e.g. the entrepreneurial environment in China. Figure 1 illustrates the effects of institutions on entrepreneurial activity and vice versa, the influence of the developed entrepreneurship on the transformation of institutions. This could help us to identify the distinctive qualities of

entrepreneurship in China through analyzing different entrepreneurship models.

Secondly, Figure 1 indicates two important aggregate conditions: culture and institution, which both impact on the promotion of entrepreneurship in China. The Figure summarizes the norms associated with regional culture, where entrepreneurship is derived from being given autonomy to make decisions as well as flexible institutions. It also shows the link between entrepreneurship and institutions; the link between entrepreneurship and culture, as a feedback from the development of entrepreneurship to renewing institution and culture.

Thirdly, Figure 1 indicates that entrepreneurs in the center of the framework play an important role in mobilizing the resources to exploit the entrepreneurial opportunities. Among them, culture plays an active role and shows that sometimes there are constraints to finding and collecting resources, it also influences how to make use of the informal institutions to find opportunities. For instance, networks, trust system, core values and human resources.

Based upon all this, I propose the following hypothesis:

H1: In the absence of access to the formal power structure and banks, informal institutions (social capital and cultures) will have a significant, positive effect on the process of entrepreneurship in China.

H 2: The variety of institutional environment influences the type of business models.

H3: The developed entrepreneurship will have a positive effect on the transformation of institutions (formal and informal institutions).

2.3 Approach Introduction

To approach these objectives and find answers to the questions above, the study focuses on three major sources of information that have been selected and are essential to the research objectives. The first source is publications, such as academic journals, magazines and newspaper, textbooks on entrepreneurship, biographies or autobiographies of entrepreneurs, proceedings of conferences, etc. The second source of information comes from interviews with some entrepreneurs and enterprises. I have had twelve important interviews between 2006 and 2011, including meetings with the overseas business men/women from Wenzhou, Sunan,

and Shenzhen, and business delegations from China. Several telephone interviews were made in Sunan and in my hometown of Xuzhou, in the Jiangsu Province in 2009. This information will be used in a comparative study of the rural and urban entrepreneurship in this paper. The third comes from video frequency reports given by the entrepreneurs on the Internet.

Generally speaking, quantitative studies use “what” and “how much” questions, but “why” and “how” questions seemed to be more important for the explanations when enquiring about the process or the analysis on the factors influencing the phenomena. In this sense, case studies are ideal complements to statistical analysis in the study of the development of entrepreneurship in China.

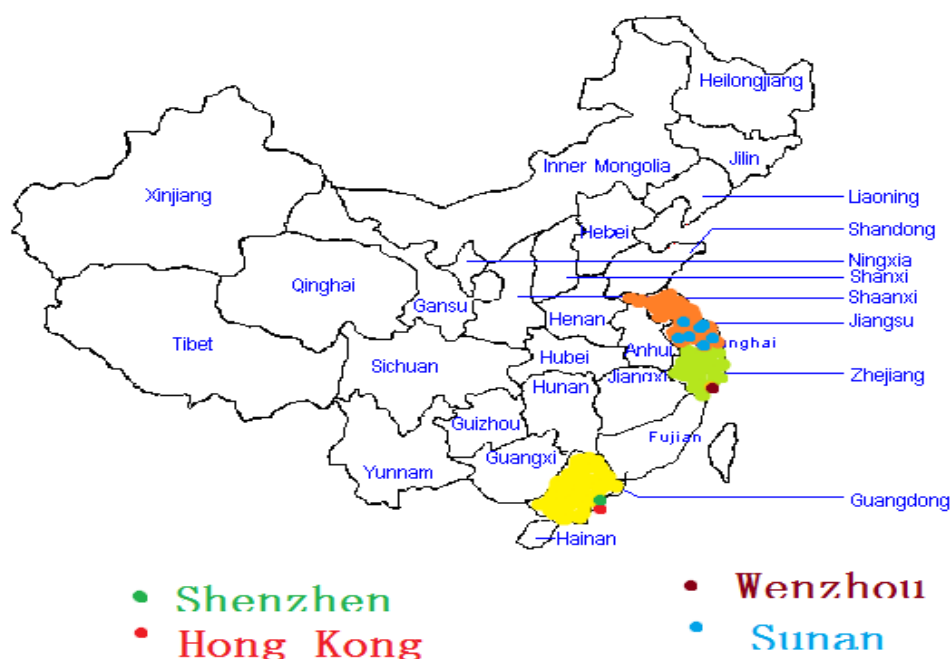
A case study can be used as a tool for understanding other cases or something more universal (Stake, 1995). In this study fourteen cases were analyzed and used as a basis for the empirical studies. These cases are selected from three different regions which have their own regional cultures and individual institutions. Some of the cases come from the interviewees and some are selected from publications. I analyzed them mainly for the purpose of illustrating how certain cultures and institutions work in a particular context, and not merely for just reporting the details of entrepreneurial experiences. Furthermore, the cases are meant to show how the interaction between entrepreneurship, cultures and institutions can work together to shape the varied business models.

3. Content Introduction

This paper includes three parts. First the introduction; then the comparison of the development of entrepreneurship in different regions in China, including the peasant entrepreneurship in rural China and entrepreneurial development in Shenzhen and finally the conclusion and some suggestions on policy making in education.

Some details of the historical context for the emergence of entrepreneurship in China are present from the beginning of economic reform in the late 1970s or the beginning of 1980s. I will report on emerging trends and innovation in Chinese entrepreneurship and analyze various entrepreneurship models in regions influenced by different institutional environment. They are: Wenzhou peasant entrepreneurship,

Sunan peasant entrepreneurship and Shenzhen immigrant entrepreneurship (see Map 1: the locations of the three models in China). In this paper, investigations will be dealt with on the three regions in China, to focus on the context in which entrepreneurial opportunity was created and where entrepreneurial activity occurs. For instance, I carried out twelve interviews with entrepreneurs who are from Wenzhou, Sunan and Shenzhen. I will try to explain what institutional environment the entrepreneurs met with in their entrepreneurial activity, how entrepreneurial development were influenced by regional cultures and informal institutions, and what the determinants of nascent entrepreneurship are in China. There is a brief history on Mao but this focuses on the last three decades of China's economic reforms since 1978.



Map 1 The Locations of the Three Models in the Map of China

4. Significance of the Study

With entrepreneurship development in China, the research on entrepreneurship has grown rapidly in recent years in China. In the newspapers, stories about successful entrepreneurs constantly make the headlines, and new books about how to start your own business and analysis on case studies easily catch your eyes in the bookstore. And in 2005, the “Win in China” Show had been broadcast on Chinese Center

Television (CCTV) in China and internationally for a total of eight months. The venture capital and investment firms SAIF Partners, IDGVC, and Capital Today Group are the exclusive fund providers. Chinese entrepreneurship research has gradually pervaded academically. Chinese economists and sociologist scholars carried out a lot of theoretical and empirical research on China's entrepreneurship. Some researches are in the discipline of sociology and psychology, for instance, entrepreneurship analysis on individual, organization and social aspects, the comparison between necessary entrepreneurship and opportunity entrepreneurship, and the influence of culture on entrepreneurship in China. Most of the literature to date has focused on the individual, for instance who becomes an entrepreneur and who becomes rich, and why? However, the business environment surrounding entrepreneurs and potential entrepreneurs have received relatively less scrutiny.

In an ill-functioning institutional environment how did the entrepreneurs pursue the entrepreneurial opportunities and how did the entrepreneurs develop in the LDCs? Has Chinese entrepreneurship, as the ultimate agent, been incessantly destroying the old economic structure and incessantly creating a new one? And how do the causes of such creative destruction function and arise on its own initiative, from within? Hence this study on Chinese entrepreneurship may supply a view on the answer to these questions.

Entrepreneurs can hardly make decisions to exploit entrepreneurial opportunities in a vacuum, but instead are influenced by the context in which they operate. Chinese entrepreneurship research is not an exception. We know the difference between the social-economic environment of the developed and of developing countries. The Western concept of entrepreneurship is focused on the ability of the individual to identify profitable opportunities (Kirzner, 1973). But some scholars argued that the key factor in successful entrepreneurship in China is the ability to form an alliance with those economic agents who possess or control the financial assets, physical assets, or specific human capital needed for brokering market entry (Krug and Mehta, 2004, p.60). There are many particular phenomena worthy of further study in entrepreneurship research. This study reveals how entrepreneurship not only developed in China but also flourished. The research on the informal institutions in China will benefit further study on what can be done to enlighten people on entrepreneurship education.

CHAPTER ONE: THE THEORETICAL FRAMEWORK

This section offers a review of the literature relevant to the study of entrepreneurship and institutional environment. The significant areas to be reviewed include: (a) the theory of entrepreneurship, (b) the entrepreneur and entrepreneurial activity, (c) the institutional environment, such as the political, economic and socio-cultural environments, (d) the conceptions and perspectives on institutions, with particular emphasize on the theories of Douglass North, (e) the conceptions of culture and social capital and their perspectives.

1.1 Key Concepts and Perspectives on the Theory of Entrepreneurship

1.1.1 Literature Review on the Key Concepts of the Theory of Entrepreneurship

Till now it is difficult to find either a definition of entrepreneurship or a universal set of indicators. The diversity of views on the definition of entrepreneurship is due to three classic economic theories. According to Høbert and Link (Høbert and Link 1989, pp.39-49), the first theory is the German tradition of Von Thünen and Schumpeter (Schumpeterian Entrepreneurship), the second is the Chicago or new-classical tradition of Knight and Schultz (Knightian Entrepreneurship), and the third is the Austrian tradition of von Mises and Kirzner (Kirznerian Entrepreneurship).

These traditions point to different aspects of the function of the entrepreneur. In the Schumpeterian tradition economists concentrate on the entrepreneur as a creator of instability and creative destruction, where the entrepreneur (or enterprise) changes the rules of competition for the industry (Schumpeter 1912, pp.521-536). According to Schumpeter, the entrepreneur is an individual who combines resources in novel ways that add value, hence earning what he terms “entrepreneurial profit” (Schumpeter, 1934, p.128). These new combinations of resources stand in stark contrast to the existing circular flow of goods and services and typically follow one of the following forms: 1) new goods, 2) new production methods, 3) new markets, 4) new sources of inputs, and 5) new organizational structures (Schumpeter, 1934).

Knight argues that entrepreneurs are people who are willing to bear uncertainty (Knight, 1921). This uncertainty indicates the unknown item, e.g. future prices of

inputs, future legal environment for doing business, etc. To Knight, the distinction between risk and uncertainty is that the former can be estimated and insured while the latter cannot (Knight 1921; McMullen and Shepherd 2006). In the view of the above argument, people's perceptions of the future govern how willing they are to accept decision-making responsibility. Knight thought that a perfect equilibrium was a theoretical impossibility due to constant individual activity (Knight 1921).

The Austrian school of thought focuses on the abilities of the entrepreneur to perceive profit opportunities, usually after some exogenous shock (Kirzner 1979; 1997). Kirzner postulates that entrepreneurial opportunities are not plainly visible; rather, the entrepreneur discovers them by being naturally alert to changes in the environment. The Austrian school argues that uncertainty is a fact of life (Yang 2007, p.44). This discovery process contains the element of surprise; it is not the search for a profitable opportunity or the knowledge leading to such an opportunity; rather it is the recognition of "previously unthought-of knowledge" (Kirzner, 1997). Unlike Schumpeterian opportunities, which are rare and radical, Kirznerian opportunities are plentiful and modest. Combining the two views, Nooteboom notes that "the creation of potential may be seen as Schumpeterian and its realization as Austrian" (Nooteboom, 1993). Kirznerian opportunities involve arbitrage within and across markets.

Entrepreneurship scholars must now try to define entrepreneurship studies, which is a difficult task due to its varied research perspectives. Entrepreneurship may be defined as a purposeful activity to initiate, maintain, and develop a profit-oriented business (Cole, 1954); the process of creating or seizing an opportunity and pursuing it regardless of the resources currently controlled (Bygrave and Timmons, 1994); or as the creation of new organizations (Gartner, 1988). Moreover, entrepreneurship can attack monopolies and promote economic diversity through the "creative destruction" of monopolies, or "business as usual" and because "small is more efficient", creative and flexible than big and inflexible monopolies (Zimmer/Faltin,1999) Wennekers and Thurik integrated these views, and defined entrepreneurship as the "the perception and creation of new economic opportunities" combined with "decision-making on the location, form and use of resources" (Wennekers 1999, pp.27-55).

In summary, it is not easy for scholars to find a cohesive definition based on parts or characteristics of entrepreneurship, because entrepreneurship is a complex process that entails, amongst other aspects, certain personal, market, financial and political conditions. Resource deficit, coordination, the seizing of opportunity and creating new organizations are all components of the process, but none of these components alone is able to define entrepreneurship. In this study, entrepreneurship will be defined as a process of combining the individual resources to produce goods or services and that this combination fosters economic growth, increases productivity, and creates new technologies, products, and services (Stoner and Freeman 1992).

1.1.2 The Definitions of Various Types of Entrepreneurship

In the meantime, we should increase our understanding of the various catalogues of entrepreneurship based on the already existing entrepreneurship theory and research. Included amongst the types of entrepreneurship are such types as social entrepreneurship, business entrepreneurship and institutional entrepreneurship.

Eventhough there is no universally accepted definition of the phenomenon of social entrepreneurship, social entrepreneurship may be aimed at benefiting society rather than merely maximizing individual profits (TAN, WeeLiang, et al. 2005). Social entrepreneurs play the role of change agents in the social sector, by adopting a mission to create and sustain social value (not just private value). There have been three approach in considering this form of entrepreneurship (Alvord, Brown and Letts, 2002): Social entrepreneurship viewed as combining commercial enterprises with social impacts (Emerson and Twersky, 1996), as innovating for social impacts (Dees, 1998) and as catalysts for social transformation.

The term institutional entrepreneurship refers to the “activities of actors who have an interest in particular institutional arrangements and who leverage resources to create new institutions or to transform existing ones” (Maguire, et.al. 2004, p.657). The term is most closely associated with (DiMaggio, 1988), who argued that “new institutions arise when organized actors with sufficient resources see in them an opportunity to realize interests that they value highly”. These actors, institutional entrepreneurs, “create a whole new system of meaning that ties the functioning of disparate sets of institutions together” (Garud, Jain and Kumaraswamy 2002).

Institutional entrepreneurship is therefore a concept that reintroduces agencies, interests and power into institutional analyses of organizations.

1.2 Entrepreneurship Definitions and Perspectives

The term “entrepreneur” originated in French economics as early as the 17th and 18th centuries. In French, it means someone who undertakes a significant project or activity. Jean Baptiste Say put it in this way, “The entrepreneur shifts economic resources out of an area of lower and into an area of higher productivity and greater yield” (Say, 1803). Say identified that the entrepreneur’s action created value for society (ibid.). Schumpeter (1934) was the first to identify entrepreneurs as an entity distinct from business owners and managers. He defined the entrepreneurs as the innovators who drive the “creative-destructive” process of capitalism, and who introduce new combinations of the means of production. Drucker (Drucker, 1985) argued that an entrepreneur always searches for changes (in technology, consumer preferences, social norms, etc.), responds to it, and exploits it as an opportunity. For Drucker, starting a business is neither necessary nor sufficient for entrepreneurship. Gartner (Gartner 1988, p.11) suggested that entrepreneurs should be defined by what they do, and not who they are. Entrepreneurs have a mind-set that sees the possibilities rather than the problems created by change. Gartner indicated that entrepreneurs’ sole purpose is to create organizations. This paper defines an entrepreneur as the individual responsible for the process of creating new value, innovation, and/or new organizations. The role of the entrepreneur is to discover, evaluate, and exploit entrepreneurial opportunities, that is, new products and services, new strategies and organizational forms, new markets, processes and raw materials that did not previously exist (Shane and Venkataraman 2000, p.217).

1.3 Understanding of Entrepreneurial Activity

This section intends to catalog the different types of entrepreneurial activity, such as self-employment, the perception and discovery of market opportunity, the assembly of unique boundless resources, new firm formations. Furthermore, this section intends to discuss the tradeoffs implicit in the definition for entrepreneurship which I have selected for this dissertation, that is the seemingly discontinuous process of

combining resources to produce goods or services and noted that it fosters economic growth, increases productivity, and creates new technologies, products, and services.

There are many forms of entrepreneurial activity that one might study. Shane (2003) describes the two main forms of entrepreneurial activity as self-employment and new company formation. J.Hughes defined it as, "Entrepreneurial activity is the pursuit of pure profit through the exploitation of existing disequilibria or through the creation of disequilibria by the introduction of new products, methods, or techniques into the stream of economic life" (Hughes, 1980). Inherent in their categorization is the idea that not only an individual is the actor, but also the existing firms work as actors to participate in series of business activities to bear uncertainty, recombine resources in an innovative way, or arbitraging markets. The entrepreneur combines resources to fulfill unsatisfied needs or to improve market inefficiencies or deficiencies. However the research on an individual would hardly describe the portrait of the entrepreneurial development in regions of China. Hence this study focuses on both the existing firms in certain regions and the individual, which can be described as "the process that takes place... that causes changes in the economic system through innovations brought about by individuals who generate or respond to economic opportunities that create value for both these individuals and society (Hills, 1994)".

Self-employment encompasses new firm formation and small business ownership. The self-employment can be contractors or sole proprietors, or they can be owners/managers of firms employing any number of salaried workers. New company formation is usually the founding of a firm by an individual or team of individuals. Studies of new firm formation have focused on individual traits like innovation (Acs and Audretsch 1990), absorptive capacity (Shane 2003), market knowledge (Klepper and Sleeper, 2001). The innovative activity can be technological, organizational, or even institutional, as long as it introduces new production functions (Bromley, 1989). Capabilities include the human and social expertise required to leverage a firms resources to market. In an entrepreneurial context, these innovative capabilities include the perception and recognition of a match between creative resources and market opportunities. Market entry need not result in the founding of a new firm or the use of market mechanisms, however "it does require the creation of a new way of exploiting the opportunity (organizing) that did not previously exist" (Shane 2003p. 7). Hence the perception and discovery of market opportunity is one of the most

important abilities of successful entrepreneurs (Ardichvili and Cardozo 2003) and this is one of the core questions in this study. This may include the skilled capabilities as well as unique or unusual social networks and connections. The perception and discovery of market opportunity is an important focus of entrepreneurship research and depends on environmental factors which provide an incentive for, and make possible, entrepreneurial activity. Then what is the research on environmental factors and how does it impact on the entrepreneurial activities?

1.4 Literature Review of the Environmental Determinants of Entrepreneurship

1.4.1 The Theories of the Environmental Determinants of Entrepreneurship

The objective of this section is to discuss the salient aspects of the determinants of entrepreneurship theory and why this approach is chosen over alternative approaches. To gain a better understanding of the environmental determinants of entrepreneurship, this part begins with the comprehensive theoretical framework at the macro level, and then I detail the pertinent context of institutional environment on opportunity exploitation, with particular regard to Shane's view.

Generally speaking, the factors such as the market or industry conditions, the financial environment, and the geographic environment create the economic environment for entrepreneurs to start-up. Furthermore, the creation of firms depends not only on the economic environment, but also on the socio-cultural and political environments, such as the education system, cultural environment and cultural values.

Figure 1.1 presents a study on the comprehensive theoretical framework at the macro level. In the framework factors, Wennekers (2002) emphasizes what kind of aggregate conditions benefit entrepreneurial activity, such as, technology, level of economy, institution and culture and are incorporated into the framework as influences on the development of entrepreneurship. These factors are also reflected in nascent entrepreneurship, start-ups and total business ownership. Although Figure 1.1 focuses on the country level of analysis, it is also linked to the level of individual occupational and career choices. The framework shows that the rate of entrepreneurship impacts on economic performance at the individual, firm and societal levels, affecting personal wealth, firm profitability, and economic growth.

Some scholars emphasize the regional environmental impact on the entrepreneurial activity. Furthermore, they suggest that entrepreneurs interact with the environment and not only shape, but are shaped, by the environment. In Figure 1.1 Wenekers (2002) implies a causal sequence from aggregate conditions to the rate of entrepreneurship to economic performance, and we acknowledge the dual causality amongst these relationships as reflected by the feedback loops shown in the figure structure.

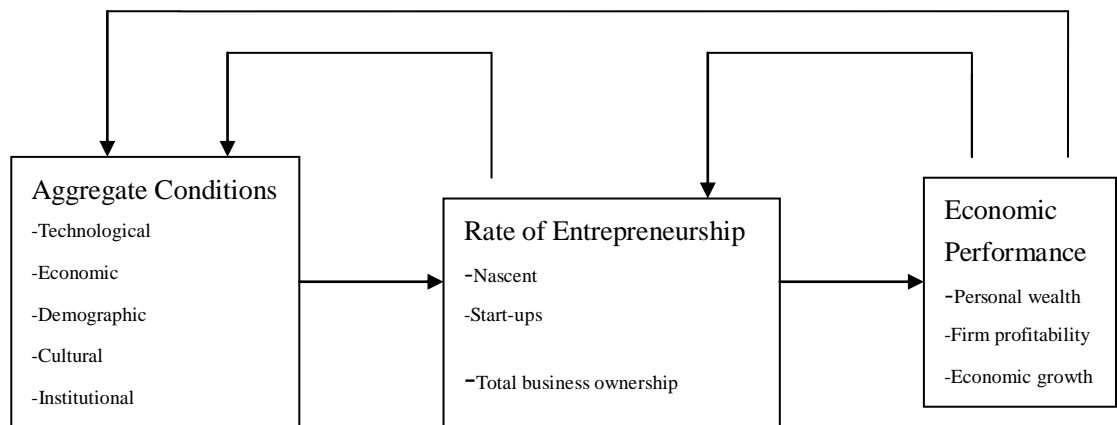


Figure 1.1 A framework of Entrepreneurship at the Macro Level

Source : Wenekers Lorraine 2002, pp.25-68

Table 1.1 The Effect of Institutional Environment on Opportunity Exploitation

<p>1. Economic environment</p> <ul style="list-style-type: none"> --Income and capital gains increase the level of opportunity exploitation, property taxes reduce that --Economic growth and society wealth increase the level of opportunity exploitation --Low rates of inflation and stable economic conditions increase the level of opportunity exploitation
<p>2. Political environment</p> <ul style="list-style-type: none"> --Freedom increases the level of opportunity exploitation --Strong rule of law and property rights increase the level of opportunity exploitation --Decentralization of power increase the level of opportunity exploitation
<p>3. Socio-cultural environment</p> <ul style="list-style-type: none"> --Social desirability of entrepreneurship increases the level of opportunity exploitation --Presence of entrepreneurial role models increases the level of opportunity exploitation --Specific cultural beliefs increase the level of opportunity exploitation

Source: Scott Shane (2003) "A General Theory of Entrepreneurship ---the environment context of entrepreneurship" p.147

Many researchers have listed the positive effective factors which are important to

promoting successful regional entrepreneurship, and the negative effective factors which reduce the level of opportunity exploitation. These include the economic, political, legal, and social factors in the regions (Lee and Peterson, 2000). Shane (2003) argues that the institutional environment (the economic, political and social context in which an entrepreneur is found) influences people's willingness to engage in socially productive entrepreneurial activity. Box 1.1 shows a summary on the effect of institutional environment on the willingness of people to engage in productive entrepreneurial activity (Shane, 2003).

1.4.2 Conceptions and Perspectives on Economic Environment

The level of economic development is a dimension primarily influencing environmental opportunities. Firstly, the shift in industrial structure from manufacturing to services creates opportunities and the rising incomes greatly boosts general demand for goods and services (Inman, 1985). As I will discuss in the next chapter, the rapid transformation of the Chinese economy since 1978 has been considered by many scholars as a miracle. Between 1978 and 2008, the Chinese economy as a whole, grew by an average rate of 9.7 percent per annum (Wu and Yang, 2011). In particular, China has been transformed from a planned economy to a mixed economy where resource allocation is mostly done by the market. This has given risen to greater entrepreneurial opportunities. Secondly, greater wealth provides potential entrepreneurs with the capital that they need to self-finance their entrepreneurial activities. Most entrepreneurs face capital constraint in China; these financial constraints affect their ability to self-finance their new ventures. The level of economic development influences the supply side of entrepreneurship, for example through the availability of financial resources for business start-ups. Hence entrepreneurial activity is more viable when the economy is strong and wealth creation encourages positive attitudes towards entrepreneurship.

Apart from the economic environment mentioned previously, Shane (2003) emphasizes the determinants of political environment and socio-cultural environment. The next part discusses these two items in turn.

1.4.3 Conceptions and Perspectives on Political Environment

Shane (2003) emphasizes that political freedom is considered a prerequisite in entrepreneurial institutions. This includes the freedom from being subjected to the will of others. In the view of Shane and other researchers, political freedom encourages the free exchange of information (Hayek 1945, p.519), and encourages entrepreneurs to have more internal locus of control (internal locus of control: people with an internal locus of control have a stronger sense that they can control their own environment, and will be more likely than people with external locus of control to exploit entrepreneurial opportunities, (Shane p.108)). Property rights are defined as the rights to own and contract for assets according to an established set of rules and laws (Shane 2003, p.155). Under strong property rights, people believe that any entrepreneurial profit that they earn will not be taken away from them arbitrarily, facilitating opportunity seizing and development.

Harper argues that the rule of law facilitates the coordination of resources in transactions that occur at different points in time (Harper 1997). It gives an entrepreneur the confidence that those who provide him with access to resources also have the legitimate rights to them. On the legitimacy and protection of the contract, the rule of law allows for greater division of labor and specialization because it allows for the enforcement of contracts. (Libecap 1993, p.67). As a result, entrepreneurs can obtain financial and human resources from external parties, and do not have to internalize the entire value chain to exploit opportunities. These characteristics encourage opportunity exploitation by people whose opportunities are best developed through contractual organizational arrangements, and who need to obtain capital and labor from external sources. Therefore, property rights and the rule of law are stronger and support greater levels of exploitation of entrepreneurial opportunities.

Centralization is the degree to which one political actor coordinates the economic, political and social activity in a society (Shane, 2003). Entrepreneurial activity usually benefits from decentralization. In decentralized societies, the relationship between entrepreneurial action and market-based rewards can be protected. The prospect of entrepreneurial profit provides an incentive for opportunities development. Additionally, in decentralized societies people have more internal

locus of control than that in centralized society. The reason is that the economic success in centralized societies depends less on one's own actions than on those of the state. China is transforming from a planned economy to a market economy. How the centralization and other political factors influence a transforming economy, and how the political environment influences entrepreneurial activity, these questions will be discussed in the next chapter. The following subsection discusses the socio-cultural environment.

1.4.4 Definitions and Perspectives on Socio–Cultural Environment

Like the political and economic environment, the socio-cultural environment is an important dimension of the context in which entrepreneurial activity takes place. The socio-cultural infrastructure consists of the beliefs and attitudes of the members of society towards what is desirable and to legitimate activities, as well as the social and cultural institutions that support a particular society's way of life (Shane 2003, p.157). The social and cultural environment influences the amount of opportunity exploitation in a society in several ways. Firstly, societies with more successful entrepreneurial models will encourage more novice entrepreneurs to engage in entrepreneurial activity. Secondly, much of the knowledge necessary for entrepreneurial activity is acquired by "learning by doing" and is transmitted through social networks, apprenticeships or through the observation of others. Specific norms and cultural beliefs are associated with the types of actions, such as certain types of decision-making, specific approaches to resource acquisition, distinct strategies and particular methods of organization design. Hence, certain cultural beliefs encourage entrepreneurial activity. In summary, this study intends to discover how, under conditions of uncertainty and information asymmetry, the social norms and beliefs that support reciprocity and moral commitments encourage entrepreneurial activity by facilitating resource acquisition.

1.5 Conceptions and Perspectives on Institutions

This section intends to discuss the aspects of a new institutional theory. Firstly, to review the definitions of institutions and various perspectives from the social sciences; and secondly, to introduce the pertinent characteristics of the new institutional theory, with particular regard to Douglass North's view and thirdly, to argue its related definitions and perspectives on culture, social capital and their

influences on entrepreneurial activity. Finally, the conclusion will be made on institutional benefits to entrepreneurial activity.

1.5.1 Definitions of Institutions and the Introduction on New Institutional Theory

As defined by North (1999), institutions are the rules of the game in a society or, more formally, are the human devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether it's in the political, social, or economic areas (North 1990, p.3). In his other work (North 1981, p.201) institutions are defined as: "Institutions are a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals". This study focuses on the effects of institutions on entrepreneurial activity and vice versa; the influences of the developed entrepreneurship on the transformation of institutions. The research on institutions concerns the operation of these institutions at the political economic level (e.g. between the country and the local government). North's view of institutions is adopted as my working definition that is that institutions are "humanly devised constraints on human interaction" (ibid.).

There are some items of North's conception worth discussing. The first is the understanding of institutions. As suggested by Schumpeter, there are two ways of understanding of institutions, a narrow one and a broad one. The narrow understanding refers to specific organizations and concrete procedures that entrepreneurs have to encounter and deal with throughout the whole process of establishing new business ventures, including financial and taxation institutions, governments, property inheritance, regulations of contract, and so on (Schumpeter 1934, pp.86-87). In contrast, institutions in the broader sense include social customs (Schumpeter theory, p. 87), established practices (Schumpeter, 1991.p.413), etc. Hodgson (2006) defines institutions as "systems of established and prevalent social rules that structure social interactions." This broad definition encompasses self-enforcing coordination devices such as language as well as externally enforced constraints such as contract law (Troilo, 2007). This study adopts the understanding of institutions in a broader rather than in a narrow sense.

Many organizations have been set up to enhance the development of entrepreneurship since the beginning of economic reform in China in 1978. One

might conceive that an organization or an organizational structure would serve as a constraint on human behaviour. Hence the distinction between an organization and an institution is the second item to be argued. Consistent with North's view, I perceive organizations as "players" in the economy whereas institutions as "a rule of game" (North 1990, p.5). North argues that organizations and their structure variety come into existence in response to the incentives that a given institutional system offers. The above section has mentioned the theories on determinants of institutional environment; in addition, the various institutional environments will be discussed as the backgrounds to the study of regional entrepreneurial activities in China. The varieties of the organizational structures respond to their regional institutional environment. It is important to explain that North doesn't specifically say that organizations can never be institutions; rather, North's focus is on the institutions as "a rule of game" under which organizations and individuals operate. This is how I treat institutions in my dissertation.

The third item to be indicated is the relationship between what North terms formal and informal institutions and their effects on entrepreneurial activity. Formal institutions are codified in law; they carry the weight of legal sanctions. Informal institutions may be understood as the collection of social norms, conventions, and moral values that constrain individuals and organizations in pursuit of their goals (Raiser, 1997). North (1990) suggests that informal constraints "come from socially transmitted information and are a part of the heritage that we call culture... Culture provides a language-based conceptual framework for encoding and interpreting the information that the senses are presenting to the brain" (North, 1990). Informal institutions are grounded in the norms and values of a society and its mechanisms. North argues that the informal constraints are important in themselves since the implementation of the same formal constraint could result in different outcomes across different nations.

Therefore, the difference between formal and informal institutions is one of degree rather than of kind. Institutions exist on a continuum of unwritten to written; from a simple society to a complex society (North, 1990). Informal institutions may be the basis of formal institutions; while formal rules may complement informal constraints and increase their effectiveness. Primary examples of the former are rules of law and property rights, while trust exemplifies the latter. Institutions offering protection

against expropriation of rents (see the definition, Chapter 2) can either be formal or informal (North, 1990). In order to better reflect the characteristics of Chinese entrepreneurship models, the informal institution is treated as a part of the framework of my study to highlight the interaction between formal and informal institutions.

1.5.2 Institutional Subversion and Conversion

This study adapts the definitions of institutional subversion and conversion to indicate the transformation of institutions. Institutional subversion occurs when people ignore formal institutions. This may occur out of ignorance, inconvenience, or incongruities in official rules. Institutional conversion occurs when actors appropriate formal institutions to serve their own ends (Thelen, 2004). This process is associated with the rise of adaptive informal institutions. It usually requires some form of collaboration with bureaucrats, or at least those who have access to the enforcement of formal institutions (Tsai 2007, p.209).

Institutional subversion and conversion are different expressions of processes that give rise to adaptive informal institutions. They do not occur sequentially, even though institutional conversion certainly conveys a degree of institutional subversion. But both processes are more likely to occur in certain institutional environments. This is how I treat the transform of institutions from informal institutions to formal institutions in this study. Institutions support entrepreneurship in two fundamental ways. The first way is by legitimizing entrepreneurial activity, and the second is to protect against expropriation of rents. Comparatively speaking, the items of property rights and rule of law are considered more as static conditions supplied for entrepreneurs to help with starting-up. However, in the discussion on political environment in China above, the institutions were hardly able to support entrepreneurship in these two fundamental ways. Therefore institutional subversion and conversion occur. In this study the argument of institutional subversion and conversion emphasizes their dynamic relationship between formal and informal institutions and their effects on entrepreneurial activity.

1.6 The Conceptions of Culture and Social Capital and their Perspectives

1.6.1 The Definition and Perspectives of Culture

There are over two hundred different kinds of culture definitions in the world. Scholars have carried out a lot of research in the field of culture. For example, Barnouw (1979) defines culture as configurations of “stereotyped patterns of learned behavior which are handed down from one generation to the next.” Hofstede refers to culture as “the collective programming of the mind that distinguishes the members of one group or category of people from another.” Since values are typically determined early in life (Hofstede, 1980; Barnouw, 1979) they tend to be “programmed” into individuals resulting in behavior patterns consistent with the cultural context and enduring over time (Hofstede, 1980; Mueller and Thomas, 2000).

As mentioned above, informal institutions are grounded in the norms and values of a society and its mechanisms. North suggests that informal constraints “come from socially transmitted information and are a part of the heritage that we call culture...” (North, 1990). This study focuses on the effects of institutions on entrepreneurial activity, and therefore I adopt Kroeber’s definition of culture as the “patterns of values, ideas and other symbolic-meaningful systems as factors in the shaping of human behaviour” (Parson and Kroeber 1958).

There are some facets of Kroeber’s definition worth examining. Firstly, since values are typically determined early in life (Hofstede, 1980; Barnouw, 1979) they tend to be “programmed” into individuals resulting in behaviour patterns consistent with the cultural context and enduring over time (Hofstede 1980; Mueller and Thomas, 2000); secondly, culture is learned, not innate. Prof. Wulf states that:

“Interaction with the other plays an essential role. It leads to a better understanding of culture, which no longer appears to be an isolated island whose inhabitants are simply in contact with the inhabitants of other islands. The other is rather a part of our own cultural world (...)” (Wulf 2002).

In the process of economic development, old economic and cultural values are being redefined, and new innovations are being created. These are the two ideas which I use when I use the term of culture in this dissertation.

1.6.1.1. The Values of Culture and its Impact on Entrepreneurship

Some sociologists have carried out research on the relationship between entrepreneurial traits and culture. One of the theories is included Hofstede's (1980) extensive study on culture. The study leads to the development of four cultural dimensions, i.e. power distance, uncertainty avoidance, individualism, and masculinity, which is considered to provide a clear articulation of the differences between countries in values, beliefs, and work roles (Mueller and Thomas, 2000). However, Hofstede did not specify the relationship between culture and entrepreneurial activity per se; the researchers considered his culture dimensions as useful in identifying key aspects of culture related to the potential for entrepreneurial behavior. Based on the meaning of cultural dimensions and entrepreneurial dimensions, the researchers have tried to discover the relationship between culture and entrepreneurial orientation. They selected the important characters of entrepreneurs, such as innovativeness (adaptability), internal locus of control, risk taking, and pro-activities as factors to test the significance of the relations of culture and entrepreneurial orientation. The research (Shane, 2003) proved that entrepreneurial culture has a positive effect on entrepreneurial orientation. Some personal characteristics are believed to be instrumental in motivating entrepreneurial behavior.

Davidsson (1995) identifies two views regarding the relationship between cultural values and entrepreneurial behavior. Firstly, the aggregate psychological trait explanation for entrepreneurship is based on the idea that if a society contains more people with entrepreneurial values, more people will be entrepreneurs. Davidsson notes that this is essentially the perspective taken by McClelland (1961) and other proponents of the individualistic view of culture. Davidsson also identifies a second view, first set forth by Etzioni (1987) and is referred to as social legitimating. This latter view assumes that variations in entrepreneurship are based upon differences in values and beliefs between the population as a whole and potential entrepreneurs. According to this latter view, it is precisely this clash of values between the groups that drives potential entrepreneurs away from the average organization and into self-employment. Prof. Faltin argues "We should be aware that it is values which motivate for entrepreneurship and it is the value system that creates culture in a society" (Faltin 1999, p.196). Some scholars assert that an entrepreneurial culture is

about a framework in which entrepreneurs have the potential to emerge and local economic resilience is promoted (Krueger, 2003).

1.6.1.2 The Discussion on Dominant Culture and Regional Culture

National culture is an important factor in shaping human behavior, motivation, personalities, core self-evaluation or cognitive processing which influence much of regional culture and habit. Although national culture is an important factor in shaping human behavior, it is too general a concept to explain the dynamic aspect of the entrepreneurial-related disequilibrium resolution. Every region has its own unique culture or set of values. Some regions can have a strong culture with a high degree of sharing and be sharply differentiated from other regions. On the other hand, we can find regions with a weak culture having a low degree of internal sharing and external differentiation.

Considering Chinese culture, we have to ask one question: “Could Confucianism be the right and only philosophy to explain the Chinese economic performance?” Geert Hofstede has been inspiring us to catch up and move on (Fang 2001, pp.347-368). Fang maintains that moral development rather than economic interest is intrinsic to Confucian traditions, and that “there is no causal relationship” between the “Confucian ethic” and the “East Asian entrepreneurial spirit” (Fang, 1984). Hence broad appeals to “Confucian values” in China seem equally implausible, since the exceptional performance that we seek to understand occurs only in specific historical contexts. It is omni-directional, with a lasting influence on economic development. A shift from national culture to regional culture is also needed here. A community often has several different cultures within a dominant culture. In China, apart from the dominant Confucianism, there are other regional cultures, such as the “Yongjia” culture in Wenzhou and the “Wu” culture in Sunan.

On the basic understanding of culture, my paper sums up the related core values and personal traits which benefit entrepreneurship as patterns for possible comparative research. They are: (a) the need for power that is reflected both in the rejection of the power of others, as well as in the need for independence and the search for more power, (b) the need for personal realization, achievement or ambition (McClelland, 1968) (c) acceptance of uncertainty, self-employed motivation, respect for business doing, hardworking spirit, the tendency to assume risks and tolerance of failure (e) charisma or leadership, which although not a personality trait, it is affected by it

(Pfeffer, 1977). These factors may not be sufficient to describe the personal traits influenced by entrepreneurial culture. However, considering the features embedded in various regions of entrepreneurship models, the factors mentioned in this study are core values to be used to make further analysis.

1.6.2 The Conceptions of Social Capital and its Perspectives

Although there are various definitions and interpretations of social capital in the literature, there is an agreement on its main meaning: Social capital consists of networks of relationships and resources inherent in these networks (Coleman, 1988). And as social capitalists, they capitalize on resources and assets located in social networks for instrumental actions (Lin, 2001a). Research on personal networks of entrepreneurs revealed that entrepreneurs obtain information and advice from network members (Birley 1985, p.107) and access bank loans through contacts (Uzzi B.1999, pp.481-505). The idea of social capital in the Chinese context captures the indigenous social phenomenon called *guanxi* (connections). *Guanxi* is the Chinese version of social networks and networking, it emphasizes harmony and cooperation and is a web of extended family relationships (Liang, 1986). There are various interpretations of *guanxi* in different regions in China, which will be discussed as part of the informal institutions in this thesis. In the research of sociology, social capital plays an active role in the entrepreneurial activity and recent studies emphasized this point. It is created by trust, mutual obligation, expectations, and norms among network members (Gulatin 1995, p.85-112). Bourdieu defines social capital as “the aggregate of the actual or potential resources which are linked to possession of durable network of more or less institutionalized relationship of mutual acquaintance or recognition” (Bourdieu,1986 p.248). Putnam highlights the elements of trust and cooperation, and he regards social capital as networks and norms that enable participants to cooperate effectively to pursue their common interests and shared objectives (Putnam, 1993a). Coleman argued that social capital is a “variety of different entities with two elements in common: they all consist of some aspects of social structure, and they facilitate certain actions of actors...within the structure” (Coleman 1988a, p.98), and the specific forms of social capital are obligations and expectations, information channels, norms and effective sanctions.

1.6.2.1 The Definition of Network and its impact on Entrepreneurial Activity

Castells (2004, p.3) provided the following definition of networks: “A network is a set of interconnected nodes...nodes may be of varying relevance for the network. Nodes increase their importance for the network by absorbing more relevant information and processing it more efficiently”.

Networks are the context of entrepreneurial culture in relation to the connections between entrepreneurs and other economic actors that are created through recurrent interpersonal interactions and information flows. They represent a set of culturally constructed dyadic relationships, which are driven by entrepreneurs' willingness and competencies to engage in ongoing interpersonal relationships.

1.6.2.2 Trust System and the Introduction of Trust Forms

Giso, Sapienza and Zingales (2006) studied the effects of culture on values like trust and the subsequent effect of these values on various economic outcomes such as the probability of becoming an entrepreneur. The study proved that trust has a positive, significant effect on the likelihood of being self-employed.

Trust is a function of economic transactions embedded in social relationships (Granovetter, 1985). It can be defined as “the subjective probability with which an agent assesses that another agent or group of agents will perform a particular beneficial action” (Gambetta, 2002). Trust plays at least two positive roles. The first is to simplify the complexity in entrepreneurial activities, and the second is to reduce transaction costs.

When few people can be trusted, transaction costs tend to be very high (North, 1990). In a low-trust economy, it is necessary for the entrepreneur to sign a contract with the supplier; otherwise he is vulnerable to the supplier's non-performance. The most important attribute of a business culture for entrepreneurial activity is the extent to which it promotes trust (Casson, 1995).

This foundation for trust takes different forms and is necessary common ground for social action. We can distinguish between three forms of trust: pre-contractual trust, structural trust, and finally relational trust. These are formed through various

processes. Pre-contractual trust is established over time through socialization and which is taken for granted, so-called implicit trust. Structural trust is gradually institutionalized by legitimate power based on formal structures and positions, whilst relational trust develops through cooperation and negotiations based on proximity, acquaintance, and cooperation (Ellingsen, 2006). The three forms are not mutually exclusive and may operate side by side. Analyzing the dynamics between these forms of trust may give a better understanding of credit as a gendered process. Relational and pre-contractual trust can be considered as pristine forms of trust whilst structural trust is developed through modernization and institutionalization of law and state apparatus.

In summary, the trust system and networks act as motivational factors to force the intermediate process change, and this leads to the innovation of the institutional environment, either in a subversion or a conversion way.

CHAPTER TWO: GENERAL INTRODUCTION on CHINA'S INSTITUTIONAL ENVIRONMENT at the END of the 20th CENTURY

In Part One of this paper, I reviewed the theoretical framework at the macro level which emphasizes the effective factors to promote regional entrepreneurship, introduced Shane's argument on the institutional environment, and argued the aspects of a new institutional theory, with a particular regard to Douglass North's view. Before the introduction of the development of entrepreneurship in China, this part will give a historical overview of China's institutional environment which influences people's willingness to engage in socially productive entrepreneurial activity. The next sections will first address the well-know approach of Juan J. Linz and Alfred Stepan (1996) as the comparison to analyze the institutional environment in China, then introduce the economic reform in the rural areas which began in 1978, then analyze the economic environment, political environment and socio-cultural environment in the 1980s, and finally discuss some key concepts and their perspectives, such as Confucianism, regional culture, rent-seeking, etc..

2.1 Introduction of the Five Arenas of "Consolidated Democracy"

In Juan J. Linz and Alfred Stepan's approach, five arenas are defined. They are the civil society, the political society, the rule of law, a state bureaucracy, and the economic society. This framework will help us better understand the questions and barriers for the development of entrepreneurship in China raised earlier in this thesis. If a functioning state exists, the five interconnected and mutually reinforcing arenas must exist or be crafted for a democracy to be consolidated. Each one of the five arenas in the democratic system has an effect on others and no single one in such a system can function properly without some support from others. In a consolidated democracy, there are constant mediations between the arenas, each of which is correctly in the "field" of forces emanating from the other arenas. This paper focuses on the economic society to discover the necessary support it needs from other arenas and its primary mediation upon other arenas. With regard to the economic society,

the political society produces legal and regulatory standards for the economic society, while the economic society must be respected by civil society and enforced by the state apparatus. It produces the indispensable surplus to allow the state to carry out its collective functions and provides a material base for the pluralism and autonomy of civil and political societies (see Figure 2.1).

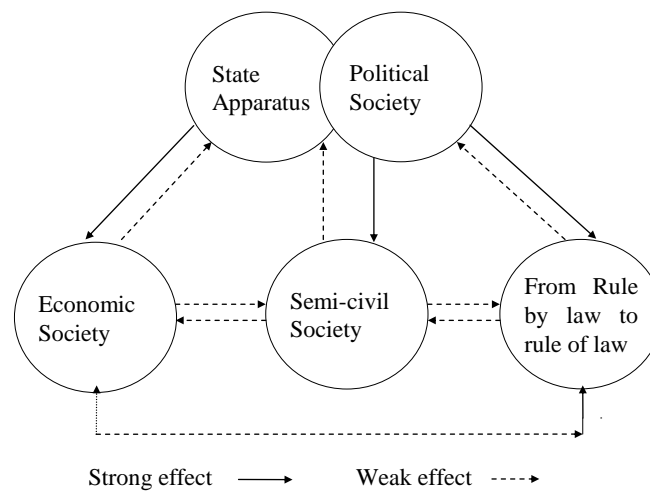


Figure 2.1 the Framework of Five Arenas of “Consolidated Democracy” in China

Source: author

Figure 2.1 illustrates that the Chinese state and political society, which should be separate from each other, combine together to have greater impact on the other three arenas, such as the civil society, the rule of law and economic society. In a sub-independent economic society, the Chinese Communist Party (CCP) is the only viable political party; there is no competition for political power unlike in Eastern Europe, where the political reform began with the economic reform. Hence China has a relatively weak democratic structural while the communist regime shows more internal strength. Furthermore, China took a much more gradual approach to privatization and market reforms than the other socialist economies (Bai, Li, Tao and Wang 2000, pp.716-738) The subsequent sections will discuss the political environment, socio-cultural environment and economic environment respectively.

2.2 Political Environment: Political Freedom, the Rule of Law and Property Rights in China in the 1980s

Institutional environment is considered as an important factor in the research of entrepreneurship, because only it can supply the environment for the entrepreneurs to operate in and the possibility to exploit entrepreneurial opportunities. As noted in part one, political freedom, property rights and rule of law are some of the most important factors coordinating the entrepreneurship activity. Those environments in which property rights and the rule of the law are stronger have greater levels of exploitation of entrepreneurial opportunities. The next part will analyze the political environment (political freedom, rule of law and property right) in China in the 1980s.

2.2.1 Political Freedom

As discussed in part one, political freedom includes the freedom from being subjected to the will of others. In a society where the communist regime shows more internal strength (see Figure 2.1), people are subject to the arbitrary exercise of the will of others and tend to have less internal locus of control. Therefore, they are less responsive to entrepreneurial opportunities (Harper, 1997). Furthermore, opportunity exploitation involves the acquisition of information about entrepreneurial opportunities and the free exchange of information could hardly be encouraged without political freedom. Civil society needs the support of a rule of law which guarantees the right of association and also needs the support of a state apparatus that will effectively impose legal sanctions on those who attempt to use illegal means to stop groups from exercising their democratic right to organize.

2.2.2 Law-making in China

Since 1978, establishing the rule of law in China has become a priority for its government. This reform is attributed to the following two main factors: on one side, Deng Xiaoping and his successors had recognized the folly of the Maoist period's denigration of law and lawyers, especially the extraordinarily destructive Cultural Revolution. The current generation of Chinese rulers has promoted "the rule of law" to the extent of adopting a constitutional amendment in 1999 to enshrine the

principle (Qian, 1998). On the other hand, these reform efforts are also linked to China's expected entry into the World Trade Organization (WTO), which requires an internal legal system administered in a "uniform, impartial, and reasonable manner" (Lubman, 1999). Establishing the rule of law in China thus coincides with the notion that economic modernization requires "getting on track with the international community" (Guthrie, 1999).

In 1979, political and legal reform was undertaken in an effort to catch up with the rest of the world and restore legitimacy to China's ruling party. The government has carried through its commitment to strengthen the legal system. A new Criminal Code was adopted in 1980, followed by a new Civil Code in 1987 (Ladány 1992). Law popularization campaigns were launched in the late 1980s and throughout the 1990s to educate the public about law and legality. But the legal infrastructure and general legal consciousness among citizens that had been destroyed could not easily be replaced. The post-Mao leadership recognizes the need for stable legal rules for a market economy. Some independent judicial authority appears to be evolving gradually, especially in the area of business law. The number of tried cases was increasing, tripling between 1993 and 1998 to almost 100,000, nearly 40 percent of all cases tried were related to business cases. Public security and land use were the most common tried cases. About half of the plaintiffs were enterprises, the other half private persons. Many suits were only filed in order to influence ongoing informal mediation (Huang, 1996). Such as, the development of the constitution and the People's Congress. Since 1978 China has been transferring from the rule by law to rule of law. The past three decades have witnessed a rapid development in China's semi-civil society, driven by the opening of China's market and its integration with the international community

2.2.3 "Rule by Law" replaces "Rule of Law"

"Rule by law" refers to the method of using legal rules and some institutional methods for enforcing them in the practice of government. In contrast to "rule by law", "rule of law" involves a normative and political theory of the relationship between the state and a legal system.

In addition to legislation, there are also regulations, sets of rules, detailed rules, measures, decisions, resolutions and orders. The complexity of the interaction among these different levels of law and their administration opens the door for political policy decisions to replace legal rules in deciding particular cases. For example, the National Peoples Congress has the sole authority to adopt legislation, but the Standing Committee acting alone may issue decrees, interpretations of laws, and partial or individually focused regulations. The legal system in China amounts to “a bewildering and inconsistent array of laws, regulations, provisions, measures, directives, notices, decisions, explanations, and so forth all claiming to be normatively binding” (Peerenboom, 1999). The most fundamental shortcoming of the Chinese legal system is constitutional. It lies in the ambiguous relationship between the constitutional supremacy of the Communist Party and the authority of the law. In addition, the Chinese Constitution itself illustrates the conflict between the authority of law and the authority of the party in two contradictory provisions. The Constitution provides that all organizations, including political parties, are subject to the law. In this manner, the Constitution purports both to subject the Party to the rule of law and to elevate the Party to a privileged constitutional position.

Generally speaking, China has made great effort in the law-making arena, but many important issues still need to be addressed. Many of these issues have a major significance on constitutional law, but the laws have to be adopted by the full NPC (National People’s Congress). This approval will take much time as there are interruptions during the process. On the other hand, the law includes some undesirable and unnecessary provisions, both on substantive issues and on procedural issues. Moreover, corruption and the acquisition of special privileges may seem to be superficial but are actually aspects of a deeper problem. This is the pervasive political control exercised by the Party without any outside check, and the natural tendency for the cadres to abuse their power.

2.2.4 Property Rights

After the establishment of the Peoples Republic of China (PRC) in 1949, the communist leadership adopted the Soviet industrialization model. China’s existing market economy was gradually transformed into a socialist economy. Agriculture was collectivized, industry was nationalized, and the private sector was eliminated

by 1956 (Debbie Liao and Philip Sohmen, 2001). Based on the above introduction of Chinese consolidated democracy, China has experienced the ideological struggles against the private sector in an unsteady centrally planned economy since 1978.

This paper analyses the development of entrepreneurship in the late 1970s. The government's policy toward the private economy had undergone tremendous changes in different regions in China. In summary, weak property rights and weak legal systems discourage entry of new firms. Under such circumstances it would seem impossible that private enterprises could survive in such a political environment.

2.3 Economic Reform - Chinese Rural Reform

The sequencing of the economic transition was very different in China than in Eastern Europe and the former Soviet Union. In China, liberalization of agriculture came first (Adams, 1993). Before 1978, the Communist Party took the urban bias policy to protect the urban interests and discriminate against rural interests, and agriculture was organized by the central government in China. In the late 1980s, China remained a predominantly agricultural country. As of 1985, about 63 percent of the population lived in rural areas, and nearly 63 percent of the national labor force was engaged in agriculture.

Chinese reform on agriculture can be divided into three stages:

2.3.1 The First Reform on Property Rights from 1976-1984

Before China's economic reform in 1976, agriculture was collectivized and the central authorities determined what and how much would be produced. In the early 1980s, the efficiency of communal agriculture was questioned and the communes were eliminated. After the price reform and the household responsibility were implemented, the peasants were freed from management and their enthusiasm was rekindled to work as never before. By 1981, the introduction of the Household Responsibility System had been extremely successful. From 1978 to 1981 the agricultural total output increased by an average of 5.6 percent a year, higher than the average rate of 4.4 percent from 1950 to 1980. The farmer's standard of living was better than ever before. The pure incomes of the farmers' family increased an

average of 18 percent a year¹. By the end of 1984, approximately 98 percent of all farm households were under the Household Responsibility System. The role of free markets for farm produce continued to expand rapidly with increased marketing possibilities and rising productivity.

But in the 1980s, constraints on private enterprise continued to exist, notably a law limiting employment in private enterprises to seven people and it was difficult to find funding as income and saving levels were extremely low and the state-owned banking system lent almost exclusively to SOEs (State-owned Enterprises).

2.3.2 The Second Stage: the Development of TVEs from 1985- 1995

By 1987 a change of policy and repeal of the law saw a surge in the private sector. The Chinese economy boomed during the second half of the 1980s. In the rural area in the south part of China, managers of TVEs demonstrated many entrepreneurial characteristics, such as the entrepreneurship development in Sunan, which is famous for its prosperous TVEs in China. But Wenzhou peasant entrepreneurs formed their individual Wenzhou models. This study will analyse the different entrepreneur models created by the peasant entrepreneurs in Wenzhou and Sunan.

2.3.3 The Third Stage of Agriculture Reform in China

With the further development of agriculture along the east coast of China, the reformation went into the third stage. From the year 1996-1997, China's economic growth was forecast to remain the strongest in Asia. Agricultural policy was predicted to continue moving gradually and incrementally toward greater liberalization, increasing the role of market forces in China's production, consumption, prices and trade. Agricultural trade liberalized as tariffs were gradually reduced and non-state trade companies became more important. While the central government's control over trade in key commodities was believed likely to continue, the share of trade handled by private or joint private and public trade companies was also predicted to grow.

By starting with agriculture reform, the Chinese government unleashed a major increase in living standards which was self-reinforcing in the medium term and which generated tremendous popular support for the reform process through the

¹ "China's Tenth Five-Year Plan Sees Good" <http://www.fpeng.peopledaily.com.cn/zhuanti/zhuanti-74.html>

1980s. Agriculture reform plus the Open Door policy allowed a decade of rapid economic growth.

2.4 Introduction of China's Socio-Cultural Environment

In most western nations, the major concern is mainly on the practices and strategies at each step of the entrepreneurial process. The study of entrepreneurship in China's economic transition requires not only the analysis of the institution environment, financial support and marketing opportunities, but also the influence of individual culture.

Amongst Chinese traditional culture, the Confucian culture, rich in its contents and great in its significance, exerted great influence on the thinking, cultural and political life of ancient China, unparalleled by any other school of thought or culture. Confucianism is an exaggeration of traditional life and culture. The Confucian ethical values have, for well over 2000 years, served as a source of inspiration not only for the Court of Appeals but also for human interaction at all levels between individuals, communities and nations in the Sinic world. Confucius (551-497 BC) himself and his follower Mencius (c. 372-289 BC) portrayed an idealized picture of the past when wise, moral rulers guided and led their people by the example of their own ethical conduct rather than by harsh laws (Vohra, 1992). The Confucians were against war, not only because it was wasteful and brought human misery, but also because real authority came not from physical power but from virtue that radiated humanity and benevolence.

Confucianism stressed five human relationships: father and son, husband and wife, elder brother and younger brother, prince and subject, friend and friend. Confucians looked on the family unit as the foundation of civilization. He put great emphasis on the cult of ancestor worship and also enlarged on the concept of filial piety (Solte 1998, p.329).

Confucians emphasized the need for self-discipline, and self-examination and the continuous cultivation of the inner virtues of righteousness, propriety, wisdom,

faithfulness and most important, of Ren, which stands for compassion, human-kindness, goodness and benevolence. Confucian theories on morality and ethics, with “goodness” as the core and “rites” as the norm, served as the key “notes” of the traditional ethics of China.

Since the middle of the second century B.C. in the Han dynasty, the pro-Confucian sentiment developed (Fu 1993, p.33). Since then, Confucianism became the official state orthodoxy for every Chinese imperial dynasty. Some themes of Confucianism persisted as official orthodoxy because of their appeal to Chinese traditional imperial autocracy (ibid.).

Influenced by Confucianism, there are some core values influencing the people’s attitude and behavior such as, the value of a strong family, commitment to education, strong kinship and social network. It advocated that people should regard righteousness (Yi) as more important than material gain. Based on this, businessmen could not have the proper social class even if they were rich. Education generally had been highly revered in Chinese culture, and meritocracy rather than plutocracy was a salient feature from early on (Holmes, p.221). Up till now the youth in China who had received a good education aimed to find a service in the government. Service in the government was much more popular and admired by the youth than to become an entrepreneur and to start-up one’s own career.

However, Confucianism is hardly the unique culture which influences the value of society. There are many regional cultures which were much more the product of particular social historical circumstances in China. For example, the ‘Yongjia’ culture in Wenzhou and ‘Wu’ culture in Sunan are typical regional cultures and will be discussed in the next two chapters.

2.5 Key Conceptions

Rent-seeking and Corruption

Under the traditional macro-policy environment, the prices of outputs and inputs are distorted; any enterprise will profit once it has obtained investment, foreign exchange, and materials which are in short supply from the planning authorities. The amount of the profit will be the difference between the market price and the planned

price multiplied by the amount of resources the enterprise has obtained. This extra income originates from the macro policy of suppressing prices and from the corresponding institutional arrangement. The enterprises that are able to obtain such cheaply priced resources are also selected according to the development policy. This kind of income is regarded as “institutional rent”. Rent-seeking activities involve illicit activities (including “back-door” activities, bribery of officials, and various kinds of lobbying by interest groups) so as to obtain resources at low prices and to earn this institutional rent. Institutional rent and rent-seeking were the inevitable outcomes of the macro-policy environment distorting relative prices. They came into being in the traditional economic system.

Entrepreneurial culture

Some scholars assert that an entrepreneurial culture is about a framework in which entrepreneurs have the potential to emerge and local economic resilience is promoted (Krueger, 2003). Others argue that an entrepreneurial community has three major characteristics. Firstly, there exists a critical mass of entrepreneurs who are capturing new market opportunities. Secondly, a group of entrepreneurs come together from different communities and are characterized by a strong support network and mutual self-help, and thirdly the community as a whole is open to change (Lichtenstein, Gregg A., Thomas S. Lyons, and Nailya Kutzhanova 2004, pp.5-24).

Transaction cost

Transaction cost is defined as a cost incurred in making an economic exchange. Transaction cost comes from a number of kinds of cost: such as, research and information costs; bargaining costs; policing and enforcement costs. Research and information costs are costs such as those incurred in determining whether the required product can find good markets, who has the lowest price, etc.; Bargaining costs are costs required to come to an acceptable agreement with the other party to the transaction, drawing up an appropriate contract and so on; policing and enforcement costs are the costs of making sure that the other party keeps to the terms of the contract, and taking appropriate action (often through the legal system) if this turns out not to be the case.

Formal institution

As defined by North, institutions are the rules of the game in a society or, more

formally, are the human devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic (North 1990, p.3). In another of his works, institutions are defined as: “Institutions are a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals” (North 1981, 201-201).

As suggested by Schumpeter, the two understandings of institutions are one narrow and the other broad. The narrow understanding refers to specific organizations and concrete procedures that entrepreneurs have to encounter and deal with throughout the whole process of establishing new business ventures, including financial and taxation institutions, (Schumpeter 1934, p.86-87) governments, property inheritance, regulations of contract, and so on. By contrast, institutions in the broader sense include social customs (Schumpeter theory p. 87), established practices (Schumpeter, 1991.p.413), or the ‘social climate’ (Schumpeter, 1982).

Informal institution

North argued that the informal constraints were important in themselves since the implementation of the same formal constraints could result in different outcomes across different nations; he suggested that informal constraints “come from socially transmitted information and are a part of the heritage that we call culture... Culture provides a language-based conceptual framework for encoding and interpreting the information that the senses are presenting to the brain” (North, 1990).

Property rights: Property rights are the rights to own and contract for assets according to an established set of rules and laws.

Core self-evolution: Core self-evolution is a psychological construct that includes the characteristics of self-efficiency and/or self-esteem, locus of control, dimensions that focus on people’s sense of control over their external environment (Judge et al., 2002)

Self-efficacy: self-efficacy is the belief in one’s own ability to perform a given task (Bandura,1997). People who have a high self-efficacy are more likely to seek entrepreneurial opportunities than people who have a low self-efficacy.

The need for personal achievement: it is the motivation that leads people to undertake activities and tasks that involve personal responsibility for the outcome, demand individual effort and skill, involve moderate risk and provide clear feedback.

Risk-taking propensity: it is an aspect of personality that measures people's willingness to engage in risky activity. Risk bearing is a fundamental part of entrepreneurship.

Design for independence: it is an aspect of personality in which people prefer to engage in independent action rather than involving others. Entrepreneurial activity entails following one's own judgment as opposed to following the judgment of others.

Locus of control: is a person's belief that he can influence the environment in which he is found (Rotter,1996). People with an internal locus of control have a stronger sense that they can control their own environment, and will be more likely than people with an external locus of control to exploit an entrepreneurial opportunity. Internal locus of control also increases a person's propensity toward self-employment. (Shane 2003, p.97 p.111)

The young business entrepreneurship rate: defines the percentage of the adult population that is the owner/manager of a business that is less than 42 months old.

The nascent of entrepreneurship rate: is defined as the percentage of adult population that is actively involved in starting a new venture.

Personal networks: include both formal and informal ties between individuals and between individuals and organizations.

Social network theory: suggests that a network is a series of direct and indirect ties from one actor to either another actor or a collection of actors.

The role of institutional rules:

Douglass North argued that the rules are the most fundamental because all economic activities will have to follow the tracks set up by the rules (North, 1994).

The role of institutional rules in economic development:

It is the structure of political and economic organization which determines the performance of an economy as well as the incremental rate of growth in knowledge and technology (North, 1981). In the view of North, institutions are much more fundamental than entrepreneurship, institutions are the root of differential economic performances. Economic actors make calculations of input and output with sufficient information and competence.

CHAPTER THREE: The DEVELOPMENT of RURAL ENTREPRENEURSHIP in WENZHOU

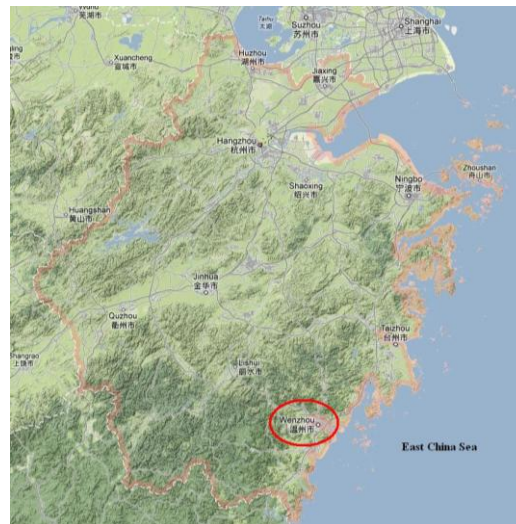
The research on Wenzhou's recent economic development dates back to 1985. On May 12, 1985, the state run daily newspaper "The Liberation Daily" referred for the first time to the Wenzhou Business Model in a front-page report. (Liu 1992a, p.696). Since then, Wenzhou Business models have become famous in China and caused academic debate. During the next three decades research on the Wenzhou Models continued (LIU 1992,p.293; WEI, 2000; ZHANG Miaoying, 2008; and Winter Nie, ed.al, 2009). Some scholars analyzed Wenzhou's history, culture, geography and economy to discover the characteristics and transformation of the Wenzhou models. Some researched the development of industrial clusters while others made comparisons between the Wenzhou business models and other business models in China.

However, there was little research made on the dynamic power for such a transformation from the "Classical Wenzhou Business Model" to the "New Wenzhou Business Model". Little attempt seems to have been made to incorporate the institutions, the role of social capital and the development of entrepreneurship in the debate. Although some academic articles mentioned the Wenzhou business models as typical for the entrepreneurship development in Wenzhou, few analyzed the identification of opportunities for entrepreneurship within the institutional environment. This part (Chapter 3) analyzes the innovative interaction among the players and how they combined official and informal institutions in the political, economic and socio-cultural environment. For a better understanding of how Wenzhou rural entrepreneurship improved, this chapter puts it into a historical context to discover how entrepreneurship and its institutional interaction acted as a base to coincide with other factors in the region, such as typical trust systems and social networks in Wenzhou.

3.1 General Introduction to the Nature and Economic Background of Wenzhou

3.1.1 Nature and Economic Background of Wenzhou

Wenzhou is a small city in south Zhejiang Province. It covers an area of 11,784 square kilometers and is surrounded by mountains. The eastern part of the city borders on the coast of the East Sea of China. Map 3.1 shows Wenzhou's location within the Zhejiang Province.



Map 3. 1 Location of Wenzhou Municipality in Zhejiang Province

Source: Google Terrain

Wenzhou's geography greatly impacted Wenzhou's economy. As a coastal city, the proportion between flat lands and mountains is 17.5 percent and 78.2 percent, Wenzhou has a very high population density. Historically, the mountain terrain and the lack of natural resources forced Wenzhou peasants to work in the fields of commerce and handicrafts in order to supplement their income from agriculture. Many Chinese journalists and scholars mentioned that Wenzhou has always had a strong tradition of creating small businesses (Wu, 1986). The geographical isolation created by the mountains forced Wenzhou peasants to trade through shipping channels using the East Sea of China. In the Song Dynasty (A.D.960 -1279) their commercial and handcraft activities reached their peak. The first recorded Wenzhou businessman who engaged in foreign trade with Korea can be traced back to A.D.998.

The first time that Wenzhou city officially opened its doors to foreign business was in 1132 A.D. After that point, Wenzhou started to do business with Japan, Korea, Cambodia, and India, and even as far as Africa (Yuan, 2003a).

Starting in 1949, communist state-owned enterprises were established in Wenzhou and traditional private businesses became prohibited. At the end of the 1970s, Wenzhou was a backward city in the Zhejiang Province because of a lack of industrialization. In the 1980s, Wenzhou quickly developed economically and changed from being poor to a rich modern city.

3.1.2 The Development of Wenzhou City

Wenzhou's entrepreneurial process can be divided into two periods. The first period of development was from the 1980s to the mid 1990s, when Wenzhou peasants were able once again to start their traditional private businesses. In this successful period they established, what scholars later referred to as the Wenzhou classical model. The phase beginning in the mid 1990s was named the new Wenzhou model. During this transformation, dozens of industry clusters were established in the region. Wenzhou developed advanced transportation and traffic systems, such as the development of Wenzhou Harbor and the construction of Wenzhou Airport and key expressways.

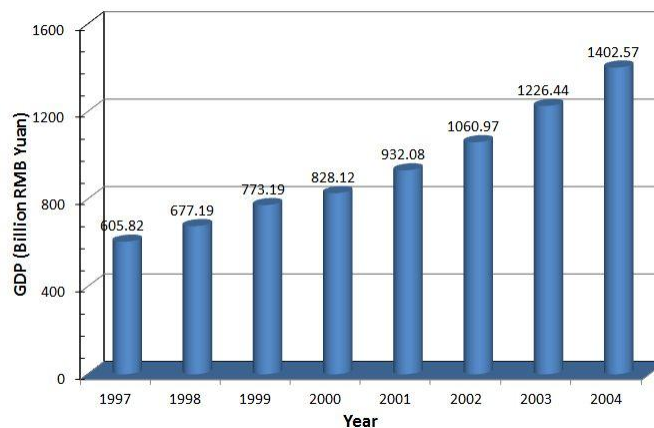
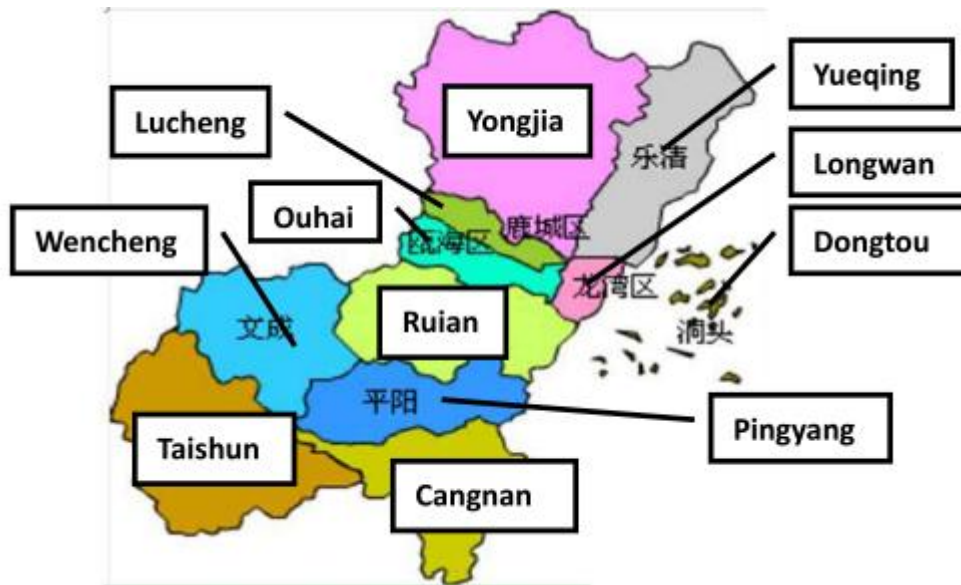


Figure 3.1. Statistics of Wenzhou Gross Domestic Product (1997-2004)

Sources: Wenzhou Municipal Bureau of Statistics .<http://www.wzstats.gov.cn/infoshow.asp?id=5785>

Figure 3.1 shows that the GDP in Wenzhou more than doubled from RMB 605.82 billion in 1997 to RMB 1402.57 billion in 2004. By the end of 2004, the city had a total population of 7.4619 million, including 1.3714 million urban residents (Wang 2009, p.4). Wenzhou municipal government covers three districts, which are Lucheng, Longwan and Ouhai; two cities: Ruian and Yueqing, and six counties, such

as Dongtou, Yongjia, Pingyang, Cangnan, Wencheng, and Taishun (see map 3. 2).



Map 3. 2 Districts and Cities in Wenzhou Municipality

Source: Wenzhou Municipal Bureau of Civil Affairs Official Website – www.wzqhdm.gov.cn

3.2 Evolution of Wenzhou Classical Models from the 1980s to the 1990s

From the early 1980s to the second half of the 1990s, the Wenzhou Classical Model, as a successful peasant entrepreneurship form, created what's considered to be a history making economic miracle. It was featured in an article as “Small Commodity but Huge Markets”. The next section analyzes the features from the following case study in Qiaotou Town, Yongjia County (the location of Yongjia see Map 3.2).

3.2.1 Qiaotou Button Specialty Market: The Origin of Wenzhou Classical Model

The story of the Qiaotou button specialty market was well-known because it represented the origin of Wenzhou's classical model. This part focuses on how the peasant entrepreneurs acted upon the business information available and started the development of entrepreneurship.

In 1979, Mr. WANG Kechun and Mr. WANG Kelin determined that the buttons made in the Jiangxi Province could reach a much broader market. They transferred unsold buttons to their hometown in Qiaotou Town, which was a small village in Wenzhou.

Before this, in 1976, Qiaotou Town had a rural periodic market specializing in products from their own family businesses, such as plastic craft bags, nylon key chains, nylon craft bags, hair pins and leather gloves. Buttons were needed and their sales immediately increased at the Qiaotou Town specialty market.

Business opportunities continued to develop and five million more buttons found their market in Qiaotou's specialty market, which had been in storage in Liaoning Province (in the north of China) for 10 years. After "sleeping" in Guangzhou Province for 20 years, 24 tons of buttons were sold in Qiaotou's specialty market. The WANG brothers and other relatives became the first successful entrepreneurs to open a button business at the specialty markets of Qiaotou Town. In 1980, one year after the WANGs set up their first shops in Qiaotou, there were more than 100 buttons shops and the Qiaotou specialty market became well-known nationwide. The income structure in Qiaotou Township has changed (see Table 3.1).

Table 3.1 The Changes of the Income Structure in Qiaotou Township, Yongjia County (1952-1987)

	1952	1957	1967	1977	1982	1987
Arable land per capita (ha)	0.029	-	-	-	0.018	0.015
Total household income (yuan)	320	340	520	1,250	5,000	18,420
Income structure (%)						
a. Agricultural income	75.0	58.8	42.3	20.0	7.0	2.3
b. Income from commercial activities outside the township	-	-	-	40.0	90.0	59.7
c. Income from shops at the wholesale market in Qiaotou Township	-	-	-	0.0	0.0	38.0
d. Income from other sideline activities	25.0	41.2	57.7	40.0	3.0	0.0

Source: Yongjia Xian Qiaotou Zhenzhi Lingdao Xiaozu (1989), p. 243 cite in Sato Hiroshi (2003) "The Growth of Market Relations in Post-reform Rural China - A Micro-analysis of Peasants, Migrants and Peasant Entrepreneurs"

Table 3.1 shows the income from commercial activities outside the Qiaotou Township increasing sharply from 40 percent in 1977 to 90 percent in 1982. However, by 1987 the income from outside commercial activities was reduced to 59.7 percent while the rate of income from retail shops at the wholesale market grew to 38 percent of total household income. The rate of income from other sideline business activities increased from 25 percent in 1952 to 57.7 percent in 1977, but it then fell sharply until nearly no household income came from the sidelined activities in the late 1980s. As a result the number of local markets increased quickly in

Qiaotou Township. By building up the wholesale markets and retail shops in wholesale markets, the income in the 1980s was mainly from commercial activities.

The case of Qiaotao Town specialty market illustrates the “small commodity and a huge market” character of the Wenzhou classical model. Wenzhou peasants created a huge market out of thousands of such little specialty items and their corresponding markets. The growing number of markets integrated local economic activities into the national economy by getting many outside traders, brokers, merchants and investors to meet locally. This meant that the local small commodity production of a household industry, based on reprocessing of factory waste, became closely tied to the market. The next part of this thesis introduces the models of the building of huge markets in Wenzhou in detail.

3.2.2 Market Building and Flow of Information in the Markets

Since 1979, more and more specialty markets have been created in Wenzhou and can now be divided into three types. The first are wholesale markets which specialize in agricultural products, the second are markets specializing in small industrial commodities such as Qiaotou Town buttons; and third type are those selling local family industrial products to Mainland China or to export markets (Zhang 2008,p.9). Because they were based on a locally specialized family industry, these markets specialized in a certain category of merchandise such as fabrics and shoes, of which the average volume trade was large. (Lin 2008, p.26).Wenzhou specialty markets supply large amounts of small commodity goods, ranging from shoes, household wares and detergents. Most of the products come from Guangdong or other provinces nearby, such as textile, apparel, hats and shoes. Wenzhou concentrated more on the production of garments.

As indicated in Figure3.2, the huge market structure is built on various levels of markets and shops, from intermediate markets in provinces, then to general markets and shops in cities and towns/villages respectively. Here the function of the huge market with respect to the information flow will be discussed.

The products or semi-finished products from family manufacturers are delivered through such a structure into the markets downstream. The shops might play a role in collecting and exchanging information between their suppliers and purchasers.

Figure 3.2 shows how the small commodities are delivered from specialty markets to downstream markets quickly. The information from consumers in downstream markets is quickly gathered and transferred to the upstream markets, thus the family workshops receive the information immediately, and can adjust their production to meet market demands. Wenzhou businessmen are well-known for their entrepreneurial spirit, gaining timely and accurate information to seize on market opportunities.

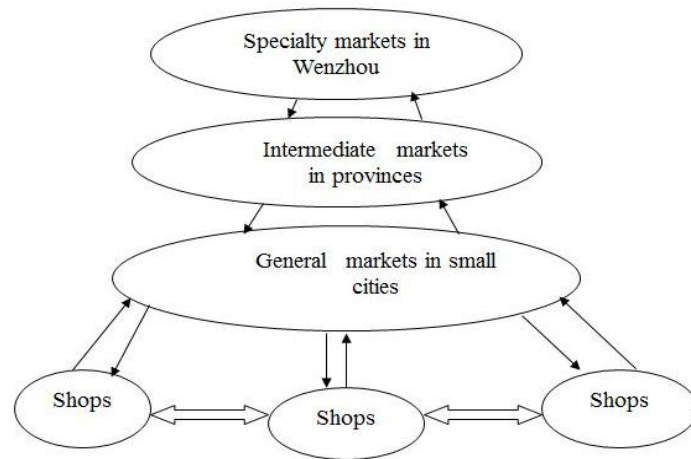


Figure 3.2 A Structure of the Huge Markets

Source: author

The formation of Wenzhou markets has gone through three processes. The first period, from 1979 to 1985, nearly 140 commodity markets were constructed based on the traditional local markets in Wenzhou. The market products included agricultural goods, small commodity products and raw material products. From 1986 to 1995 Wenzhou market proceeded into its second period when many large specialty markets with their large sales networks were developed. In 1995 the number of the various specialty markets in Wenzhou numbered 532, the market area increased to 2,548,000 square meters and the annual business turnover rose to RMB 24.8 billion(Xie 2008, p.105). After 1996, the Wenzhou market structure changed again and the market size went into decline. This is referred to as the third period and will be discussed later in this chapter.

3.2.3 Household Industries and Low-tech Small Commodities

In 1980, Wenzhou small household industries were the leading actors in rural industrialization. Many family workshops produced commodities. They gradually formed clusters of manufacturers in the counties and villages. Usually one county or

village produced no more than one or two kinds of products. For instance, over 2,200 family workshops produced plastic goods in Jinxiang, which is a small village in Cangnan County (see Map 3.2). In Liuzhou 10 villages nearby produced over 1,200 different types of electric hardware, such as high and low voltage switchgear sets. Based on the family workshops, low-tech small commodities products were sold through various markets to the shops on the Mainland. The specialty markets supplied raw materials for their family workshops. Family workshops, huge markets and thousands of sales agents, these three factors characterize the Wenzhou classical model. For instance, over 500 shops provided the family workshops with raw materials for plastic products in Cangnan, and over 7,000 sales agents worked at plastic markets in other parts of China. In Liuzhou City, there were over 1,100 shops supplied with raw materials and 10,000 peasants working on sales for Liuzhou electric production (Zhang 2008,p.7). Wenzhou Municipal Government reported that over 1.6 million Wenzhou sales agents traveled and exploited markets on the Mainland in the 1980s, over 0.5 million sales agents from Wenzhou did business abroad.

Figure 3.3 illustrates the structure of the Wenzhou classical model. It shows how small businesses form the basis of the Wenzhou classical business model, which in turn feed the specialty markets in China. These small businesses based mainly on family workshops purchase raw materials from Wenzhou local specialty markets, and then sell their products into a system of markets on the Mainland. According to the Heckhel-Ohlin Model, if a country enjoys abundant labor resources, then its comparative advantage lies in labor-intensive industries (Bertil 2003, p.116). The Wenzhou classical business model is built around an organizational structure that takes advantage of the benefits of lighter and labor-intensive industries in the region. Since the production process in such industries utilizes the region's cheap labor, such industries are able to compete globally and become profitable, often accumulating large surpluses.

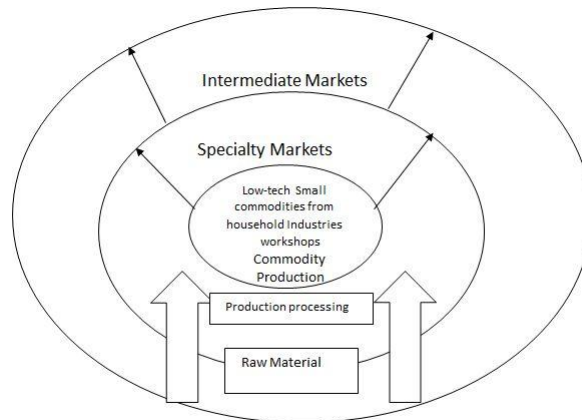


Figure 3. 3 The Organizational Structure of the Wenzhou Classical Model

Source: author

3.2.4 Drawbacks of the Wenzhou Classical Model

In the 1980s, problems began appearing in Wenzhou's private enterprises, particularly with regard to quality control. For instance, in 1987, customers in Hangzhou and other cities rioted, burning stores in response to the poor quality of the products the stores were selling. In the 1980s, more and more shoes were made from hard paper or glued by starch. On August 8, 1987, about 100,000 pairs of shoes made in Wenzhou were set on fire at a demonstration in Hangzhou in Zhejiang Province. Similar burnings were held by the local customers in Nanjing, Changsha and Wuhan (Anonymous, 2003b). Inferior products, such as shoes, lighters and low-voltage items, etc., ruined Wenzhou's reputation. From then on, many department stores used the slogan: "No products from Wenzhou" as a guarantee of quality (Li, 2001). Although some of the manufacturers in Wenzhou began providing better quality products by building up their own brands, they had to switch to an OEM (Original Equipment Manufacturer) and left off the "Made in Wenzhou" label on their products. Many private enterprises closed, leading to the end of the "Wenzhou Classical Model."

3.3 Barriers to Wenzhou Classical Business Models

The following part will analyze the failure of the Wenzhou classical model, the economic environment in Wenzhou in the 1980s; the political environment, such as the government's discrimination policy against private enterprises and the failure of the formulation and implementation of its local industrial policy.

3.3.1 Economic Environment in Wenzhou in the 1980s

Because of the special geographic location, Wenzhou was treated as the possible front line in case of war between Mainland China and Taiwan. A comparison of the two cities, Wenzhou and Ningbo (another city in Zhejiang Province) shows that state investments in Wenzhou were extremely limited. For instance, the per capita investment from the government was only RMB 154 in Wenzhou before 1979, and the total investment from 1949 to 1979 from the government was RMB 655 million in Wenzhou. However, Ningbo received more than RMB 550 per capita with total investments of RMB 2.8 billion during the same period (Parris 1993, p.242). The accumulated assets of local collectives were very small in Wenzhou. Before economic reformation in 1978, there were only a few state-owned enterprises with no more than 1,500 employees (Chen and Ma, 2004). Wenzhou's traffic routes inland were restricted to several rough roads through mountains, and its contact with other coastal cities relied upon under-developed maritime shipments. According to Jin and Zhou (2003), Wenzhou had no expressways and railroads until the first half of the 1990s with only two national single lane highways running through Wenzhou.

These problems with the infrastructure weakened the industrial foundation in both the state and the collective sectors. There was a popular folk writer in Wenzhou who wrote: "Qianshi buxiu, Shengzai Wenzhou, Shiersan sui, Jieshang yidiu," which documented a popularly held belief that a child was unlucky to be born in Wenzhou as teenagers here were forced into the labor market.

Qiaotou Township was a small village in Yongjia County. Table 1 shows the changes in the economic structure in the Qiaotou Township, including the arable land per capita, household income and other factors including income structure. Notable is the arable land per capita which indicates the poverty of Wenzhou before 1978. The total household income in Qiaotou Township increased from the year 1952 to 1987, while the rate of agricultural income, in total, reduced from 75 percent in 1952 to 2.3 percent in 1987.

The case of Qiaotou is not an exception. In the 1970s Wenzhou owned only poor natural resources. The economic environment led to low social wealth and weak industrialization. In the transfer from a planned economy to a market economy, China's policy and the economic conditions were unstable. Political freedom was

very limited, and there were few opportunities for the peasants to start a business in Wenzhou.

3.3.2 Discrimination of Private Enterprise

The discrimination policy against private enterprises expressed itself mainly in the financing and legitimizing processes. Comparing it, Wenzhou had more political freedom to improve its local economy than other cities on the Mainland, such as the protection from the local cadres and the municipal government. Despite the protection, the Wenzhou municipal government was too weak to promote private enterprises' competitiveness. For instance, in the middle of the 1980s many products, especially the semi-finished industrial products, remained under state production control although China had initiated market-oriented reforms. Under such circumstances, many obstacles hindered the private enterprises. For instance, it was difficult for micro and small private enterprises in Wenzhou to obtain their quota of materials needed to sustain their businesses. Because the pricing structure implemented by state-owned factories was able to fully reflect the relative scarcity of all the factors, the Wenzhou enterprises could automatically adjust production so that they could use as many cheap alternative production factors as possible. This scarcity and adjustment caused Wenzhou to become one of the country's biggest regions for manufacturing inferior products. For instance, pure silver is a material needed for low-voltage electrical components but private firms could not get their quota from the state. They used cupronickel as a substitute for silver, and the quality suffered. Wenzhou shoe factories also lost their quality reputation because of the lack of appropriate raw materials. Apart from this, private enterprises also remained uncompetitive on the financial market. The limited credit availability in the financial system brought about financing difficulties for the development of the private economy and led to indirect financing. Wenzhou has a variety of people's credit including traditional, self-organized credit associations, individual private loans arranged directly or with a middle man who would get a fee, and underground illegal private banks (Parris 1993, p.242). Wenzhou people received capital in the early 1990s through self-organized credit associations or through personal savings of friends, who were willing to invest and participate in the business activities.

All this resulted in difficulties in technological innovation and more risk-taking and ended up in low quality level production. The credit restrictions prevented the

economic development in Wenzhou. In the 21st century this situation has not been completely resolved yet. The case of Mr. ZHOU Dahu is an example of the failure of the municipal government's role in Wenzhou's cigarette lighter industry, and how, despite these problems, Mr. Dahu's lighter factory survived such a situation.

3.3.3 Case Study: Mr. ZHOU Dahu

By early 1993, the inferior cigarette lighters produced in Wenzhou region destroyed its reputation for producing the product. Foreign agencies canceled their orders and nearly 90 percent of the lighter mills were forced to close. The exception was a company run by Mr. ZHOU Dahu.² Orders eventually exceeded his factory's production capability. Other lighter firms hoped to produce as OEM (Original Equipment Manufacture) for Mr. Zhou, but he refused since their quality could not be guaranteed (ZHANG Jian, May 2001). Two years later, in 1994, Dahu Lighter was honored for the "inspection exempted products" by the local Bureau of Technology Supervision (Anonymous, 2003a).

How did Mr. ZHOU's company establish itself as a reliable producer of lighters while thousands of others failed? To seize opportunities and earn money, a large number of lighter mills emerged in Wenzhou. The participants of this lighter industry imitated each other and cut material cost in their price competition with each other. At the beginning of the 1990s, many foreign agencies went to Wenzhou and bought lighters because of their cheap price. During the peak in 1992, there were more than 3,000 lighter factories and mills in Wenzhou. Mr. Dahu ZHOU started his lighter mill in May 1992 when Wenzhou's lighter industry was in chaos. When he started his business, he put quality first. He painted the slogan, "inferior products will destroy our business" on the wall of the factory. He struggled to survive under the fierce competition of higher costs, lower productivity, but better quality (ibid.). After 1994 his sales increased yearly to become a leading company with over 1,000 employees. But these 1,000 employees worked only in sales, design, molding and assembly. Another 45 local suppliers with over 15,000 employees produced all the components for Dahu (Jia,2003).

² ZHANG YUE, 2005

3.3.4 The “Eight Kings” Episode: The Political Environment in Wenzhou in the 1980s

Liuzhou is a small town in Wenzhou. In 1978, many peasants were released from the obligation of working on agricultural land and began their nascent entrepreneurship in Liuzhou. Some became the well-known “Eight Kings”, who succeeded in having good start-ups in different fields. For instance, “King Screw” Mr. LIU Dayuan, who did business specializing in the screw market between Shanghai and Wenzhou: The others were “King Motor” Mr. HU Jinlin; “King Coil” Mr. ZHENG Xiangqing; “Catalogue Printing King” Mr. YE Jianhua; “Miner’s Lamp King” Mr. CHENG Buqing; “Contacts King” Mr. LI Fangping; “Electric King” Mr. ZHENG Yuanzhong, and “Second Hand Goods King” Mr. WANG Maiqian. They seized entrepreneurial opportunities and became rich and well-known in Wenzhou. In fact they became the first successful peasant entrepreneurs in the south part of China in the 1980s.

The successfulness of these entrepreneurs in Wenzhou caused a serious debate in China about whether they were engaging in capitalism. The semi-legal situation placed Liuzhou at the fringe of the planned system. In January 1982, an emergency notification from the central government called on a campaign “combating criminal activities in the economic field.” The Liuzhou’s Committee regarded the “Eight Kings” as a serious criminal economic case and began to investigate on behalf of the state. All the “Kings” were put into prison except the “King Screw” Mr. LIU Dayuan, who had managed to successfully escape from Liuzhou.

Entrepreneurs were shocked by the persecution of the “Eight Kings.” They closed their shops and mills. Some fled to other cities while some hid at home. Soon there were no entrepreneurial activities in Liuzhou at all. Liuzhou became a quiet city in which all the shops were closed. Nobody even dared to talk about business anymore. The “Eight Kings” judgment destroyed the market economy and the semi-legal situation in Wenzhou. How did the people survive? How did the economy further develop in Wenzhou? The Wenzhou cadres had to deal with these problems.

Finally, the leaders of the Wenzhou municipal government made the decision to set the “Eight Kings” free. This was the only alternative for the Wenzhou local government to develop the Wenzhou economy. This encouraged the peasants to restart their entrepreneurial ventures in Liuzhou. The closed shops re-opened and

many capable men started small businesses.

The “Eight Kings” episode indicates the institutional barriers for entrepreneurs to start-up in private form. However the Wenzhou local government took a flexible policy and the peasants in Liuzhou began their entrepreneurship again.

During the period of 1978 to 1980, the government prohibited peasants from a series of productive activities. These included: re-contracting their contracted land to other households, hiring others to assist in agricultural production, abandoning agricultural activity to specialize in commercial activity, and possessing mechanical transportation tools for commercial purposes. Actually, the peasants in Wenzhou had no possibility to start a business without the innovations that took place in the institutional environment.

After analyzing the institutional environment in Wenzhou, Table 3.2 (§ 3.5.1) shows a summary of the conditions for entrepreneurial exploitation. The institutional environment in the 1980s was not conducive to entrepreneurial activity in Wenzhou, in particular in the economic and political environment. As indicated in Table 3.2, Wenzhou had no advantage in terms of economic environment, but it had unique political and socio-cultural characteristics at the beginning of the economic reform. The Wenzhou classical model describes how the organizations and their structural variety come into existence in response to the incentives that a given institutional system offers in Wenzhou.

3.4 Analysis of the Success Factors of Wenzhou Classical Model

Many scholars argue that the early entrepreneurship development in Wenzhou benefited from the traditional small businesses (Hu, 2004). Many other scholars point to the regional culture in Wenzhou. However, why did the neighboring cities, with the same traditional culture, not develop as early as Wenzhou? Why did the Wenzhou business model become a uniquely successful model with long-term vitality? There are many factors that influence an entrepreneur to make a decision to go for an entrepreneurship as a career. Chapter one lists some issues of core values and psychological factors as researched by the scholars, such as the aspects of

personality and motives, core self-evaluation and cognitive properties (Shane 2003, p.96). However, psychological issues are not sufficient conditions to cause people to seek entrepreneurial opportunities, even though these influence their decisions. People can and do change their personalities, motives and core self-valuation, but these changes are rare in comparison to the changes in cognitive characteristics and they are relatively difficult to accomplish. Shane argues that cognitive characteristics are largely situation dependent (Shane, 2003 p. 97). This paper attempts to argue that the institutional environment provides the situation for cognitive characteristics to rely on, such as the political environment, economic environment and socio-cultural environment, in which to allow the interactions of the terms for elements that are necessary for the entrepreneurial regional development.

3.4.1 Social Capital (Trust System and Network) as Informal Institutions

Wenzhou might still be a small poor city today without the creation of a competitive organization, recognized today as the Wenzhou classical business model. Because the institutional environment was not favorable for entrepreneurial firms in Wenzhou in the 1970s, due to the low level of economic activities and technology, lack of state capital investment and unstable political environment. However, the social context in which an entrepreneurial cultural is found influences people's willingness whether to engage in entrepreneurial activity.

Social capital consists of the networks of relationships and resources inherent in these networks (Coleman, 1988). In the construction of the Wenzhou classical business model, Wenzhou's socio-cultural environment and social capital impacted the rate of entrepreneurial activity. The key to its success lies in its local trust-based social networks. As discussed in the evolution of the Wenzhou classical business model, the personal networks of entrepreneurs revealed that entrepreneurs obtain information and advice from network members in the building of the classical business model in Wenzhou. Wenzhou's social capital found a positive correlation between social capital (such as trust and network) and entrepreneurial activity. However, trust and traditional network as concepts still lack in-depth research, especially in the field of the Wenzhou entrepreneurial activities research.

This next part discusses how peasant entrepreneurs in Wenzhou capitalized on resources and assets located in social networks for instrumental actions. Then my

paper argues how the Wenzhou classical business model facilitates in generating competitive advantages.

3.4.2 Trust System and Extended Family Network

3.4.2.1 Traditional Clan System

Wenzhou is located far away from the central control of the Han Empire by virtue of its geographical isolation. In order to keep Wenzhou under control, the Han Dynasty (B.C. 206 - A.D. 220) permitted the clan system to be developed in Wenzhou about two thousand years ago (He,2004).

Thus, the trust system of Wenzhou belongs to the relational trust and is placed above the pre-contractual and below the structural trust. (see introduction in chapter one) The clan system was the most important social bonding asset in the grass-roots society in Wenzhou. It was the essential means of keeping the society in order. Wenzhou's Ancestral Hall was a symbol of the clan. Nearly every small village had an Ancestral Hall. Worship of the ancestor's ceremony was organized within the clan system; the clan chiefs were also given the authority to handle the affairs of the clan. Information was exchanged within the local social network of clans, including information on business. The powerful clan system influenced the daily life in Wenzhou into recent history, and to some degree characterizes the entrepreneurship model in Wenzhou (Liu, 2005). Informal institutions such as trust and network will enable entrepreneurs to know the values and beliefs of partners better, and facilitate interpersonal and cognitive trust in entrepreneurs' abilities and intentions.

The entrepreneurial engagement is a decision that is made with uncertainty, often under time pressure and with limited information (Busenitz and Barney 1997, p.3). However, this does not mean that an entrepreneur should make decisions blindly. In the 1980s, under the planned market, the SOEs lacked motivation and experience to join the market economy. There was little communication among the state-owned enterprises and this led to their slow reaction to market information. Wenzhou peasants had a large network which increased their tendency to find entrepreneurial opportunities in Mainland China quickly.

The WANG brothers, on the one hand, had their intuitive knowledge of the Qiaotou market in their hometown; and on the other hand, they received information about buttons through their information network in China. Therefore bits and pieces of information came from Wenzhou businessmen in China and abroad. The case of Qiaotou button specialty market indicates that many opportunities were identified from the Mainland, the information flowed through Liaoning Province in the north part of China, Guangdong Province in the south, and Jiangxi Province in the west and finally gathered in Qiaotou town. Peasant entrepreneurs started nascent entrepreneurship; their prior professional relationships verify the networking skills and contact resources of more entrepreneurs, which is a core advantage in the economy of personal network. Wenzhou became a successful entrepreneurial region linked to a close-knit familial and village-based local network.

3.4.2.2 Extended Family Network

Generally speaking, proximity not only effects interaction, it also forms the basis of various kinds of familiarity based on family ties, clan system, ethnicity, religion, sub-culture, professional community, gender, etc.. In contemporary Wenzhou, the local entrepreneurs try to find business partners through the web of extended clan system, and, on the same convention, geographical location, business experience, religion and even within the same districts, which is titled the “five proximity relationships” in Wenzhou. Cultural features of the Wenzhou people, such as a strong sense of role obligation, favoritism, and inclinations to categorize people into in-group and out-group circles, also facilitates better communication between entrepreneurs who know each other. For instance, according to the principle of the “five proximity relationships”, the local entrepreneur distinguished the business men into in-group and out-group circles. Ones who have five proximity relationships are considered as friends within their circles, the others without five proximity relationships are outside the circles. A person from Wenzhou might deeply trust the persons within the circles and lack essential trust to a person outside the circles. For instance, a business man in the circle gets into the habit of doing business by oral promise and not by written contract. Wenzhou businessmen rely a lot on the support within the circles for the exchange of valuable information, cooperation, opportunity exploitation and finance collecting. A Wenzhou businessman in Italy said, “I borrowed money from my friends in my circle orally without a written form, otherwise no one would lend me money anymore” (Interview P11, author). If a person loses his trust in a circle, it is not easy to find a new circle to receive him as a member.

Mr. WANG Chunguan (2000) made a comparative research on the activities of entrepreneurs from Wenzhou in Beijing and Paris. He pointed out that entrepreneurs from Wenzhou had quite limited information and resources, so it would seem to be difficult to start-up, especially as an entrepreneur abroad. However the personal network, the trust system and its expanded form of “five proximity relationships” make up for these defects. Wenzhou entrepreneurs could gain plenty of information, exploit opportunities by nascent investment and survive in fierce market competition. And the successful entrepreneurship in Wenzhou and its development provides benefits for further expansion which grew out of this social network (Wang, 2000).

3.4.2.3 Personal Trust Based on Personal Reputation: “Renqing”

Trust is an essential part of a functioning economy. As Arrow suggests, “virtually every commercial transaction has within itself an element of trust” (Arrow 1972, p.357). Trust plays at least two positive roles. The first is to simplify the complexity in entrepreneurial activities and the second is to reduce transaction costs. Trust is a dynamic social quality that must be shared by those interacting on the basis of a mutual agreement. The absence of trust would damage a vital part of the partners and in the worst case the relationship would dissolve.

The configuration of various trust forms varies in different situations within any society. The “five proximity relationships” establish a closer network among the participants and this trust system acted as “a secured credit” in the civil society of Wenzhou in the 1990s.

Wenzhou’s important trust system is built on relational trust and keeps contact with others by “Renqing”. “Renqing” (personal reputation) might be regarded as a consequence of social interaction resulting in trust. A person, who supplies renqing is sympathetic and gives favor to others in need. And the person who receives renqing, such as kindness and financial support, is obliged to repay the person who gave him/her that favor. In such a way, renqing is transformed from “supply” to “repayment” in a revolving way. A person who doesn’t repay renqing might lose his reputation among his/her relatives and friends. A man with such a bad reputation will have difficulty joining in any grass-roots organization ever again in Wenzhou. Renqing (more than favor, as its value can be measured amongst others in monetary terms) might be exchanged as a kind of “resource” among people, which can be acquired more easily than trust. Trust is built on long-lasting exchanges of renqing.

Thus, the trust system of Wenzhou (renqing) belongs to the relational trust and it is based on experience, proximity and knowledge of one another. The resulting expectations and the mutual understanding are the basis for cooperation. In a repetitive continuation of renqing-exchanges they are turned into a deepening trust among the participants.

The cost of renqing can add up to a considerable amount. For instance, according to a report in “Wenzhou Daily” in 2003, the volume of renqing in Wenzhou was estimated, on average, at over 800 RMB Yuan per person annually, as compared to the volume RMB 300 Yuan per person in Beijing and RMB 200-300 Yuan in Shanghai (Ma, 2003).

3.4.3 Establishment of Financial Associations

As discussed above, it was difficult for a private enterprise to gain a loan from the state banks, many underground private organizations operated as informal financial institutions to supply financial support to the private enterprises. For instance, a local association named “Qianhui” is still popular in Wenzhou. “Qian” means money and “Hui” means association. Qianhui worked as a local private investment organization. In the nascent (seed) stage of entrepreneurship, entrepreneurs in Wenzhou often turn to “Qianhui” or similar kinds of private organizations. Relatives, friends and good neighbors, are invited to have dinner, and people who attend, will discuss the collected information and evaluate the opportunities for start-up. Usually, it needs ten members to form an association like Qianhui. When the members are positively convinced about investing in a venture, they will move on and negotiate e.g. the number of shares, the investor’s rights, reporting standards and capital structure. All “Qianhui” members meet once a month. The applicant to be financed, who gets the highest rating in a random selection game will win and get the investment first. Thus, the other receivers will be selected later, one by one, until all applicants get the investment. So “Qianhui” operates as a venture capital firm, the members of it being both venture capitalist and entrepreneurs. This association provides services as a private bank without any written contract. Members trust each other and keep it in good order by private reputation. (ZHANG Miaoying, 2000, p.107). For instance, Mr. ZHENG Xiukang is the founder of Kangnai Shoe Ltd. Company. In the 1970s, Mr. Zheng borrowed RMB 500 Yuan from his neighbors and started his nascent entrepreneurship with RMB 1,000 Yuan (including his savings) as registered capital

to open his shoe factory (ibid., p.61).

3.4.4 The Yongjia Doctrine and its Impact on Entrepreneurship

The social capital was discussed in the section above. The following subsections will analyze the regional culture in Wenzhou, because it influences the choices of the peasants becoming grass-roots entrepreneurs. How was their work impacted by the “Yongjia” doctrine, such as the trust system, clan system and network building?

3.4.4.1 Regional Culture: Marine Culture and “Yongjia” Doctrine in Wenzhou

Influenced by its traditional overseas business experiences, marine culture influenced Wenzhou deeply due to its geographical location. Under these circumstances, “Yongjia” doctrine as an individual way of thinking came into being from the Southern Song Dynasty (A.D.1127-1279). The founder of “Yongjia” thoughts was a famous Chinese thinker named “YE Shi” (A.D.1150-1223). As a branch of Confucianism it impacted the culture of Wenzhou and its regions deeply. (ZHANG Miaoying, 2008) Worrying about losing their regional culture, the Wenzhou intelligentsia started to revive the “Yongjia” thoughts in the Qing Dynasty (A.D. 1644-1911) (Chen, 2003). When the Qing Dynasty reopened Wenzhou’s port, according to the Sino-British Yantai Treaty in 1876, Britain set up a customs house in Wenzhou. Western culture and philosophy poured into Wenzhou (Yuan, 2003a).

As mentioned above, the main doctrine in China was Confucianism, which puts agricultural work at a much higher position than doing business. Confucianism emphasizes more value on righteousness (Yi) rather than earning money. Pursuing money was not advocated in the federal society. Merchant activities were not valued highly as the pursuance of money was its only goal. Even if they were rich, businessmen were not well respected. However, the “Yongjia” doctrine in Wenzhou was quite different from the national culture of Confucianism. Comparing the “Yongjia” doctrine with Confucianism, four points are important in the view of entrepreneurship exploitation.

Firstly, the “Yongjia” doctrine sounds like “Jing Shi Zhi Yong”. It argues to learn skills which could be used in daily life and it suggests that “to do” is better than “to talk”. The practical experience provided Wenzhou peasants with a sensitive and intuitive business sense. Wenzhou peasants are famous for their quick and flexible

reaction to changing situations. Because intuition is a belief or feeling that something is true without actually gathering evidence to demonstrate its veracity. Intuition will help increase a person's ability to realize entrepreneurial opportunities (Allinson, Chell and Hayes 2000, p.33). Schumpeter (1934, p.115) suggested that entrepreneurs must have an ability to make decisions about opportunities using intuition rather than by analyzing information (Ripsas 1998, p.103). Wenzhou peasants' talent for business intuition results from the experience emphasized in "Jing Shi Zhi Yong".

Secondly, "Jing Shi Zhi Yong" highlights personal ability and innovation in daily life. It emphasizes "individual" action and not only "collective" activity as the opposite of what is emphasized in Confucianism. Design for independence is one of the characters of psychological factors. It is an aspect of personality in which people prefer to engage in independent action rather than action involving others. (Shane 2003, p.106) In entrepreneurial activity, entrepreneurs often have to make decisions contrary to the opinions of the majority to grab opportunities. "Individual" judgment on action is emphasized in the Yongjia doctrine. In Wenzhou, each one has the tendency to do one's own business; this is an important motivation which is based on individual action in Yongjia doctrine. In history, Wenzhou people prefer taking risks around the Mainland and abroad rather than staying in poverty at home.

Thirdly, influenced by Confucianism, education is generally highly revered in Chinese culture, and meritocracy is much more valuable than a plutocracy, the latter being a salient feature from early on. (Holmes, 1997) On the contrary, the Yongjia doctrine emphasizes that businessmen and craftsmen should be respected the same as farmers. The Yongjia doctrine suggests that each profession should be treated equally, because the world could not realize harmony and peace until the intelligentsia, farmers, craftsmen, and businessmen reached a balance and each obtained the reward that they deserved (WU, 2004). Influenced by the Yongjia doctrine, Wenzhou people have the habit of doing business, and this provided much experience and motivation for entrepreneurship. They believe doing business is a respectable job. They are never ashamed of being businessmen.

The mentioned Qiaotao Town specialty market of buttons is a small specialty market within the structure of Wenzhou's specialty markets. During the 1980s, Wenzhou concentrated more on garments. The unmarketable buttons found their market within

the structure of Wenzhou prefecture's specialty markets, at the small specialty market in Qiaotou Town. Successful Wenzhou peasants shared their experiences and valuable information with others, so their relatives and friends could take up the opportunities offered by the speciality markets. According to ZHANG (ZHANG Miaoying 2008 p.7), there were nearly ten thousand sales agents from Wenzhou searching for markets on the Mainland.

Fourthly, the "Yongjia" doctrine suggests that material gain is as important as righteousness (Yi). Without material gain, 'Yi' is in vain. It is not practical for people to abandon material gain and pursue only 'Yi'. Instead, it is better to integrate material gains toward the pursuit of 'Yi' in a practical way (WU, 2004). Being a businessman in Wenzhou, pursuing money seldom means not only money-chasing. In summary, almost everybody in Wenzhou prefers to be an entrepreneur, even teenagers, because they know that they are supported by the well-known team working spirit. These entrepreneurs can get immediate support and protection from their teams, such as investment, information about potential markets and the partner's choice. As indicated in the case study of the Wang brothers, it was their relatives, friends, and neighbors who took part in their activities that made Qiaotou Town become a well-known specialty market of buttons.

3.4.4.2 Risk-taking and Team Work

Mr. NAN Cunhui, the founder of the CHINT Group, was one of the grass-roots entrepreneurs. He had to leave school at the age of 13 to work as a shoeshine boy, wandering the streets and roads to earn money every day. Several years later, he stopped shoe-shining and managed to start business in the low-voltage industry in Liushi. Later, the "Eight Kings" event (see § 3.3.4) had an effect on Liushi's businesses and in 1982 almost all the family mills had to close, including NAN's small workshop. Fortunately, the local cadres had a flexible policy and later set the 'Eight Kings' free. This encouraged Mr. NAN and other peasant entrepreneurs to start up their entrepreneurships again in Wenzhou. In 1987, Mr. NAN and Mr. HU Chengzhong (the founder of Delixi Switch Electronic Group) gathered RMB 50,000 Yuan and set up a low-voltage electrical enterprise (named Qiuqing) in Yueqing County (see Map 3. 2).

Before the Qiuqing factory was founded, Mr. NAN spent three years in low-voltage production; his partner Mr. HU was a tailor who had some business experience. Both

of them had received little education let alone specialist knowledge on low-voltage industry. “Everything seemed difficult at the beginning” remembered Mr. NAN many years later. But the potential market of low-voltage in China inspired them to take risks in this field. The joint investment of RMB 50,000 Yuan was no small sum of money, especially for peasant entrepreneurs.

How did they start without equipment and technology support? Mr. NAN and Mr. HU managed to borrow some equipment from other factories and invited Mr. Wang from Shanghai to be an engineer. Even while setting up the company, Mr. NAN and Mr. HU continued with advanced studies and in 1990 achieved their MBAs. Several years later, “Qiuqing” became a well-known private enterprise with total assets of RMB 2 million and its sales output reached RMB 10 million annually. Their success grew due to their good cooperation. For example, the local government encouraged the private enterprises and honored them with many titles. “Qiuqing” was awarded almost each year from the Yueqing municipal government and gained a very good reputation. For peasant entrepreneurs, awards from the government were not only titles but also precious social capital, which facilitated their career. They were favored by the state bank obtaining loans and receiving preferential policies from the municipal government. Mr. NAN and Mr. HU won personal awards in turn. They trusted each other and kept a good partnership in their first five years.

In summary, the social capital, strong teamwork and financial associations codified the rule of law and carried the weight of legal sanctions. “Renqing” needs interpersonal trust in a social network. The trust system makes it easier to obtain information and financial support among network members. In this context, social relationship increasingly serves as a mechanism that reduces uncertain ties; Entrepreneurs are more likely to hedge their risks by using private or particularistic channels (such as five proximity relationships), when formal institutions prove dysfunctional. Social capital works as an informal institution to construct a durable network of more or less institutionalized relationships of mutual acquaintance or recognition. So analyzing Wenzhou’s social capital helps to discover how the socio-cultural environment impacted on the entrepreneurial activities and how the development of entrepreneurship improved the institutional environment to be more conducive.

Mr. FIE Xiaotong (a famous Chinese economic scientist) characterized the Wenzhou

peasant entrepreneurship as follows:

...[At] the beginning of the Chinese economic reform it seemed that it “roughly” transforms the Chinese economy from a planned to a market economy; however the Wenzhou classical model stemmed from the civil society with the strong vitality of a grassroots economy. Hence, Wenzhou classical model grew absorbing Chinese traditional “nutrition”, (the trust system, network, e.t.), while the improved institutional environment supplied it with the appropriate “weather” and “soil”. One day we were surprised to find that the little grass “seed” had been growing so rapidly and all the ground was covered with green grass.

3.5 Analysis of Institutional Subversion and Conversion in the Early Reform

3.5.1 Analysis of the Institutional Environment in the Early Reform

Why were Wenzhou people able to find opportunities to develop its economy? Not only was this the preferred local socio-cultural environment but also the innovations of the institutional environment contributed to forming entrepreneurship in Wenzhou. Further analysis of the institutional subversion and conversion in the early reform stages may describe how Wenzhou peasants grasped the entrepreneurial opportunity much better than any other cities in China. This section starts first with the analysis of contradiction of the institutional environment in the early reform in Wenzhou, and will then discuss how the institutional environment improved through the interaction of institutional subversion and conversion.

Table 3.2 The Institutional Environment in Wenzhou in the Early Reform before 1979

	Active factors for Entrepreneurial Activities	The Environment in Wenzhou before 1979
Economic Environment	Economic growth and societal wealth Low rates of inflation and stable economic conditions	No independent economic society, Low level of technology Low level of personal wealth
Political Environment	Freedom, Strong rule of law Property rights, Decentralization of power	Individual household farming reform, NO property rights Weak rule of law Centralized power from the state with local protection of private industry
Socio-cultural Environment	Social desirability of entrepreneurship, Presence of entrepreneurial role models, Specific cultural beliefs	No freedom to do private business officially Absence of entrepreneurial role models officially Extended network, local trust system Yongjia culture

Source: Personal interview P 1, P11 and P3, author

The political environment includes mainly the freedom from being subjected to the will of others, strong rule of law, property rights and decentralization of power. In China, the political environment is characterized by the non-existence of private property rights, the lack of rule of law and the strict constriction of freedom. How was the institutional environment in the region of Wenzhou in the 1980s? Table 3.2 shows the institutional environment in Wenzhou in the early reform.

At the beginning of the economic reform in 1978, the practice of household handicrafts and private businesses were severely denounced and suppressed in the political campaigns of collectivization on the Mainland after 1949. Wenzhou was no exception, although private business, commerce and small commodity production still managed to survive. So how could private business survive in Wenzhou? This paper will start at Wenzhou's local economic reform in 1956 to discover what was behind the political freedom in Wenzhou.

3.5.2 Local Reform on Agricultural Responsibility in the mid-1950s

The agricultural reform in China started with the responsibility act for everyone's own household in the year 1976. However, in Wenzhou the efficiency of communal agriculture was questioned and the first household responsibility act, the introduction of household farming, was tested in Wenzhou in the middle of 1950s. In 1956, this experiment began in Yongjia County where the land was divided among families and a production contract was assigned to production teams or individual peasant households. The communes were eliminated and the peasants were set free from the obligation of working on agricultural land. In the Yongjia County in 1957 over 1,000 collective farms (Advanced Agricultural Producers' Cooperatives) changed secretly to individual household farming. This included about 178,000 families, almost 15 per cent of the total population. This secret innovation was considered the first successful reform of property rights in the countryside of Wenzhou, which resulted from the strong local resistance to collectivization. It was adopted nationwide in the post-reform era twenty years later in all of China. (Zhang, Miaoying p.5) During the Great Leap Forward and the Cultural Revolution, peasants in little villages and towns were allowed to have old fashioned businesses, such as spinning and weaving, these were an important source of income. Some small mills were set up in mountain areas in the early 1970s.

When comparing the political environment in Wenzhou with other rural areas on the Mainland, it is noticeable that the main difference between the two is that the Wenzhou local government adopted some policies which were not allowed in other areas in China.

Household farming, regarded as a setback to communism, was later denounced as anti-county, and was purged in the Great Leap Forward movement in 1958. Nevertheless, peasant household farming was never completely eradicated in Yongjia County in the following years. As soon as each political campaign subsided, the household industries and private businesses prospered again. From 1966 to 1973, small household farms were founded among villages in Yongjia County until the local cadres were purged in 1973 because they tolerated household farming. (LIN, B. et al. 1987, p.85) This back-and-forth struggle with peasant household farming pushed from below and collectivization imposed from above meant that the commune system imposed by the state never really took hold in Wenzhou (ZHOU Xiaohan, p.5).

3.5.3 The Rise of Small Private Enterprises

The economic history in Wenzhou indicates how private enterprises survived and developed in the years before the economic reform. Wenzhou practiced individual household farming and household industry twenty years before the state initiated economic reform in 1978. Early in the 1970s, rural carpenters set up small workshops to maintain and repair agricultural tools. They distributed the income based on the work everyone had done (Yang and Zhai, 2002). Many state-owned enterprises (SOEs) established collective factories as branches, which were actually operated by individual persons. They could use the same title and account to the parent SOEs. (Interview p.2) Very few private factory enterprises were willing to be identified as “private,” most private factory enterprises in Wenzhou liked to be called either “local collective enterprises” or “partnership enterprises” (hegu-qiyue). This appeared to promote greater security, because the higher degree of collectivization provided a kind of “safety in numbers” in the volatile Chinese politics. These long-term underground private workshops enabled the private economy of Wenzhou to boom up to 1978, and eventually helped Wenzhou to become the first district on Mainland China to embrace a predominately private economy. This was the origin of the so-called Wenzhou classical model.

A partnership enterprise, though privately owned, was treated as equal to a collective enterprise by the municipal government and enjoyed the same favorable treatment. Newly-opened private joint ventures in poor areas in Wenzhou enjoyed a tax exemption for the first three years, and its income tax rate was the same as for collective enterprises (Wenzhoushi xiangzhen gongye guanliju, 1987, p.18), which was much lower than the official rate for private enterprises. It seemed that the local government in Wenzhou was sheltering private industry from political discrimination, and this protective policy served to promote local development in Wenzhou.

This underground economy survived in an environment to be considered as the semi-legal situation in Wenzhou. The following story describes how the entrepreneurs and the local cadres behaved in such a semi-legal environment in Wenzhou.

3.5.4 The Local Cadres' Tolerance of Private Enterprises

Private business could not have been restored without the flexibility of the central government (LIN Bai et al.1987, p.94). While researching peasant entrepreneurship, I wondered how Wenzhou's private economy managed to survive during the years 1949 to 1978. Chinese scholars argued that Wenzhou cadres' pragmatism and willingness to take risks were the keys to the speedy development of the private sector. It seems that the Wenzhou cadres implemented state policies in accordance with their interpretation. Even though they did not overtly support deviant practices, they did not take any serious action against them, and this made the private economy possible (Interview P.4 and P3, author).

How did the Wenzhou cadres develop their unique capacity for collective resistance against undesired state encroachment and in the face of repeated purges in the past four decades? Why were the local cadres willing to take risks to support the private economy? The cadres understood that the peasants had ventured into non-agricultural family businesses in an attempt to escape poverty.

Away from the center of the political and economical stage, the people were more independent, self-reliant, and generally more business-oriented. This was a challenge but also an opportunity for Wenzhou to start-up private businesses and to build their

business network ahead of other cities in China. They interpreted the state policies according to the local situation. For example, in the early 1970s, many workers in collective enterprises had already contracted work in their enterprise to produce at home. When political control tightened, the household enterprises were closed and people returned to work in the collective enterprise. Thus, the collective economy was never effectively eradicated in Wenzhou.

The effective unity between local cadres and peasants worked more thoroughly in Wenzhou than elsewhere. Some cadres lost their jobs because of sympathy for a private economy, but as long as the state did not remove the entire body of local cadres, it was impossible to uproot the deviant local political tradition. In the Yishan district, the peasant's sidelines, such as spinning and weaving, remained an important source of income since 1949, and despite a series of attacks from the state in the political campaigns of collectivization, such as the Great Leap Forward and the Cultural Revolution. In each of these campaigns the work teams organized by their superior authority were sent to assume the local power. During this time many local cadres, who supported the peasant's sidelines and small commodity production, were immediately denounced and purged (see Yongjia County, § 3.5.2). Despite these purges, peasant's sidelines and handicrafts resurfaced again after each campaign subsided, and the local cadres stood on the side of the peasants. They tried to protect their interests. Many Yishan cadres and their families were engaged in the local textile industry during the 50 years. Moreover, cadres could always make more money from their businesses than peasants, because they could get higher prices when they sold their products to the local supply and marketing companies; their higher position in the local hierarchy offered them a business advantage. This decentralization supplied Wenzhou the unique advantage to start nascent entrepreneurship. Peasants in Wenzhou who were placed at the fringe of the planned system, responded instantaneously to the market opportunities, opened up due to the economic reforms.

Many scholars studied the reasons for the successful entrepreneurship in Wenzhou. Amongst their conclusions were that local institutions and policies played key roles in the booming private economy in Wenzhou (Yang and Zhai 2002, p.309). One leader of the Wenzhou city committee said while giving an interview in July, 2004: "The great advantage in Wenzhou is to have our own human resources." On how the

people of Wenzhou succeeded in their quick economical development, he concluded that; forced by poverty, Wenzhou people seized the opportunities motivated by hard work and bravery. Wenzhou entrepreneurs became well-known for their risk-taking entrepreneurial spirit (Ye 2008, p.27). The private economy became predominant in Wenzhou as a result of the tolerance and risk taking of the local government.

3.5.5 Autonomy from the Central Government and the Protection of the Local Government

Before 1978, due to the geographical remoteness and the lack of natural resources (land, minerals, etc.), the average per capita fixed assets in Wenzhou were only 28 percent of the average in the Zhejiang Province. The Chinese central government left the people of Wenzhou relatively autonomous; Wenzhou municipal government took flexible policies which were not allowed by other local government. In the early stages of China's economic reformation, there were no clear instructions from the state government on many economic activities. Moreover, debates on ideologies, socialism and capitalism frequently occurred when the central government announced a new economic policy (LI Y.J., 2003).

The tolerance from the central government and the wisdom of the local cadres in Wenzhou are factors which attributed to the rapid growth of the private economy in Wenzhou in late 1978. Wenzhou changed many existing institutions of the state socialist system in the process of self-development (Parris, 1993, p.242). Wenzhou would be the first to take household responsibility, the first to allow land transfer among peasants and the first city dominated by private industry. Wenzhou issued the first business license for privately owned enterprises, founded the first stock corporation, began the first social pension system and acquired the first legal statute for private enterprise (Follow-up Interview P 2, author).

Later, these innovations in the institutional environment were regarded as deviations from the state policies. Many of the economic practices in Wenzhou were not allowed by the state policies such as underground mills, private household farming, and private banks. Some of these were not even sanctioned by the state government until as late as 2000.

In summary, the Wenzhou classical model was influenced more by informal institutions and traditions and followed an innovation of institutional transformation. In Wenzhou the degree of political-economic cooperation depended more on the final decisions of the central government. The political environment was not favorable and the reform on marketization was not completed, these hindered the economy development in Wenzhou. The next section discusses how the Wenzhou model transferred in 1990s.

3.6 Evolution of the Wenzhou Model since the 1990s

The Wenzhou entrepreneurial model since the 1990s has adjusted more rigidly to export markets for the economic development. It manufactured goods by creating a complex industrial zone with enhanced transportation access for business and tourism, breaking through the geographic bottleneck of the surrounding mountains.

3.6.1 The On-going Reform of Rural Finance

Family businesses were the leading organizational structure during the initial stage of industrialization in Wenzhou. However the family mills and scattered production organizations could no longer keep up with the fierce competition from other districts (such as the TVEs development in Sunan). Enterprises used to borrow money with comparatively high interest rates. The annual percentage rate (APR) of the people's credit was about 10.63 percent, against the APR of a bank of only 5.58 percent. Also the bureaucracy involved with getting a bank loan required too many steps and worked against small businesses. Most of the capital from underground private organizations was used as the initial investment in small-scale commercial activities and not in industrial projects (Xia, 2002). How could the quality be improved if it was not possible to invest because it was too expensive to borrow money? In the early 1990s, the quality improvement in Wenzhou focused on the elimination of fake products and illegal imitations of inferior quality.

The Wenzhou municipal government did not intervene directly with the development of the underground financial associations. Hence, Wenzhou pioneered China's reform of its financial system in the 1990s which began to supply loans for private

enterprises. After Wenzhou private enterprises had the financial capability, they reinvested their considerable accumulated capital in the 1990s in quality and product improvement. During this period, various local loans appeared in Wenzhou and complete production chains were established to control and improve quality.

Consequently, starting in 2005, the introduction of outside investment was the top priority of Wenzhou's government. Successful companies like Ruili and SORL Auto Parts Factories had to attract central financing from private banks and had to become public companies. Ruili Auto Parts Factory is listed on the NASDAQ stock exchange, making its debut in November of 2006 with an IPO (initial public stock offering), of \$ 31,071,000. The SORL Auto Parts Factory, makers of automotive air brake components and part of the Ruili Group industrial conglomerate, constitute the second largest company in Rui'an. Up to that time the United States was the largest automotive parts export market.

3.6.2 Industry Clusters appearing in the 1990s

In the 1980s, the Wenzhou model showed a relatively good growth performance. At the beginning of the 1990s, the evolution of the Wenzhou industry in this period was mainly characterized by the emergence of more specialized cluster structures based on the development of family owned small business. Many private organizations appeared (see §3.8.3). The number of cluster firms has been growing since 2002 (see Table 3. 3). In particular since the end of the 1980s there has been an intensification of new company forms in the Wenzhou industry cluster. A more detailed analysis shows that the dynamic development of the industry cluster since the 1990s was mainly based on the setting up of new ventures in the fields of low-tech industry, such as shoe-making, apparel and metal shell lighters. Some of them were good enough to enter the international market, exporting large amounts of shoes, metal shell lighters, razors and low-voltage electric components; the other enterprises focused on the domestic market, selling buttons, zippers, writing utensils or offering services like printing. The rate of new business established has increased. Many grass-roots clusters developed from only one or two people, then the whole village became involved in the factory, each family specializing in one part of the production. Companies include spectacle manufactures and various manufactures of automobile products for the automobile industry.

Table 3.3 shows Wenzhou's data on some predominant industry clusters after 2002.

Apart from the mentioned clusters in Table 3.3, there were another sixteen industry clusters in this region, including spectacles, leather, printing, buttons, zippers, valves and pumps, automobile and motorcycle accessories, seamless stainless steel pipes, and so on (ZHANG Yue, 2005).

The shoe-related clusters were model firms among cluster industries in Wenzhou. On the one hand, the fierce competition in the industry cluster would result in a great leap of quality improvement within each step of the production chain. Vertical disintegration³ within an industry makes specialization in either one or several production stages possible (Ottati, 1991,p.76). It was possible for the shoe industry cluster in Wenzhou with a large number of small firms to realize mass production. Each separate company performed a limited subset of activities required to create a finished product with only a small investment from every firm. Hence, innovation should be easier in a shoe industry cluster because every related firm needs to invest only a small amount of capital to realize the shoe related technology innovation. On the other hand, the bits and pieces of shoe manufacturing information was held by different actors in the production chains could transferred and collected, which supplied entrepreneurs more opportunities to exploit in the shoe making industry more effectively than in other production fields.

Table 3. 3 Statistics of Wenzhou Main Industries (after 2002)

Industry	No. of Firms	No. of Employees	Domestic Market Share	Percentage to Export
Shoes	Over 3,000	200,000	Above 25%	28%
Electrical Components and Appliances	Over 4,000	150,000	35%	12%
Apparel	Less than 2,500	300,000	10%	10%
Razors	Over 100		60%	60%
Metal Shell Lighters	500		90%	80%

Source: ZHANG Yue (2005) "The Development of Wenzhou Industry Clusters-Its Quality Improvement and Innovation Capability" P. 7.

³Vertical disintegration: refers to a specific organizational form of industrial production. As opposed to integration, in which production occurs within a singular organization, vertical disintegration means that various diseconomies of scale or scope have broken a production process into separate companies, each performing a limited subset of activities required to create a finished product.

3.6.3 Enhancing Export, High-tech Innovation and Brand Building: “Made in Wenzhou” in the mid-1990s

When the domestic market changed from sellers to buyers in the 1990s, especially, when the industries tried to expand their sales to overseas, they needed to upgrade the quality of material, have fashionable designs, prompt delivery, and so on. Miss. Sitong and Mr. Ye were interviewed about my research and concluded that the good market research of Wenzhou industries for popular new products and low cost production helped them to expand in overseas markets. Wenzhou industries are famous for their low price. The average export price of Wenzhou shoes is less than US\$6 per pair; the price of metal shell lighters is about US\$2.5 each. Most of these cheap products are now sold in big supermarkets like Wal-Mart and bazaars or exported as OEM products (Interview P11 and P3, author). The Wenzhou region has managed to reinstate its' reputation for good quality.

In 1995 Wenzhou people invested RMB 6 billion in technological innovation. Over 400 important projects had a technological transformation, from which 40 projects exceeded RMB 10 million. A group of leading companies with high quality products and a good reputation appeared in Wenzhou (Ye 2008,p.82). The specialty market has been gradually replaced by a new kind of direct market system, for example with the Metersbonwe Co., which is the first virtual company. A number of private enterprises thrived in the fierce market competition, and many other industry clusters were established gradually after 1996. The following case studies of the shoe industry cluster are examples of how the international markets were opened for Chinese products. The following shoe case studies are examples to study how the Wenzhou industry cluster opened the markets abroad. The analysis focuses on three aspects enhancing export, high-tech innovation and brand building.

Many companies in the shoe industry achieved a good reputation through high-technology and new management. The following sections discuss three shoe companies, they are: Kangnai, Ji'erda Shoes Co. Ltd and Taima Shoes Co. Ltd.

The owner, Mr. ZHENG Xiukang, was the founder of Kangtai Shoe Co. Ltd. He was the first to install a shoe production line in Wenzhou in 1991. After that, he continued to expand and improve production lines, importing machines from Taiwan

and Italy. He realized the need for the computerized control of key processes in 1996. When many other shoe manufacturers had to do business as OEMs for the adverse market, Mr. ZHENG insisted on building his new brand, Kangnai. In 1999, Kangnai became one of the most famous brands in China (Hu and Deng, 2004). The shoes from Kangnai Shoe Company were later honored for the “inspection exempted products” because of their credible quality. Kangnai set up more than 80 shops in Europe and the U.S. to sell their own brand with a retail price of \$60 and above (China Leather Trade Net, 2005).

The story of Ji'erda Shoes Co., Ltd, which was founded in 1973, was a leading enterprise of the China Leather Industry Association. In February 1984, Mr. YU A'shou franchised the sale of the shoes to stores in a few big cities, such as Wuhan. Then 28 provincial level branches were set up, over 1,700 exclusive agencies and franchised stores were established on the Mainland. Abroad, self-supporting branch companies were set up in Russia, America, Germany, Spain, etc.. Ji'erda employed over 2,500 workers in a 52,000 square meter workshop, and had a daily output of over 20,000 pairs of leather shoes in 2009⁴. Table 3.4 indicates the import and export in the Wenzhou region from 1997 to 2004.

Table 3. 4 the Import and Export in Wenzhou Region (In \$billion)

year	Importing amount	Percentage of increase	Exporting amount	Percentage of increase
1997	0.11	n/a	0.53	n/a
1999	0.40	n/a	0.82	n/a
2000	0.52	27.70%	1.50	82.20%
2001	0.71	37.90%	2.00	33.90%
2002	0.80	12.68%	2.65	32.50%
2003	1.05	31.32%	3.42	29.06%
2004	1.39	32.38%	4.58	33.92%

Source: Wenzhou Municipal Bureau of Statistics cite in ZHANG Yue (2005) “The Development of Wenzhou Industry Clusters-Its Quality Improvement and Innovation Capability” P. 7.

Wenzhou Taima Shoes Co., Ltd. was founded in 1987. Taima shoes sell well all around the world including the USA, South and Middle America, Europe, the Middle East and Japan. ⁵ The name of “Taima” appeared in an advertisement in a local run Chinese newspaper in Berlin in 2005. In my interview, Miss DONG Sitong was just over 20 years old and had just started to open a shoe store in Berlin. She

⁴ <http://www.chinajierda.com/main/>

talked with me while dealing skillfully with her business (Interview P1). In the large warehouse, over one hundred newly designed summer shoes were exhibited on the shelves, including mens' and ladies' safety and casual shoes. Most of them were made of artificial leather with a fashionable design. She told me, that in order to expand the market, the firms must care more about quality. The international market asked for better products and services. Overseas customers always want faster delivery and better services as well as low prices, so domestic enterprises have had to follow the fashion as fast as possible and increase the quality.

Table 3. 5 The Percentage of Main Export Markets in Wenzhou (2000-2004)

	2000	2001	2002	2003	2004
Asia	45%	n.a	42%	41%	39%
Europe	31%	n.a	32%	31%	33%
North America	10%	n.a	11%	11%	12%
Africa	8%	n.a	10%	12%	10%
Other Regions	6%	n.a	6%	6%	6%

Source: Wenzhou Municipal Bureau of Statistics. [Http://www.wzstats.gov.cn](http://www.wzstats.gov.cn) In ZHANG Yue (2005)

Design and marketing are two important factors which are necessary for the success of a new brand name. In 2007, two years after our first meeting in 2005, Taiman had eight franchises named “1&1” shoe shops in Berlin. The trademark of “Taima” has been registered as of now, in more than 100 countries. Taima has been successively recognized as one of the top 10 export orientated enterprises which had foreign investment in Wenzhou (<http://www.tai-ma.com>). Table 3.5 shows the percentage of the main export markets from 2000 to 2004 in Wenzhou.

3.6.4 Case Study: The Zhengtai Group: The Transformation from a Family Business to a Joint-Stock Company

Family businesses were the leading organizational structure in Wenzhou. There were, however, many disadvantages in a family business management. The family businesses only trust family members in important positions and also therefore they do not have alternative “co-owners” or partners. These problems were wide spread among private enterprises in Wenzhou.

From the beginning in 1984, Mr. NAN and Mr.HU made an agreement not to employ any relatives from either of their families. However, their friends and relatives did gradually join Qiuqing. The important positions were eventually

occupied by their relatives. Qiuqing changed into a family run business. Under consideration of their individual strategy and management, Qiuqing was then divided into two enterprises in 1990. One was named “Delixi Switch Electric Group” under the management of Mr. HU’s family; the other became the “Zhengtai Group” under Mr. NAN’s family. The Zhengtai Group’s transformation from a family concern to a joint-stock company was a success, as we shall see in the case study below.

In February 1994, the CHINT Group was founded. This was the first group in the low-voltage industry in Wenzhou and Zhengtai had completed its transformation from a family enterprise to a joint-stock company. Why and how did Mr. NAN transfer his family enterprise into a joint-stock company?

On entering the 1990s, the backward household-style management became one of the biggest problems in the Zhengtai group. As professional managers didn’t feel appreciated enough, the managers gradually left the Zhengtai group.

How did Mr. NAN persuade the remaining important non-family members to stay in his enterprises? Mr. NAN had to reform the ownership of the family enterprise. From 1991 to 1998 Mr. NAN reduced the amount of his shareholding three times. In September 1991, Mr. NAN reduced his shares to 60 percent and gave the rest to his relatives as they joined his enterprise. After 1991 Mr. Nan began to reduce his shares a second time. When many other small low-voltage electrical enterprises joined Zhengtai to produce the brand Chint, Zhengtai then took about 1 percent of their total sales as a reward for the additional management. By 1994, there were nearly 40 small enterprises which had joined Chint Group. The number of shareholders was enlarged to 40 and the rate of Mr. NAN’s shareholding in Chint Group was reduced to 40 percent. Mr. Nan’s ownership reform to Zhengtai was opposed by his families, however Chint Group’s assets rose up from RMB 4 million to RMB 50 million during this ownership transformation. In 2003, the Chint Group had 1,400 employees and its assets reached RMB 3.1 billion. Total sales were up to RMB 10.1 billion, which equaled 30 percent of the low-voltage market on the Mainland. In order to persuade more talented employees to stay in the Chint Group, Mr. Nan negotiated a deal with his family shareholders to reduce the rate of Nan’s family shares in the Chint Group once again. After an asset valuation, he distributed the best shares to the non-family experts, scores of millionaires appeared in the Chint Group in 1998. The number of the shareholders increased from 10 to over 118, this included

the former family shareholders, the owners of nearly 40 other joint-companies and the experts on sales, management and technology within the Chint Group. In the third ownership reform, Mr. NAN's shares were reduced to 20 percent, despite this reduction the total assets of the Chint Group increased largely. Mr. Nan said: “Sharing with others is not generous but wisdom.”

Mr. NAN succeeded because he grasped the opportunities of family ownership reform and finished Zhengtai's transformation from a family business to a joint-stock company. The Chint Group has become a leading enterprise in low-voltage industry in China.

3.6.5 Case Study: Metersbonwe Company

Xunzi says: “the only distinction between a successful man and an ordinary man is how to take advantage from others”.

Mr. ZHOU Chengjian is a businessman over forty years old, and in 2009 he was ranked number 246 on the Forbes Rich List with \$2.6 billion. Mr. ZHOU was the third richest person in China in 2009. How did he become rich? In 1992 Mr. ZHOU created the domestic apparel brand “Metersbonwe”. The Metersbonwe Company was the first to adopt the virtual operation business model in China's apparel industry in 1995. He succeeded in taking advantage from others and performed a miracle in the Chinese apparel industry.

3.6.5.1 The Origin of Virtual Operations in Metersbonwe

After 1995 Mr. ZHOU closed his garment factory in Wenzhou and used other garment factories' machines, laborers and management to produce casual apparel with the Metersbonwe brand. In the 1990s many Chinese garment factories were unable to react quickly to the demand of the market because they handled sales through agents and retailers in a traditional way. How did Metersbonwe exploit the garment market?

How to consider the market as an integral part of entrepreneurial design? The “blue ocean” of the garment market was so large that Mr. ZHOU had to find alternative co-owners or partners to reduce the risk of the market exploitation. Mr. ZHOU

finally managed with a virtual team structure to exploit the market.

Depending on the individual location, the affiliate stores invested between RMB 50,000 and 350,000 respectively as a charge for the permission to join Metersbonwe. The brand Metersbonwe quickly catered to the needs of the youth with new fashion designs, good quality and medium prices. The franchisees' network increased quickly in China. Metersbonwe supplied professional services to the franchisees, such as logistic distribution, business information and consulting services. The group also provided training courses for the franchisees. The first Metersbonwe's franchise store opened in Shanghai in 1995, the sales income reached RMB 50 million in 1995.

3.6.5.2 The Development of Virtual Operations in Metersbonwe

Metersbonwe was the first to adopt the virtual operation business model in China's apparel industry. The implementation of a virtual management allows and creates many benefits including reduced real estate expenses, access to the Mainland markets and reduced costs for business travel, in particular the virtual management absorbed large amounts of "zero" interest capital for further development. The investment from the franchisees reached RMB 200 million. However in 1997, most of Mr. ZHOU's employees left his company because they could not understand the practice of virtual management. Mr. ZHOU did not give up his exploitation of virtual management, insisting on high level design and professional quality control of the products. From 1995 to 2000, Metersbonwe invested in the first generation of e-commerce system research, linking all PCs in the end-to-end chain, connecting the departments of design, production, logistic, management and point of sale together. It enabled these departments to share internal information and resources to systemize the management process. With the implementation of the enterprises resource planning system, the delivery period was reduced from 15 days to 8 days, and accounts feedback was reduced from 30 to 2 days. The Metersbonwe Group had a world-wide design team with long-term cooperation contracts with leading designers from France, Italy and Hong Kong. Over 1,000 new styles are introduced annually to the market. In 2000 the number of franchise stores increased to 400. Approximately 20 percent of the new stores were direct distributors with investment from Metersbonwe, while approximately 80 percent were chain stories with no investment from Metersbonwe.

The sales output increased from RMB 50 million to RMB 510 million in the period from 1995 to 2000, and in 2001 it reached RMB 810 million. In 2003 the company invited popular stars to become the brand's image ambassador and since then MetersBonwe has become the best selling brand in China in 2004.

Mr. ZHOU began virtual operations in Metersbonwe in 1995. By 2006, the number of franchisees had reached over 1,500 in China. The virtual management minimized the transaction costs and shared with the franchisees capital, labor force and market integration. Metersbonwe became a leading company in the garments field in China. In 2007 there were explicit federal (and in the U.S.A) laws covering franchises in China. Mr. ZHOU's story indicates that their trust system on the principle of the "five proximity relationships" had been extended; people doing business can also be trusted outside of their circles. The cases above indicate also that Wenzhou entrepreneurs invested their energy in analyzing industrial trends, learned from new technological breakthroughs and increased organizational effectiveness as well.

3.7 Analysis on the Role of Entrepreneurship in Wenzhou after 1990s

As mentioned above, the Wenzhou model after the 1990s was characterized by industry cluster appearance with diverse ownership enterprises, and which included the specialized market sensitive production and the financial reforms in rural Wenzhou. Wenzhou produced a host of social and economic consequences. The next section analyzes the impact of the SMEs on the following aspects: the market and employment, enhancing high-tech cooperation with the foreign organizations and institutions, social wealth, and the improvement of the industrial structure in Wenzhou.

3.7.1 The Influence of SMEs in the 1990s

This section discusses the role of SMEs with respect of the market, employment, social wealth and cooperation with organizations.

Firstly, with regard to the market and employment, Wenzhou played two special roles in China's modernization. The first was as a national free market. It was no longer just a trading center, but was oriented toward the whole of China, and people

from all over the country came to Wenzhou's famous ten market towns to trade. Wenzhou's second role was a link between China's "forward area" and the "backward area". For example, a 1988 press report stated that since 1979 some 40,000 Wenzhou merchants had arrived in the southwest border province of Yunan to open up business (Renmin Ribao, February 27, 1988, p.2). With regard to employment, the most tangible effect of Wenzhou's entrepreneurial firms was the reduction in the number of surplus laborers. By 1987 household industries and other private business had absorbed not only 75 percent of the surplus labor in Wenzhou (Wenzhou Di Juqiye, pp.9 and 72), but the Wenzhou enterprises had also absorbed a large amount of surplus labor force around the Mainland.

Secondly, with regard to social wealth, this wealth is associated with vigorous investments when opportunities appear (Shane 2003, p.148). The high increase in the income of the Wenzhou people (see Figure 3. 4) facilitated their financial ability to start new entrepreneurial firms.

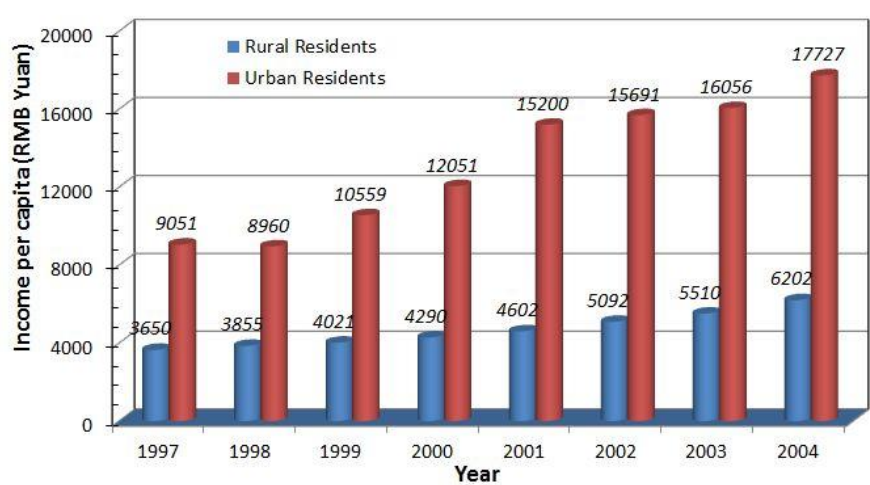


Figure 3.4 the Income of the Rural and Urban Residents in Wenzhou (1997 - 2004)

Sources: Wenzhou Municipal Bureau of Statistics. <http://www.wzstats.gov.cn>

Figure 3.4 shows the urban residents' average per capita disposable income reached RMB 17,727 in Wenzhou in 2004, which had increased by 10.6 percent as compared to 2003. The rural residents' average per capita disposable income was RMB 6,202, and it increased 11.8 percent compared to 2003. Institutional constraints for private enterprises were gradually diminishing in the commodity market as well. When peasant entrepreneurs succeeded in their business, their greater wealth provided

potential new entrepreneurs to self-finance their entrepreneurial activities. The improved wealth positively influenced the financing environment in Wenzhou.

Thirdly, enhancement of high-tech cooperation with foreign organizations and institutions was developed through the network of Wenzhou merchants who had close connections with their relatives and friends overseas. It was easy for Wenzhou companies to start cooperation with overseas institutions and companies, and international trade fairs facilitated this move. Some of these Wenzhou enterprises established joint ventures with foreign enterprises in China; some successful Wenzhou businessmen purchased overseas companies; some Wenzhou enterprises established manufacturing facilities outside of China; while others cooperated with foreign technical institutions for international standards and technical support. (Interview P 5, P11,P4 and Telephone Interview P2)

3.7.2 The Improvement of the Industrial Structure in Wenzhou

The rapid economic development in the 1980s transformed Wenzhou's economics from an agricultural to a commercial and industrial one. The industry and service sectors accounted for two-thirds of the total gross production in Wenzhou since 1985 (see Table 3.6).

Table 3.6 The Quality Improvement of Wenzhou Industry: the Proportion of Sectors in Gross Production Output

Year	Agriculture	Industry	Service
1978	63.4	17.5	-
1980	68.4	26.7	4.9
1984	33.8	47.4	-
1985	31.3	52.55	16.15
1986	29.8	53.5	16.7

Sources: 1978 and 1984: ZHANG Dexi (ed.), *Wenzhou Moshi* (1986), p.13; 1980 and 1985: HE Rongfei, "The Economic Structure of Wenzhou," p.98; 1986: Statistics provided by cadres in the municipal government, cited in, LIU Yia-Ling "Reform from below: The private economy and local politics in the rural industrialization of Wenzhou" *The China Quarterly*, No.130 (Jun., 1992), p296

Since the 1990s Wenzhou enterprises have improved their primitive production methods by absorbing foreign investment and high-tech knowledge. The Wenzhou municipal government organized investment projects to attract foreign investment, drafted many policies to encourage the development of high-tech industries to

further increase the advantages already established in their relatively free economic structure. Furthermore, the local government delineated high-tech industrial zones for industries like computer production and automobile accessories, and the high-tech industry enjoyed financial support from the government (Interview P2 and P3).

The industry structure in Wenzhou improved gradually, the secondary and the tertiary industries grew more quickly (more than 12 percent annually) than the primary industry. The growth of primary industry decreased from a high of more than 4.5 percent in 2000 to 1.5 percent in 2003 (see Table 3.7). It indicates the GDP distribution among the primary industries, the secondary industries and the tertiary industries from the year 2000 to 2004.

Table 3.7 Statistics of the Wenzhou Industry Structure (the primary industries, the secondary industries and the tertiary industries) from the year 2000 to 2004 (in RMB Billions)

	GDP (billion) /over the precious year (%)	The primary industry over the precious year (billion) / (%)	The secondary industry over the precious year (billion)/ (%)	The tertiary industry over the precious year (billion)/ (%)
2000	82.81 /12.7%	5.44 /4.5%	47.62 /13.3%	29.75 / 13.2%
2001	93.21/12.6%	5.7 /3.8%	52.78 / 12.4%	34.66 / 13.8%
2002	105.5 / 13%	5.57 /4.1%	59.80 /13.4%	40.13 /13.6%
2003	122.03/ 14.8%	5.7 / 1.5%	69.88 / 16.3%	46.47 /14.4%
2004	140.25/14.1%	6.48/3.5%	79.614 /15.4%	/ 13.4%

Sources: Wenzhou Municipal Bureau of Statistics

<http://www.wzstats.gov.cn>

<http://www.wzstats.gov.cn/infoshow.asp?id=5785>

<http://www.wzstats.gov.cn/infoshow.asp?id=2146>

<http://www.wzstats.gov.cn/infoshow.asp?id=2144>

<http://www.wzstats.gov.cn/infoshow.asp?id=2145>

<http://www.wzstats.gov.cn/infoshow.asp?id=2143>

Over a period of three decades, Wenzhou transformed its production structure from small family businesses to industrial clusters, a miracle in peasant entrepreneurship in China. Wenzhou built up comprehensive industries like chemical industry, medicine, machinery, and shipbuilding. Other industrial branches developed for producing food, paper, garments, leather, and household appliances.

In summary, rural entrepreneurship played an outstanding role in the development of

the local industry cluster in the region of Wenzhou. Newly founded and small enterprises could be regarded as crucial innovation factors in the market reform, strengthening the cluster's scientific capabilities, influencing social wealth and promoting knowledge interactions both within the cluster and beyond.

3.8 Analysis of Institutional Subversion and Conversion after 1990s

3.8.1 Dynamic Private Financing System in Wenzhou in the 1990s

Venture capital firms and business angels were a missing factor in Wenzhou. The main reason for this is that the state bank and other financial organizations had a preference for traditional credit instruments and a widespread adversity to risk taking. Consequently, business associations in Wenzhou were forced not only to develop technological but also financial innovations. As discussed above, in the late 1990s, many underground financial associations were founded in Wenzhou. By 2004, Wenzhou's people seemed to be receptive to any profitable investment opportunity, including real estate, stock market, coal mines and foreign currencies. This could only be realized on the basis of a variety of traditional, self-organized credit associations and the underground illegal private banks in Wenzhou. Hence, individual private loans were arranged directly or through a middle man, who would receive a fee from these underground illegal private banks (Parris 1993). From 1978 to 2005, the average GDP increase rate was 15.24 percent in Wenzhou, far higher than the national level of 9.39 percent (Xie 2006, p.1). According to an investigation carried out by the Chinese Academy of Social Science, Institution for Rural Development, at Cangnan, a county town in Wenzhou, discovered that of 22 firms which needed loans in 2003, only two received all the needed money from banks (Feng, 2004). Eleven of them borrowed from people's credit (a kind of private loan), and their satisfaction level was over 60 percent.

With the approval of the People's Bank of China (PBOC), an experimental financial reform, the first of its kind in the whole of China, was launched in entrepreneurial Wenzhou in April 2003. The reform, aimed at revamping the structure and mechanism of the financial system, covered six major measures and 12 supporting measures.⁶ For instance, a mechanism was introduced for small loans (under RMB

⁶ [Online]available:

500,000) under which the credit manager is responsible for the extending, managing and collecting of the loan and his income is linked to the yield from the loan; private enterprises were allowed to invest in urban commercial banks in a bid to revamp the equity structure of such banks and set-up a check-and-balance legal person management system. This led to the establishment of a new breed of small and medium-sized investment companies; rural credit cooperatives were reformed and re-organized.

In December 2007, the interest rate for private lending in Wenzhou reached a high of 1.16 percent per month (compared to an average of 0.6 percent per month from the banks) and it increased to 1.225 percent per month in June, 2008. Private capital became the primary source of external funding for private enterprises (SMEs and large private enterprises included), particularly in Wenzhou, Taizhou etc. In Zhejiang Province, the Hangzhou city branch of the PBOC estimates, that 830 billion RMB now in private hands were seeking new investment opportunities (Wang and Feng, 2009).

In May 2008, the China Banking Regulatory Commission (CBRC) and the country's central bank, the PBOC, jointly released guidelines for establishing micro-credit companies and the Zhejiang Province was selected as the first pilot area. In July 2008, the Zhejiang provincial government announced that 111 micro-credit slots had been allocated to Zhejiang's counties.

The first group of new legal private lenders started issuing loans in October 2008. In general, each county should have one micro-credit company. Wenzhou city was allowed to have five additional slots for private lenders due to their larger liquidity. With its 11 counties and townships, the Wenzhou prefecture could have 16 legal private lenders during the unspecified trial period, but underground lenders felt that the quotas were still insufficient. "Even if the registered capital of the 16 micro-credit companies in Wenzhou is 200 million Yuan each, the total amount is just RMB 3.2 billion. It is still too little when compared with the RMB 600 billion liquidity of private capital," said Mr. ZHOU Dewen, president of the Wenzhou

council for the promotion of small and medium-sized enterprises, on September 21st, 2008.⁷

Due to the turbulence in the stock market and real estate industry after 2007, Wenzhou investors recently began to concentrate their capital on the manufacturing sector. According to a report by the Wenzhou branch of the People's Bank of China, in June 2008, about 88.5 percent of local liquidity capital was used in the field of production.⁸ Figures from 2008 from the Wenzhou branch of the China Bank Regulatory Commission (CBRC) show that the private working capital in Wenzhou reached RMB 300 billion and on top of this at least RMB 40 billion was available for private lending.⁹ All private financial tools, like lending associations and illegal micro-loan companies, created by private activities, have helped to sustain the development of the private economy in Zhejiang.

3.8.2 Ownership Reform in Wenzhou in the 1990s

The industry clusters in Wenzhou Region developed various ownership forms (see Table 8). Facing great challenges to overcome poverty and permanent government interventions against entrepreneurial freedom, the peasant entrepreneurs pioneered reforms to facilitate their private enterprises. As a result, various types of ownerships appeared in Wenzhou. The family firm which had formed the basis of the Wenzhou classical model was replaced by various other forms of ownerships in the new Wenzhou model.

In the spring of 1979, Mr. LI Daochang combined more than 40 villagers to found a textile factory in Cangnan County's Lijiadong village. Each villager paid 150 Yuan and shared the sum of altogether RMB 6,000 Yuan with the other founders. In 1982, the shared capital rose to a minimum of RMB 600 Yuan per person. They invested a total of RMB 71,400 Yuan to buy wool and textile producing machines and renamed their enterprise from "Lijiadong Knitting Factory" into "Cangnan Woolen Enterprise". This was the origin of the joint-stock cooperative enterprises in Wenzhou. In the 1990s the joint-stock cooperatives with multiple ownerships

7 "China's Zhejiang, Wenzhou: Underground Lending Sees the Sun" September 21st, 2008 [Online]available: <http://trendsniiff.com/2008/09/21/china-zhejiang-wenzhou-underground-lending-sees-the-sun>

8 "China's Zhejiang, Wenzhou: Underground Lending Sees the Sun" September 21st, 2008 [Online]available: <http://trendsniiff.com/2008/09/21/china-zhejiang-wenzhou-underground-lending-sees-the-sun>

9 "China's Zhejiang, Wenzhou: Underground Lending Sees the Sun" September 21st, 2008 [Online]available: <http://trendsniiff.com/2008/09/21/china-zhejiang-wenzhou-underground-lending-sees-the-sun/>

became popular in Wenzhou. For example, there were 97 enterprises in Qianku Town among which 82 were joint-stock cooperative enterprises, reaching a rate of 84.5 percent (see table 3.8).

Table 3.8 indicates that the rates of joint-stock cooperative enterprises, whose annual sales were above RMB 5 million, were from 1998 to 2000 12.5 percent, 11.6 percent and 15.5 percent respectively. The rate of stock cooperative enterprises reached 8.4 percent in 2000, and no private enterprises' annual sales were above RMB 5 million in these three years. And among the enterprises with less than RMB 5 million, the rates of joint-stock cooperative enterprises increased from 20.9 percent in 1998 to 25.3 percent in 1999 and it reached 24.9 percent in 2000. The fraction of individual businessmen diminished from 33.5 percent in 1998 to 29.4 percent in 2000.

Table 3.8 The Structure of Various Ownerships in Wenzhou in 2001 (%)

Items	1998 (Year)	1999 (Year)	2000 (Year)
Gross Industrial Product (GDP)	100	100	100
Annual Sales above 5 Million RMB	30.7	29.1	34.6
State-owned enterprises	3.9	3.4	2.8
Collective enterprises	4.2	3.1	1.8
Joint-stock cooperative enterprises	12.5	11.6	15.5
Stock enterprise	5.5	7.7	8.4
Others	4.6	3.3	6.1
Foreign Enterprises (Including Hong Kong, Macau and Taiwan)	3.3	3.2	4.0
Annual Sales below 5 Million RMB	69.3	70.9	65.4
Collective enterprises	7.9	6.6	3.3
Joint-stock cooperative enterprises	20.9	25.3	24.9
Private enterprises	6.1	7.0	5.5
Individual businessman	33.5	29.7	29.4
Others	0.9	2.3	2.3

Source: "Wenzhou Tongji Nianjian 2001" (Wenzhou annual statistic 2001) in ZHANG Miaoying p.63

The joint-stock cooperative ownership was a new economic organization in Wenzhou in the 1990s. Their collected private capital could be invested in high-tech and partners' professional knowledge and skills could be better used to form a competitive team (ZHANG Miaoying 2007, p.63). In a joint-stock cooperative enterprise, the board of directors was responsible for the business management and the shareholders were not allowed to participate in any decision-making.

3.8.3 Local Business Associations in Wenzhou

The establishment of business associations was an institutional innovation in Wenzhou. It included a power shift which meant that the business community did not want any intervention from either the central or municipal government; they made decisions by themselves. The establishment of their industry clusters and quality control institutions were also among such decisions. This section discusses the development of local business associations.

In the early 1990s, business associations in Wenzhou concentrated on self-regulation and local quality supervision. In 1994, a series of quality targets were set up in Wenzhou. In 1994, the Wenzhou municipal government passed its first local quality improvement regulation, Wenzhou Measures of Quality. It set up three-year, five-year and eight-year quality targets for the whole city, such as the percentage of qualified sampled products, the number of firms passing the International Organization for Standardization (ISO) 9000¹⁰ inspection and the percentage of firms with proper quality inspection facilities (ZHANG Yue, 2005). In October 1996, the Yongjia Qiaotou Button Association was founded in Yongjia County and legitimized its rights and interests to protect the innovations and patents of new products. Members of the association had to obey the regulations. With the purpose of improving the quality of the low-voltage electrical components, Wenzhou municipal government began to issue production permission certificates to only those, who could produce qualified products. The industry standard was drafted by the business associations and the inspection was conducted by the local Chamber of Industry and Commerce, so the qualified products would be more able to start production sooner. In June 1988 China's first regional industry association, the Lucheng Shoe Association was established in Lucheng city. This association combined over 370 shoe factories (Interview P 4). In November 1988, two other civil organizations, such as Wenzhou Food Association and the Department Stores Association were founded in Wenzhou. Ten years later in 1998, the number of established associations had risen to 18, including associations for furniture, lighters,

¹⁰ The **ISO 9000** family of standards are related to quality management systems and designed to help organizations ensure that they meet the needs of customers and other stakeholders. The standards are published by ISO, the International Organization for Standardization, and available through National standards bodies while meeting statutory and regulatory requirements. ISO 9000 deals with the fundamentals of quality management systems,[2] including the eight management principles on which the family of standards is based. ISO 9001 deals with the requirements that organizations wishing to meet the standard have to fulfill. http://en.wikipedia.org/wiki/ISO_9000

shoes, garment, glasses, metal, transport, textile, etc. There were many other local business associations for buttons, medicine, electrical appliances, ceramics, toys, zippers, etc. were scattered in the surrounding Wenzhou counties (Ye 2008, p268).

All of these efforts prevented local firms from imitating each other and competing by slashing prices. Nevertheless, these improvements were related to technical innovation, which could not be promoted simply by administrative methods or policies from business associations; it needed the large scale cooperation of the municipal government, private enterprises and the business associations (ibid.)

3.8.4 Reducing Legal Discrimination: the Government Policy after 1990

In 1992 DENG Xiaoping made a speech during his inspection of the southern parts of China. DENG Xiaoping's speech and all the decisions from the central government sent a strong message to those private business owners that their economic activities would be encouraged and protected by the state. Then in September 1997 the 15th Congress of the Chinese Communist Party (CCP) decided to reduce legal discrimination against non-state and non-collective forms of ownership. It passed resolutions to privatize much of the state-owned sector and to increase the economic opportunities to the outside world (Woo 1999, p.115). This was a declaration from and for the general public, key opinion leaders and government officials that the private enterprise would be protected against discrimination. The development of the private industry and its industrialization is the key to Wenzhou's economic transformation. The government policy after 1990 contributed to the transformation in Wenzhou.

3.9 Conclusion:

The Wenzhou classical business model, which is constructed on the basis of household industry together with the assistance of international markets, is a good organizational structure with which to use its comparative advantage. It might be described briefly as a combination of three factors: intuitive opportunities recognition, social capital as informal institutions and local preferential policies. The spirit of grass-roots entrepreneurship was manifested in the rapid growth of private household industries. On entering the 1990s, the evolution of Wenzhou industries

was mainly characterized by the emergence of a more specialized cluster structure based on the family owned small businesses. Wenzhou serves as China's outstanding example of successful entrepreneurial regions financed by household level initiatives toward international marketing. Contributive factors include the active impact of Yongjia culture on the spirit of entrepreneurship, as well as using informal institutions to adapt to the institutional environment in Wenzhou. Chinese economic reform started from the bottom up. The government was not able to legitimize grass-roots entrepreneurial activities simultaneously. In this situation, the entrepreneurial rural firms in Wenzhou played an important role to stimulate the transformation of political environment. As an organization, entrepreneurs managed the uncertainty and information asymmetry inherent in the exploitation of an opportunity created by the effective Wenzhou classical model in the 1980s. The activities trust and personal networks act as cohesive elements which enables economic exchange to proceed smoothly. For instance, the local cadres' protection of private ownership, as well as the decentralization of power made Wenzhou a pioneer in political institutional reform, reducing legal discrimination.

However, to some extent social capital constrained the innovation and entrepreneurship development in Wenzhou, such as the traditional trust system and the out-dated management, which became obstacles in retaining experts in the family-owned companies. Hence experienced managers with competencies in the fields of high-technology were rare.

After decades of entrepreneurship development, the on-going reform of rural finance indicated the institutions still as barriers for rural entrepreneurship in contemporary Wenzhou. Wenzhou should strengthen the following construction. For instance, a key barrier to the development of the Wenzhou entrepreneurship was the bottleneck of venture capital on a local scale. This did not only mean that the financing opportunities were rare from the banks, such as the State Bank and the Commercial Bank. It also points to a lack of functions, which are usually fulfilled by venture capital firms. These include the selection of promising technologies and ventures, provision of support for the formation of management teams, the monitoring of the development of the young firms and the establishment of contacts.

CHAPTER FOUR: the DEVELOPMENT OF RURAL ENTREPRENEURSHIP IN SUNAN

“Generally speaking, our rural reforms have proceeded very fast, and farmers have been enthusiastic. What took us by surprise completely was the development of township and village industries....This is not the achievement of our Central government. Every year, township and village industries achieved 20 percent growth....This was not something I had thought about. Nor had the other comrades. This surprised us.”

___ Deng Xiaoping in 1985 ¹¹

Mr. DENG Xiaoping’s speech indicates that township and village enterprises (TVEs) had risen spontaneously during the rural reform in the late 1970s. Sunan is located on the Yangtze River Delta, and it has been one of the most dynamic economies in China. The success is credited to local state corporatism and development from below (MA and FAN 1994, p.1625; OI 1995, p. 1132). Since the early 1990s, the Sunan model met with great challenges and the orthodox Sunan model, which centered on the development of TVEs, became inadequate to account for the further development and restructuring. So Sunan proceeded to the “New Sunan Model” through privatization and the infusion of global capital (White, 1997). Some researchers discussed the problems caused by the mechanisms, some academic articles analyzed the transformation of the Sunan model, some compared the Sunan culture and Wenzhou culture, and some debates have been intensified in the context of heightened globalization and regional competition (Pike, 2006).

Although the institutional environment has changed in Sunan since the early 1990s, little analysis has been made on the Sunan models’ transformation in the interaction between institutions, the role of social capital and the development of TVEs. There has been little research made on the connection between institutional environment and organizational learning. Little attempt seems to have been made discussing the social capital, which includes regional cultures as a whole, and its impact on the business model construction. This section first introduces the institutional environment in Sunan, and then analyzes the underlying factors which led to the rising and decline of TVEs in Sunan. Finally it discusses the new business model’s construction. This part attempts to advance the research on the organizational

¹¹ http://www.cass.net.cn/zhuanti/y_party/yd/yd_j/yd_j_101.htm

experience to explain the innovation and change of routines, with a particular focus on problem-solving activities in such a transformation.

4.1 Geography, Natural Resources and the Economic Background in Sunan

Sunan is located in the south of the Jiangsu Province, which is a developed region on the east coast of China. At the beginning of the economic reform in 1978, the Sunan area included only three cities: Suzhou, Wuxi and Changzhou. In the 1980s the industrial districts of Sunan extended to seven cities (see Map 4.1). Sunan lies to the west of Shanghai and shares the “Wu” dialect with Shanghai. Zhejiang Province is located at the south of Sunan (Wenzhou is located in Zhejiang Province). By the Taihu Lake on the Yangtze River Delta, Sunan enjoys well-developed transportation networks within China. Historically, Sunan was well-known for its natural resources and the traditional Wu culture. Suzhou Municipality, as the prototype of the Sunan model,¹² owns 4,488 square kilometers of territory. About 10 percent is cultivated farmland, 30 percent hilly land, and the rest is covered by waters with numerous rivers, lakes and canals. In the Ming and Qing dynasties (1368 AD-1911 AD), Suzhou expanded its modern handicraft industries to include silk, textile, national musical instruments, jade carving, and food processing. Together with Hongzhou (the capital of Zhejiang Province), it formed the Su (Suzhou)-Hang (Hongzhou), named “paradise on earth”.

Map 4.1 shows the location of Sunan district in the Jiangsu Province in the 1980s, the district in green color shows the Sunan location in 1978, which includes Suzhou, Wuxi and Changzhou. The district in yellow indicates the extended location of Sunan in the 1980s. Sunan includes Suzhou, Wuxi, Changzhou, Yangzhou, Zhenjiang, Nanjing and Nantong.

Besides the favorable location (near Shanghai and other developed provinces), rich resources and skillful technology in handicraft industry, Sunan businessmen and scholars gave priority to industries influenced by the Western industrial revolution. In the Qing dynasty, metallurgy industries and textile mills appeared in Sunan and Sunan’s worldwide business network was considered to be a pioneer of the earliest national industry.

¹²The municipality consists of Suzhou City and six counties and county-level cities that Suzhou City administrates, including Kunshan and Taicang bordering Shanghai.



Map 4.1 The location of Sunan District in Jiangsu Province in the 1980s

4.2 Evolution of the Sunan Model

FEI Xiaotong was a Chinese economist and sociologist. He researched the Sunan Model and concluded in the 1980s that:

“At the very beginning of these enterprises, they were not called village and town industries but commune and production team enterprises... Actually, every commune and every village was an economic enterprise... Big collectives were still managed by local governments, and for a long time there was no separation between enterprises and local governments.” (White 1997, p.118).

TVEs blossomed in Sunan, creating a successful path of development known as the Sunan Model. In reference to Mr. FEI Xiaotong's argument, this study analyzes the trajectories of Sunan's model in four stages; the first stage is from the late 1950s to the mid-1970s; the second is from the late 1970s to the mid-1980s; and the third, from the late 1980s to the late 1990s (Fei, 1983). At the beginning of the 21st century the Sunan model entered into the fourth stage.

4.2.1 Local Socialist Rural Industry in the 1950s and the 1960s

During the Great Leap Forward in 1958, the Jiangsu provincial government announced that every town (commune) should open 15 to 25 small factories within three to five years. Many small-scale private enterprises in Sunan were transformed into collectively owned enterprises. However the economic depression of the early 1960s led to a retrenchment campaign, during which the government closed about half of the rural factories. In 1961 over 5,000 rural factories were closed in Jiangsu province. During the next ten years the founding of rural industry was prohibited. However, not all such factories were closed in the Jiangsu Province and many of the surviving firms remained small or under-reported for a decade.

The collective ownership serves as a mechanism to reduce transaction costs; hence the TVEs rose quickly, supported by the centralized endowment power in the 1970s. Wuxi County and Tangqiao Town are two cases of start-up TVEs.

4.2.2 Collective Enterprises Rising in Wuxi County and Tangqiao Town in the Initial Stage of the Sunan Model

In the 1970s, collective enterprises increased in Sunan. This is regarded as the initial stage of the Sunan model. Tangqiao Town and Wuxi County are two cases on analyzing how the enterprises started.

Tangqiao Town (Commune) lies near Suzhou city. In the Great Leap Forward some firms were founded in the village in Tangqiao. From 1960 to 1970 to run an enterprise in rural areas was considered to be peasant capitalism by the leading radicals of the day. The village (brigade)-run enterprises in Tangqiao were closed in 1962, but were later resumed in 1970 (White 1997, p.114). Why did the Tangqiao municipal government ignore directives from the central government and resume their village operated enterprises?

Firstly, as Tangqiao's agriculture had reached the limits of its productiveness under the technology available at that time, the only way for peasant leaders to increase their incomes was to set up town and village factories. Secondly, since the first power plant was set up in Tangqiao in 1971, many village-run enterprises were

founded within the next three years. Such as a cardboard box manufactory, several metalwork shops, and an animal feed processing factory. Some of the village-run enterprises proved to be very profitable. The village's industrial products quickly made Tangqiao rich, earlier than other towns. Hence Tangqiao municipal government had a good reason to support village-operated enterprises when they resumed at the beginning of the 1970s. Thirdly, these unique technical conditions favored Sunan's development at the beginning of the economic reform in the late 1970s. After that, the Sunan business model gradually reached its peak over the next few years.

Wuxi County is located in the south part of Jiangsu, between Suzhou city and Changzhou city (See map 4.1). The beginning of Wuxi's rural industry dates back to the early 1970s. Many enterprises were established and most of them were licensed at the village (brigade) level. Later they became a cooperative, run by townships and villages (TVEs). Nearly four-fifths of Wuxi County's 1,600 rural factories in 1974 were managed by or authorized by villages. An indication of the growth of the decentralized industry in Wuxi County was the increasing percentage of rural output from brigades and communes. Between 1970 and 1977, the rate of industry growth in Wuxi soared from 23 to 64 percent (Frank, 1997).

4.2.3 Rapid Growth of the Township and Village Enterprises in Sunan Rural Areas in the late 1970s to the mid-1980s

From the late 1970s to the mid-1980s, Sunan TVEs began to enter a stage of rapid growth. In 1978 Sunan rural areas owned a huge number of 18,511 TVEs employing 890,000 and paid taxes of RMB 170 million to the state. In 1985 the number of TVEs increased to 28,969 and employed 2.28 million. Taxes paid by the TVEs amounted to RMB1.17 billion. The TVEs absorbed 40 percent of the surplus labor force in Sunan's rural areas (HU 1987, P. 26).

The portion of total non-state output, which was from rural communes, brigades and teams in Jiangsu's Wuxi County, rose very sharply after 1970. It was just 23 percent in 1974; but in 1977, it had increased to 64 percent (Frank 1997, p.115). The ownership type that was booming was the collectives and not the state or privately owned. In 1974, 1,212 new rural factories were founded in Wuxi County. TVEs in

Tangqiao in the 1980s are an interesting case to study.

4.2.3.1 Case study: Township and Village Enterprises in Tangqiao Town in the 1980s

Table 4. 1 The Industrialization in Tangqiao Town (1967-1985) and Jiangsu (1970-1985)

(Gross value of industrial product, percentage growths: rural industrial product in Jiangsu total gross output, and growth in that ratio)

	Tangqiao Commune /Township (thou.yuan)	Tangqiao Product percent change	Jiangsu (r.i./total prod.,percent)	Jiangsu Product percent change
1967	146			
1968	169	16		
1969	210	24		
1970	391	81	7	
1971	1,038	165	8	14
1972	1,611	155	9	13
1973	2,380	148	10	11
1974	2,910	122	12	20
1975	3,736	128	16	33
1976	5,299	142	21	31
1977	10,031	189	31	48
1978	17,025	170	31	0
1979	24,788	146	33	6
1980	42,727	172	43	30
1981	61,099	143	44	2
1982	66,100	108	42	-5
1983	91,916	139	46	10
1984	129,630	141	49	7
1985	204,270	156	58	18

Sources: Rounded from figures in Xu Yuanming and Ye Ding, *Tangqiao gongye hua zhilu* (The way to Industrialization in Tangqiao) (Shanghai: Shanghai Shehui Kexue Yuan Chuban She, 1987), p.61, and *Jiangsu xiangzhen gongye fazhan shi* (History of the Development of Jiangsu Rural Industry), Mo Yuanren, ed (Nanjing: Nanjing Gongxue Yuan Chuban She, 1987), pp.321-22 and 402. Cite in Lynn T. White, III (1997)

As discussed above in §4.2.2, the case of Tangqiao indicates that TVEs in some districts in Sunan started in the early 1970s, earlier than in other parts of China. And the town cadres ran a certain political risk by setting up industrial offices in the early 1970s. Take Tangqiao as an example, the reported number of factories at Tangqiao doubled from 1976 to 1978. Nearly half of the TVEs in Tangqiao had been founded before the Third Plenum of 1978. One-third was established in the years

1970-72; and most of the others were “post-leap” plants (White 1997, p.116). In the mid-1980s, TVEs gained great achievements in the form of the so-called Sunan model. Table 4.1 shows the rural industrialization in Tangqiao Town (1967-1985) and in all of the Jiangsu Province (1970-1985) (ibid.). In order to improve the management, many of the rural factories in Tangqiao switched to new managers. Local leaders who had established or reopened factories were replaced by new, more technically oriented cadres. In order to seek new markets for local production, by the beginning of 1982 Tangqiao factories were sending out a “comprehensive sales team” to tour more than ten provinces in search of buyers (ibid., p.115). The townships established 90 “sales points” in various Chinese cities, including some that were not heavily served by producers of competing products. Table 4.1 compares the rural industrial total gross output in Tangqiao from 1967-1985 and Sunan in the period from 1970-1985 (because Tangqiao developed nearly three years ahead than other Jiangsu’s counties).

Tangqiao Town enjoyed a huge leap of industrial growth in 1971 followed by continued growth throughout the later reform years. This indicates that the TVEs in Tangqiao started much earlier than in other places in Jiangsu. Nevertheless industrialization spread out to other parts of the south of the Jiangsu Province (Interview P 7). After 1974 the rate of TVEs’ total annual gross output of industry increased rapidly from 16 percent in 1975 to 58 percent in 1985.

4.2.3.2 Spatial Industry between Sunan and Shanghai

During the 1980s, Shanghai faced a tough challenge from SEZs and other coastal cities that enjoyed more favorable reform policies. Because of tight control by the central government, it faced problems, such as shortages of raw material and energy, lack of space for expansion, and fiscal difficulties. The shortage of materials in Shanghai in 1985 is shown in Table 4.2. Since 1980 especially, there have been many domestic “joint venture factories” between Shanghai and its suburban rural districts, especially in southern Jiangsu (ibid., P.360). The first kind of cooperation between Shanghai and Sunan was usually technical cooperation. The second was aimed at providing raw materials for the city’s factories. More than fifty kinds of inputs were involved, including coal, cement, iron, pig iron, nonferrous metals, and many other materials for light and chemical industries (Shanghai Jingji Nianjian,

1988, p.142). Shanghai enterprises organized compensation trade with inland localities below the provincial level. Under these plans, firms in the city exchanged money and technical expertise for factories or for out-sourcing certain production processes. The third kind of cooperation was based on the market value of Shanghai brands while the fourth kind involved professional liaisons. Sunan cities, less than two hours away by train from Shanghai, could tap the talents of Shanghai engineers while providing lower taxes and more managerial freedom.

From the beginning of 1981, the Shanghai Light Industrial Machine Company's sixteen factories established twenty-two plants in Wuxi, Wujin (a suburb of Changzhou), Shazhou (in Suzhou prefecture near the new foreign-trade harbor of Zhangjiagang), and elsewhere on the Shanghai delta. Between 1979 and 1984, this Shanghai based company increased its output by 44 percent. Its joint projects with factories in Suzhou created a 23 percent increase in just one year. Many Shanghai companies moved their activities only to the nearby suburbs. In the mid-1980s, Suzhou cadres reported that 80 percent of the firms in their city had Shanghai connections for raw materials or marketing. Sunan had many production lines for Shanghai (see Table 4.2)

Table 4.2 The Shortage of Materials in Shanghai in 1985

	Requirements (Millions of metric tons)	Planned allocation (%)	Shortage (%)
Cement	3.50	51	49
Steel	2.43	60	40
Lumber	1.50	60	40
Ferrous metals	0.21	69	31
Chemical inputs	3.04	76	24

Note and Source: The cement allocation includes both central and local planned deliveries; apparently the other materials were all centrally regulated. Tabulated from narrative material in Shanghai Jingji (Shanghai Economy), January 1985, p.3; percentages are calculated. "Requirements" may be somewhat overstated by managers, but the degrees of shortages reported in the mid-1980s clearly show the economic problems. Cite in Lynn T. White, III (1997)

Machinery, capital and licenses were supplied by Shanghai and were sometimes moved physically from plants in the cities (Interview P8). Many joint ventures reduced the bulk or weight of partially finished products that were later shipped to Shanghai for final processing. Three-quarters of the value of Suzhou's production was made or sold under arrangements with firms in Shanghai (White 1997, p.360).

Based on the close economic relationship between Shanghai and Sunan, two printing machine plants in Shanghai combined activities with Wuxi in 1981. The press they co-produced was a market success, so another Shanghai plant in the same line soon set up similar arrangements with a factory in Changzhou (see Map 4.1). By 1984, a total of 159 companies had been established on a joint basis between city firms and those in the suburbs, and nine-tenths were producing light industrial consumer products (*ibid.*). After 1984, and especially in 1986, Shanghai's trade with both Jiangsu and Zhejiang increased at the speed of 40 to 60 percent per year (*ibid.*, P.382). In 1984, Changzhou developed certain kinds of cloth and machines while Shanghai was expected to contribute technical expertise and some capital as well as designs and personnel.

4.2.3.3 Foreign Joint Ventures in Sunan after the 1990s

TVEs developed in Sunan as a result of the local educated labor force, government policies, proximity to Shanghai and social networks. This prompted foreign investors to concentrate their capital in some coastal cities in Sunan. Many FDI (Foreign Direct Investment) and FEI (Foreign Enterprise Investment) appeared in Sunan (Interview P.5).

As mentioned above, Sunan developed FDIs early in the 1980s. In 1985 all cities and counties in Sunan became open areas. These local governments obtained preferential policies for the approval of investment projects, tax relief for using foreign capital, tariff reductions on imports, and the retaining of exchange earnings (Wei, 2002). For instance, since a new leadership emerged in 1984 in Kunshan, its leaders have emphasized industrial growth and the use of foreign capital. This represents an obvious difference whereby before the emphasis had been on agriculture. In 1984 Swan (a Japanese company) was the first foreign enterprise to be established. The success of attracting foreign and domestic investment opened a new way forward for Kunshan. In the mid-1980s, Kunshan's economy grew rapidly and became one of the richest counties or county-level cities in China. In 1997 a group of well-known foreign companies had invested in Kunshan, including DuPont (United States), Mitsubishi (Japan), Toyota (Japan), and Alcatel (France) (Interview P7). From the mid-1990s Taiwan replaced Hong Kong to become the largest source of investment in Kunshan. Other important sources included the United States, Japan and

Singapore. In 1998 Kunshan was ranked the first among counties in Jiangsu for attracting FDIs (US \$ 500 million). FDI investments reached US \$505 million in 1995 and US \$ 1.44 billion in 2007, and was ranked first among the counties of Jiangsu (KSB, 2008). The employment numbers in the FDIs began to rise after 1995, in particular in the FDIs of Taiwan, HK and Macau. The accumulated FDI was US \$13.13 billion; globally 500 TNCs (Transnational corporations) have invested in fifty-five projects in Kunshan, and FIEs' industrial output accounted for 89.6 percent of the total industrial output in 2007. With regard to production fields, the FIEs are primarily in the manufacturing of electronic parts and components, information and communication technology, and the manufacturing of computer equipment.

In 1995, 72.1 percent of FDI in Jiangsu was concentrated in Sunan, with Suzhou Municipality alone attracting 48.7 percent of FDI. China's largest single industrial park is the Singapore Industrial Park, which was founded in Suzhou with strong support from the central governments of China and Singapore. Kunshan, Taichang, Wujiang, Wuxian and Zhangjiagang are six important counties in terms of rural entrepreneurship in Sunan. These counties developed in different ways. Table 4.3 compares the factors in the six counties in Suzhou.

Table 4.3 Factors Comparison of Counties in Suzhou Municipality (Prefecture)

Indicator	Kunshan	Changshu	Taichang	Wujiang	Wuxian	Zhangjiagang
Agriculture output as % of GVIAO in 1977	61.6	44.8	56.5	54.8	52.4	55.7
Rural industrial output in 1983 (million yuan)	331	1030	508	604	724	883
FDI in 1997 (US \$ million)	529	181	180	150	173	454
Exports in 1997 (US \$ million)	1076	645	400	343	461	800
FIE employment in 1999 (thousand)	107.1	61.7	36.1	33.8	15.9	62.6

Source: JSB ("Benxiang Xiandaihua Licheng" [Pathways towards modernization] Jiangsu Statistical Bureau, Nanjing 1994b, 1998; SSB (Suzhou Tongji Nianjian [Jiangsu Statistic Yearbook] Suzhou Statistic Bureau, China Statistic Press), 2000

GVIAO: gross value of industrial and agricultural output; FDI: foreign direct investment; FIE: foreign invested enterprise. Cited in Yehua Dennis Wei "Beyond the Sunan Model: Trajectory and Underlying Factors of Development in Kunshan, China" *Environment and Planning A* 2002, volume 34, pages 1725-1747. p.1730

Most of the mentioned counties like Kunshan and Zhangjiagang relied mainly on the

TVEs and FDIs, plus foreign-invested enterprises (FIEs). Changshu's TVEs output ranked high on the list in 1983, but the FDI in Changshu developed slowly. In 1997 FIEs controlled 9.72 billion RMB in fixed assets, which accounted for 69.1 percent of the total fixed assets in Kunshan (Kunshan Statistical Bureau 1998b, p.529). Foreign investors provided 58.7 percent of the investment in municipal owned enterprises. In 1999 Kunshan had 107,118 people employed in FIEs. The multiple effects of FDI also provided jobs and income opportunities for local enterprises that had developed production relations with FIEs.

4.2.4 The Decline of Township and Village Enterprises in Jiangsu Province in the 1990s

As mentioned above, in the 1980s the number of cities in Sunan extended to seven. By 1985 the rural industry's share of gross output value in Sunan was at least one-third of all industrial output there. The portion in Wuxi was 34 percent; Changzhou, 22 percent; and Nantong, 30 percent (White 1997, p.141). Table 4.4 shows the growth of rural industries from 1978 to 1987.

Table 4.4 The Growth of Rural Industries (1978 – 1987)

(I ---township and village enterprises; II--- other peasants' enterprises)

Year	Number of enterprises (millions)		Employment (millions)		Gross Product Value	
	I	II	I	II	I	II
1978	1.50		28			
1980	1.42		30		65.7	
1981	1.34		30		72.9	
1982	1.36		31		85.3	
1983	1.35		32		101.7	
1984	1.65	4.41	38	14	143.3	27.6
1985	1,57	10.65	42	28	198.8	74.4
1986	1.51	13.63	44	35	251.6	102.4
1987	1.58	15.87	47	41	322.1	152.2

Source: Almanac of China's Economy (1985), pp.V: 19-20, (1986) pp. V: 42-43, (1988) pp. V: 14-15; K. Griffin ed. Institutional Reform, Table 6.1, p.212 Cite in Lynn T. White, III (1997)

The local development conditions are crucial to the successful implementation of local development initiatives. Many opportunities were opened up to Sunan's TVEs during China's transformation from a planned economy to a market economy in the 1970s and the 1980s. By 1985, TVEs produced 48.8 percent of the industrial output

in the Suzhou municipality. As a result of the TVE sector's fast growth, the non-state sector's share of industrial output increased from 22 percent in 1978 to 47 percent in 1991, while the state sector's share declined from 78 percent to 53 percent in the same period. On the Mainland the TVE development reached its peak in the mid-1990s. The growth rate of total factor productivity of TVEs was about ten times that of state enterprises. TVE's share of gross domestic product increased from 14.3 percent in 1980 to 37.5 percent in 1995. In Jiangsu Province the TVE was the major engine of Jiangsu's industrialization and growth in the early stages of economic reform.

Table 4. 5 the GDP by Ownership in Selected Years (in billion yuan)

	Total	SOE	TVEs	Private enterprises
1980	15.1	8.7	4.6	
1985	30.8	12.7	12.9	1.2
1990	63.4	21.8	27.9	4.2
1995	246.8	53.0	147.4	17.7
2000	384.9	84.1	112.8	131.4

Source: Adapted by author from WU Ho-mou and YAO Yang "Reform and Development in China" p.166

However, after reaching a peak in the mid-1990s, the old Sunan model reached a turning point. There was a dramatic decline in TVEs output growth rates. Simultaneously there was a sharp decline in employment in the TVEs in Jiangsu. The number of TVEs in Sunan declined rapidly, falling at the rate of 14 percent annually (see Table 4.5). The change in Jiangsu Province in the late 1990s is particularly dramatic in that TVE employment declined by more than half and TVE output declined by about one-quarter (see Table 4.6).

Table 4.6 Employment by Ownership in Selected Years in Jiangsu Province (in thousands)

Year	Total	SOE	FDI	Taiwan, HK, Macau	TVEs	Private Enterprises
1980	2,821.0	402.0			388.6	
1985	3,263.0	468.8			627.1	114.8
1990	4,225.0	536.9			672.9	223.2
1995	4,385.2	576.2	18.0	19.3	668.4	256.3
2000	4,418.1	411.4	31.4	20.0	295.5	560.2

Source: China Township and Village Enterprise Statistical Materials, 1978-2002 (TVES/MOA 2003)
Adapted by author from WU Ho-mou and YAO Yang "Reform and Development in China" p.165

What caused the TVEs rise in Sunan in the 1980s, and why did the Sunan model

suffer a sudden downturn? The next part analyzes the institutional environment in Sunan with respect to success factors and barriers from the 1980s to the 1990s.

4.3 Analysis on the Success of the Township and Village Enterprises in Sunan in the 1980s

4.3.1 Analyzing beneficial Conditions for Identifying Opportunities in Sunan in the 1980s

Due to the local protection and the relative autonomy which Sunan enjoyed, the wealth of the population increased. Profits stayed within the community and wasn't taken away by the central government or arbitrary. The TVEs' "take-off" stage happened to coincide with a period when people's incomes were rapidly increasing but their demands had not upgraded to higher quality products. TVEs' cheap products catered to market needs. The following conditions also attributed to Sunan's development.

Firstly, the shortage of light industrial products provided a huge opportunity for entrepreneurship development in rural household industries, as mentioned in chapter three. Wenzhou peasant entrepreneurs grasped the opportunities and "started up" earlier than those of Sunan. Since the First Five-year Plan, SOEs had been developed primarily to serve the goal of a heavy-industry-oriented development strategy. Before 1978, almost half of the investment in fixed assets had been spent on heavy industries and less than 6 percent on light industries. This caused a severe shortage of light industrial products. Consequently, the growth of non-planned production and trade occurred at local levels which were not generally regarded as private economic activities in the Mao era. As a result, in the early 1970s, China's rural commune and bridge industries developed into a sizeable non-planned sector (Wu 1986, p.15). The Sunan local government grasped the opportunities to create miracles in the 1980s.

Secondly, there was a gap left in China's economic industrial structure. During most of the years of the Cultural Revolution, the damage to the planning apparatus and the country's tendency toward geographic anarchy prevailed and left China's economy in a semi-planned and semi-anarchistic state. The abolition of the Ministry of Allocation of Materials and the localization of many enterprises left a vacancy of

central control for the allocation of raw materials and capital goods (Xue 1979, p.108). Large industrial cities like Shanghai, which formerly relied upon central authorities to allocate the supply of raw materials from major steel and mining industrial areas, now found themselves left in the position of having to search for these supplies on their own (ibid., p.368). To fulfill the need that was not satisfied by the centrally planned supply channels, many production units exchanged their products or materials to trade with other units without the approval of their superiors. The development of this quasi-market allocation of materials and capital equipment had a significant impact on the underground private economy. This development created elementary markets within the national planned economy and provided potential opportunities for entrepreneurial ventures. The non-planned production and trade became the basis for an underground private economy (Lu 1994, p.84).

Thirdly, China is a market with drastic geographical differences in development conditions, therefore Sunan development strategies of relying on spatial conditions attributes to its success. Shanghai was part of Jiangsu in imperial times. Shanghai has many advantages as a big city in China, such as a high research level with famous universities and institutions, advanced technology and management, a rich experience of international and domestic trade, and large networks with top talents. Sunan counties located near Shanghai and other developed provinces had the advantage of sharing the same Wu (Shanghainese) dialects and culture because Sunan and Shanghai can be regarded as a natural unit. There were many domestic joint ventures with “Horizontal Relations” built between Shanghai and Sunan. (Interview P7 and P8) Technologists and managers from Shanghai were invited to supervise Sunan TVEs’ production and management. The close relationship with big SOEs in Shanghai supported these collective rural enterprises to find good markets in the restricted market situation before economic reform.

Fourthly, Sunan had enough labor force. Rural industry transformed the occupational structure of Sunan, as first local and then migrant peasants joined the labor force. At Shazhou (Suzhou prefecture), processing factories and field machine repair shops employed thousands of people. This was a truly rural area at that time, and few migrants had arrived until then. More than 95 percent of Shazhou adults still spent at least some time in working in the fields. By 1978, the area had 314 rural enterprises, mostly factories under agricultural units, in which 10 percent of these “peasants”

worked full-time and a larger number part-time. Change continued quickly over the next five years. By 1982 rural factories almost tripled in number and industrial workers made up 39 percent of the Shazhou rural labor force (White 1997, p.138).

Fifthly, regarding reasons for investing in Sunan, some important factors such as local policies and infrastructure, labor, supplies, location and market access influenced enterprises to make a location decision. Among them labor supply, market potential and firm agglomeration were at the top of the list of factors. The investment incentives and infrastructure were regarded as important factors together with other issues, such as the industrial infrastructure, land usage and major customers were considered as preferential conditions in Sunan. State policies played a more important role in the specific location choices within the city. The clustering of Taiwanese firms in Kunshan drew more investment from Taiwan (Interview P7).

4.3.2 The Structure of Sunan Local Rural Authority

When private enterprises were still prohibited, Sunan TVEs, as a collective mechanism (semi-state) market-oriented form of ownership became dominant in the rural sector. In 1970 industry's portion of rural Jiangsu output value was 13 percent; it had soared to 40 percent by 1976 (Frank, 1997). Why did rural industries in Sunan resume in the collective ownership? What is the power behind the prosperity of TVEs in the 1980s? The next section analyzes the leadership structure in rural administration.

Table 4.7 shows the leadership structures and organizations at three levels from bottom up in a local community: village, township and county.

Table 4.7 indicates that each level is in itself a corporate entity, including the leading cadres, economic commission and other agencies. The authority has three levels of hierarchy, such as county, town and village, which are intimately connected with each other. The lower levels turn over to the higher levels a portion of their revenues. Between the three levels, hierarchy involves constraints and obligations from the higher level to the lower level. The county is the highest authority above the levels of townships and villages. The local communist party secretary plays a key role in economic decision making in the local corporate state. The party leadership is at the

top of the power hierarchy, the economic commissions are comprised mostly of party members. This hierarchy of power originated from the local socialist rural industry in the 1950s to 1960s.

Table 4. 7 Three Levels of the Local Administration in Sunan

	County	Township	Village
Leading	Party secretary	Party secretary	Party secretary
Cadres	County magistrate	Township head	Village committee Chairman
	Party vice secretaries	Township party vice secretaries	
	General office director		
Key	Bank		
Economic Commissions and Agency	Economic Commission	Auditing office	Enterprise management Committee director (not in all villages)
	Finance bureau	Economic commission	
	Industrial-commercial Management bureau	Finance office	
	Planning commission	Grain station	Village committee
	Rural enterprise management bureau	Industrial-commercial Management office	
	Tax bureau	Tax office	
	Other Agency	Administrative control bureau	Agricultural technology station
	Archives bureau	Health station	
	Audit bureau	Land management Station	
	Bureau of appeals	Rural economic work management station	
	Bureau of mines		
	Civil administration bureau		
	County research bureau	Security station	

Source: Personal and telephone interviews P7,P12,P8, and adapted from Jean C. Oi (1999) "Rural China Takes off-Institutional foundations of Economic Reform" University of California Press p.100

The success of highly industrialized townships and villages brought privileges and other rewards to the county leaders, with more leverage to be "innovative" in their implementation of rules and regulations. The leaders of the county could be promoted to higher positions. Many important agencies were established only at the county level, such as the district division office, bank, land management bureau,

personal bureau, justice bureau and labor bureau (Oi 1999, p.99).

4.3.3 The Value of Asset Endowments under the type of Collective Ownership

Sunan rural areas were controlled by the central political power. In Sunan the estate and resources belonged to village communes and the government, the party and local government had more power in the management of TVEs. The local government at county, township, and village levels used their authority and administrative resources to foster the development of local enterprises. As mentioned above, in Sunan the county leaders had more rewards when the TVEs in the county were successful. Xu Jiatun was an important administrator in Jiangsu during the early 1970s. Xu expressed pride in Jiangsu's progress during the early 1970s:

“...we took a road different from the rest of the country, the planned economy was crucial, and the market economy was a supplement. We openly supported this, but in fact we had gone beyond it.” (White 1997, p.119)

Under the hierarchy of power from the system of collective ownership, TVEs had almost no risks but lots of opportunities (which private enterprises did not have) to increase the value of their asset endowments, like seed capital, cheap labor forces, low-cost land, information and talent management pools. In the initial stage, the number of TVEs in each town and village was limited, and the information about the TVEs was transparent between township leaders and managerial personnel. County and township leaders were not only familiar with the TVEs but also with the managers of the TVEs as well, they protected the TVEs from risks. Furthermore, local governments increased their revenues from a stable tax base and utilized them to exploit the new market chances (Wong 1992, p.197). At township and village levels, cadres used their administration skills to mobilize resources within their communities in order to fund collectively owned rural industry directly, redistributing capital and pooling risks (Interview p12). Limited job options restricted the TVE managers from having other alternatives. High salary levels and the community status were enough to stimulate TVE managers to work hard. Under the protection of the system of collective ownership Sunan did not only increase the value of asset endowments but also invoked new ways of organizing existing productive assets as well as reducing transaction costs at the initial stages. The factors of endowment structure referred to an economy's relative abundance in natural resources, labor force, and capital. Sunan TVEs benefited from favorable

taxation, regulation and subsidization (Interview P12). The leaders of the county approved the allocation of resources (including the various elements of resources and the system resources). For instance, the TVEs obtained large amounts of seed capital from the community's accumulated savings, procured loans from the bank by means of "the government credibility", employed local laborers and land was available either free of charge or at low cost. Furthermore the TVEs enjoyed various preferential policies of the community. As discussed in the Tangqiao and Wuxi cases in the early 1980s, they were superior in seeking markets. As a consequence, starting conditions in Sunan determined the prospects for its sustainable economic growth.

4.3.4 Flexible Cooperation Types in Sunan

Many kinds of cooperative links were established in the 1980s. Firstly, the cooperation with foreign investors developed, secondly, the links with Shanghai and other big cities near Sunan were established, and thirdly the links between urban and rural areas in Sunan became more closely joined. It was much easier to license joint enterprises, if new technology and equipment were used, if the management style could be made more efficient, and if new kinds of products would result (Interview P5). The types of enterprises in Kunshan included joint ventures, wholly foreign-owned enterprises, state-owned enterprises and private enterprises (see Table 4.6).

Many Sunan enterprises cooperated with partners from Shanghai. Local officials increasingly acted like commercial boosters, as the reform made Shanghai's border with southern Jiangsu much less hermetic. By 1988, one third of the fifteen hundred non-private enterprises in Kunshan were "horizontal liaison projects," and 60 percent of these were involved with Shanghai (see §4.3.1). Kunshan cooperated especially with the Shanghai Textile Bureau to establish an export base, which sent cloth to twenty foreign countries (Interview P 7).

Urban and rural areas in Sunan have had close economic links, and numerous small towns have long linked the rural economies to the cities in the region. (Johnston, 1993). Wuxi is the county with the largest production in Jiangsu. By 1983 one-third of all enterprises in Wuxi County already had trading links with firms in seven other cities near Shanghai. Local leaders were creating regional institutions that integrated all of the counties (White 1997, p.361). In Wuxi, one-third of the TVEs were had

links with factories, schools, or research units in Shanghai.

4.4 Barriers to Sunan Model in the Late 1990s

With the decline of the employment in TVEs, employment in the private sector in Jiangsu Province more than doubled and output increased by more than seven times that of the TVEs (see Table 4.5 and Table 4.6). Reforms on the type of ownership structure were initiated in some rural areas, and have accelerated since 1996. The Sunan model eventually followed the Wenzhou model in transforming from collective mechanism into private ownership. Why did the TVEs decline and change into private ownership? Strong competition came from two sides. One was the fierce economic market competition from the rest of the Mainland in the 1990s, and the other was barriers resulting from the collective mechanism. The next part will discuss the emergence of strong competition in the 1990s.

4.4.1 Strong Competition in the 1990s

In the 1980s, raw material price hikes created problems for state industries. The regime failed to redirect the material flows back into the state sector. For instance, by October 1989, Shanghai's industrial production was down 6 percent compared to the same month in the previous year. Its light industries' output was down by 8 percent, whereas heavy industry facing less non-state domestic competition was down only by 4 percent.

This was blamed on a "slack market." But the market for non-state industry products was not slack. TVEs were not products of a planned economy. Their major supply of energy and raw materials came from outside the state allocation plan, and their products were sold outside the state allocation plan. TVEs faced fierce market competition from the very beginning. Late in 1989 a campaign against non-state industries was instigated as an effort against inflation.

In the 1990s the reform on marketization became more widespread on the Mainland. The liberalization of the commodity market was almost complete and the private sector had grown rapidly in China. Wenzhou's private enterprises had started twenty years ago and had thrived in this hard period. The reform of the urban state sector had advanced to a certain degree. In the northern part of Jiangsu, Xuzhou city

had started to reform state-owned enterprises and foreign capital had started to enter the market full-scale (Interview P8). FDI and FEI developed in Suzhou counties in the 1980s, and many SEZs (Special Economic Zone) were successful in attracting foreign investment. Therefore, the collective-owned enterprises in Sunan faced even stronger competition.

During the initial stage of TVE development, there were political and ideological restrictions regarding private ownership. Most TVEs adopted a mode of collective ownership to facilitate the TVE's development. In the 1990s, with the development of the rural economy, institutional arrangements began to change and challenge the type of collective ownership. First of all, the development of the market, especially the financial market, had weakened the importance of the local government in the procurement of management resources.

Secondly, discrimination against non state-owned enterprise ownership in both the legal status and taxation policy had gradually faded away. The development of entrepreneurship demanded more political freedom and, at the same time, financial and policy support from the institutional environment. However, the Sunan business model became inadequate to guarantee entrepreneurial development as the collective structure of ownership and the management was not able to meet the challenges of the market. Furthermore, the collective structure was a major obstacle to executing the core values of entrepreneurship, that is, that entrepreneurs are able to make free choices on the basis of the property rights and the belief that their property rights could not be compromised. In particular, TVEs in Sunan had many problems, for example, the TVEs tended to be small and they lacked economies of scale and agglomeration. Their labor force tended to be less well trained, and TVEs were less capable in technical innovation and improving management of modern corporations.

Thirdly and most importantly, the original local supervisory powers and incentive mechanism became ineffective. With radical reforms in the early 1990s to marketize and globalize the economy, many problems appeared, like ownership ambiguity, confusion about business and the function of government funding and asset stripping (Lin 2003, p.178). The next section analyzes the obstacles for the further development of TVEs in Sunan.

4.4.2 Ownership Ambiguity and Asset Stripping within Collective Mechanism

The active role of the local government in its autonomy of the micro-management unit protection of the TVEs boomed in Sunan in the 1980s. Gradually this active role was eliminated and many problems appeared, such as corruption, mismanagement, the loss of collective assets (asset stripping), and even bankruptcy (Wei 2007, p.16). Why? The ambiguous ownership resulted in the overlapping of business and government functions, the TVEs lost its competitiveness in the new market economy. Property rights are the rights to own and contract for assets according to an established set of rules and laws (Shane 2003 p.155). The person, who is the owner of the property, has the right to consume, sell, rent, transfer, exchange or destroy his property. However, TVE's investment came from the collective capital, the managers of the TVEs or the leading cadres had no property rights, and therefore the profit and the interests of the TVEs could hardly be protected by a stable legal framework. Hence, the inequality of income distribution, the individual corruption and the misappropriation of public funds came under the jurisdiction of the audit bureau. In 1988, there was a case where the audit bureau discovered that an account of the forestry bureau had engaged in corruption involving an amount of RMB 30,000 Yuan (Oi 1999, p.97). There were related offenses including taking public funds and using them for private purposes, this also included unauthorized public expenditure. Included in this category were the illegal use of procurement funds, and the destruction of public property. In another case, a liquor factory let its grain rot and the warehouse management was held responsible (Interview P12)

The ownership ambiguity caused serious asset stripping, and the managers of the TVEs worried that their TVEs' profit would be taken away from them arbitrarily. As the township and village finances were not separate from business administrations, the county administration had the rights to control the revenue of the TVEs. The source of investment funds for firms was often used to build up the infrastructure completely new, as well as for investments in agriculture and education (Interview P 12).

4.4.3 Obstacles within Collective Mechanism: More Protection or More Marketization?

It is clear that the hierarchy of the structure and powerful centralized political environment leads not only to ownership ambiguity but also to asset stripping.

Entrepreneurs in Sunan needed more freedom in the 1990s. Table 4.8 shows the centralization in Sunan's local administration.

Table 4.8 Economic Duties of the Local Administration in Sunan

Economic Sector	County	Township	Village
Agriculture	Set production quotas	Issue grain contracts	Contract land
	Set purchase targets	Collect agricultural grain tax	Ensure tax payments
	Allocate procurement funds	Collect procurement Quotas	Divide village procurement quotas among households
	Allocate credit	Distribute production inputs Pay peasants for procurements	
Industry	Contract with state-owned enterprise	Contract with Town-owned enterprise	Contract with Village-owned enterprise
	Issue licenses	Issue credit and loans	Make production decision
	Determine tax breaks	Supply materials	Manage investments
	Administer product	Manage investments	Procure production materials
	Grant loan deferments	Make production decisions	Procure credit
	Supply materials	Contact coordination work	Generate/procure capital
	Manage investments	Repay debts	Contact coordination work
	Rate enterprises	Guarantee loans	Repay debts
	Conduct coordination work		Grant permission from outside factory work
Private Business Sector	Oversee individual entrepreneurs association	Oversee individual entrepreneurs association	Provide reference letters
	Issue licenses	Collect taxes	Check applications
	Supply materials	Process license Applications	
	Issue credit and loans		

Source: Personal and telephone interviews P12 and P7, Edited by the author from Jean C.Oi "Rural China Takes off-Institutional Foundations of Economic Reform" University of California Press, 1999. p.105

The county level attempted to have more rights and legislation on all decisions regarding agriculture, industries and the private business sector. The county leaders enjoyed more power than those at the other two levels. The county was responsible

for the loans and grant deferments, the issuing of credits and loans, the allocation of materials and managed investments. In addition the bureau of appeals, the civil administration bureau and the industrial commercial management bureau were controlled by county leaders. For instance, TVE managers had to maintain very good relations with leaders in county governments (Interview P12), because the rural factory heads had a greater chance of influencing the later use of such money, if more of it remained in town. When the decision from the lower level is in conflict with the interests of the above level, the TVEs had no alternative. Even though the TVEs might get local protection continuously, this protection would become weaker and weaker. This puts constraints on the entrepreneurial activity required by the market and hence some of the TVEs became uncompetitive.

4.4.4 Barriers to Private Enterprises Development in Sunan

The lack of rule of law, capital constraints and policy discrimination are major problems for private enterprises. Up to the 1990s these major problems still existed in the private sector in Sunan.

Historically, the assets of local collectives in Sunan were accumulated during the Mao era. In particular, the land reform deprived the landlords of their property rights, and all estates were under the authority of communal ownership after 1952. The TVEs were normally controlled by the Local County or township (commune) authorities (Interview P7 and P12). In the 1970s no laws or regulations on property rights were promulgated. The production of the private enterprises was not subject to the unified state plan and central administration (ibid.).

Until the 1980s the constraints on private enterprise continued to exist and, more notably, a law limited the employment in a private enterprise to seven people. The state-owned banking system lent almost exclusively to SOEs. The private enterprises could barely survive in Sunan in the 1970s. The following case tells the experience of a private entrepreneur in Wuxi.

In the early 1980s Mr. REN managed to open an ironworks company in Jiangyin, near Wuxi. His private enterprise survived and he managed to repay a loan of RMB 35,000 Yuan two years later. The town government approached Mr. REN to pay a land-use tax which TVEs in collective ownership did not pay. In addition, he had to pay the electricity, water, and ploughing bills of a hundred local households because prosperity should contribute to the support of the local community. However, his enterprise did not receive any protection from the local government when a conflict of interest arose between his enterprise and the villagers. His equipment was smashed by a gang of

sixty boat people. Finally, Mr. Ren decided to give his enterprise to the local production team as a collective, but retaining his position as a manager. When bureaucrats from the local supervisory powers learned that he had given away his profitable enterprise, they were angry that he had offered it to the local team rather than to their own office. They sent tax collectors to inspect his books. Then they sued him, without success, because he had broken no laws. In this case, the court upheld his right to continue in business as manager of a collective (White 1997, p.127).

The above case illustrates, that a successful private enterprise without a red cap of collective enterprise, caused envy and many costs. It also indicates that as the reforms proceeded, conflicts arose between the traditional institutional environment and the newly reformed micro-management institution, as well as the contradiction between the traditional macro-policy environment and the reformed resource-allocation mechanism. The government often chose the traditional method of administrative re-centralization to forcefully bring the reformed micro-management institution and reformed resource allocation mechanisms in line with the traditional macro-policy environment (Lin 2003, p.178). The conflicts resulted in an internal inconsistency within the economic system.

Hence, from the early 1970s Sunan peasant entrepreneurs seized the opportunity to develop local state-led “collective” TVEs to produce non-planned production near their hometown, because the collective enterprises gained loans much easier than the private enterprises. In Zhejiang Province, loans extended to private entities by state banks accounted for 8 percent of total lending during the period from 1990 to 1995. However, only 4.3 percent of bank loans went to private businesses in Jiangsu during the same time span (Huang, 2004). The expansion of Nanjing’s private economy did not start until the year 1997. The director of the Nanjing United Front for Industry and Commerce (UFIC) said that UFIC did not even keep statistics on the private economy until after the Fifteenth Party Congress in 1997 (Tsai 2007, p.178).

4.4.5 The Socio- Cultural Environment in Sunan

In the framework as described in § 2.2, culture and social capital influences the rate of entrepreneurship. As mentioned in Chapter 4, Yongjia culture in Wenzhou had a strong influence on the rate of rural entrepreneurship in Wenzhou. How about the influence of Wu culture in rural entrepreneurship development in Sunan?

4.4.5.1 “Wu” Culture and its Influence in Entrepreneurship in Sunan

Nearly 4,000 years ago Jiangsu Province was an original part of the Wu Kingdom (B.C. 1200- B.C.473). Influenced by Wu Culture and Chinese Confucianism, Sunan worshipped the thoughts of “Gewu Zhizhi”. In ZHU Xi’s (A.C.1130-A.C.1200) “Gewu Zhizhi”, followers observe phenomena carefully, think about their

significance and practical implications, and then incorporate this new knowledge into practical life (Thompson, 2007). On the contrary, Yongjia doctrine advocates “Jingshi Zhiyong “. It emphasizes learning by doing. In comparing the Yongjia Culture and LIU Ji’s Doctrine in Wenzhou, it is possible to see how the typical Wu culture influences the form of entrepreneurship in Sunan.

Firstly, influenced by Confucianism, Wu culture worships Yi (Righteousness) and knowledge. Wu culture advocates that a man should take hold of the responsibilities of his own family and the state. The Yi is in conflict with pursuing either self-interests or profits. Confucians represented by Zhu Xi and Lu Jiuyuan in China suggest that the youth should first take positions in the government to give service to the country, and then realize one’s own ideas and responsibilities. “Doing business” and pursuing only profits is not advocated in the Wu culture. Hence, doing business was not respected as a career in Sunan. On the contrary, the theory of the Yongjia School in Wenzhou, as represented by Ye Shi, emphasizes the utility of Yi with interests and advocates learning the practicalities of life. The man who does business is respected in Wenzhou. This theory had an enduring impact on the way of thinking of Wenzhou natives and has become the “cultural gene” in Wenzhou’s entrepreneurs’ lives ever since.

Secondly, Wu culture advocates education. For ZHU, cultivating learning starts with filial and fraternal training in childhood, and develops into cultural learning through the study of basic texts and the “Six arts (Liuyi)” in their youth.¹³ With ZHU Xi’s notion of investigating things to extend knowledge, ZHU Xi envisions the enlightened life as one stirred by curiosity and animated by inquiry (Qian 1971, p.504). In ZHU’s view, book learning is essential to advanced self-cultivation (Zhu 1990, p.128). For ZHU, these processes of observation, reflection, assessment and adjustment are lifelong cultivation practices. There are always new things to be seen, learned and pondered. Sunan peasants inherited a refined temperament and elegant behavior. Their life style is delicate. In particular, they are wise and diligent in acquiring new knowledge.

Thirdly, historically Sunan peasants had to work diligently to pay each dynasty very heavy taxes and therefore they lived under great pressure. However, they still

¹³These “six arts ” were considered essential constituents of good breeding: ritual action, music, archery, charioteering, writing, and ciphering.

preferred staying at home and exploiting opportunities around them. They lacked the spirit of risk-taking in entrepreneurship. Compared with Wenzhou peasants, the peasants in Sunan value collectivism, pursue harmony, worship morals and the doctrine of moderation.

Fourthly, in ZHU Xi's view, self-learning and cultivation should be conducted in the light of real life. ZHU Xi argues that people should use these gifts sparingly and carefully in support of their overall project of self-learning and cultivation in the context of real life. When China was forced to open the door to Western society in the 1980s, Sunan learned the advanced industrial technology and started national industries in the Qing dynasty. After the economic reform, Sunan absorbed large FDI (Foreign Direct Investment) successfully and developed domestic and foreign joint ventures in rural industry.

4.4.5.2 Social Network and the Personal Trust System in Sunan

Before 1949, traditional country squire and clan networks played an active role in Sunan society. During the process of collective reform which began in 1952, land and major farm equipment were removed from family units and taken to communist brigades. The country squire system and kinship did not survive this reform. Sunan social networks changed from being a decentralized unity of clan system with influential families and country squires to a direct and centralized political power. The traditional country kinship network in Sunan was completely destroyed. Table 4.7 indicates the power of the party leaders in the municipal government. The hierarchy structure in rural area substituted a centralized pattern controlled by county leaders. Hence, information and financial support were no longer gathered from the interpersonal trust and grass-roots organizations of the traditional social networks, but from the key economic commissions and agencies.

Generally speaking Guanxi needs interpersonal trust in a social network, Sunan's trust system and social network were constrained by the local hierarchy structure. Under such circumstances, peasant entrepreneurs lost their opportunities to gain information for start-up; they sought to get support from the local leading cadres and local government. In comparison, the Wenzhou clan system and kinship remained

stable during this time. Entrepreneurs in Wenzhou never lost their local clan or their personal networks during the land and collective reforms.

In summary, after analyzing the advantages of the collective ownership, including the unique natural resources and the factors of endowment structure in Sunan, this paper analyzes the barriers in the political environment and the socio-cultural environment in Sunan, these obstacles slowed down the development of private enterprises in Sunan. How was the policy of discrimination of private enterprises eliminated? and how were the TVEs navigated out of the difficult situation? The next part discusses the impact of rural entrepreneurship on the improvement of the institutional environment in Sunan in the 1980s.

4.5 The Impact of Rural Entrepreneurship on Institutional Environment in Sunan (1980s)

The quick growth of Sunan rural industries came partly from local state-led manufacturing (TVEs) and the local state's initiative in creating institutions and the strategic coupling between global production networks and the local institutions. Sunan TVEs could be regarded as crucial innovation actors, which point to a general feature of the Sunan business model. The development of TVEs played a role to improve the effectiveness of the local administration, enhancing the innovation capabilities of the TVEs in Sunan. This contributed to the further innovation of the micro-management unit and institutional environment.

4.5.1 Impacts on Employment and the Traditional Cultural Values

First of all, as discussed in § 4.3.1, TVEs absorbed a huge labor surplus which existed in rural areas from the 1970s to the 1980s. Cheap labor forces became a major advantage for TVEs and the development of the rural collective economy. For instance, in Tangqiao more than half the workers in TVEs were women by the mid-1980s. These women employees in village-run factories came from the rural areas. Many workers in rural industries were recent migrants from outside the township (Interview P7). The rate of immigrant peasants reached 22 percent in the simpler village-run factories, in the more complex ones at the higher rural level it reached 14 percent (White 1997, p.115). In Wujing County, near Changzhou, the percentage of the non-agricultural portion of the labor force was about 38 percent by 1982. Fei Xiaotong concluded that by the early 1980s, "one-third of the labor power in Sunan had turned to industry from agriculture within five years" (Fei p.48). By

1985, three-quarters of the 16,000 workers in Tangqiao, Suzhou, were involved full-time in the rural industry (Xu et al.,1985).

Secondly, the traditional ideology and cultural values are being redefined. New attitudes toward the rural entrepreneurship were established in the rural areas. The role of TVEs became manifest in a wide range of areas, ranging from the field of hard infrastructure to socio-cultural factors such as new routines, conventions and attitudes.

Sunan has never lacked “capable men” who are famous for their wisdom, diligent learning and exploitation. Since the early 1990s many unfavorable institutions had been improved. This impacted on the local people’s attitude to entrepreneurship. After Deng Xiaoping’s South Touring Talk in 1992, Sunan peasants began to accept the new concept of the socialist market economy. A market economy had developed to some extent during the time of economic reform and peasants had become used to the operation of a market economy. The peasants began to admire successful entrepreneurs. They started to understand that the key criterion for judging whether the economy is socialist or capitalist is not whether there is a central plan or planned economy, rather planning and markets were only the instruments for building socialism.

Some peasant cadres and brigade party secretaries admitted they were not up to the job. They actively gave up their controlling interest in the ownership of collective-owned enterprises (Tan 2000, p.30). The second and third generation of local leaders lived for years in the rural places where they established new TVEs (Interview P12). Hence, even if their qualifications for appointment were originally political, the market incentives surrounding them tended to make them business specialists rather than political generalists.

4.5.2 Institutional Subversion and Conversion in Sunan

The entrepreneurs often relied on their trust system and network to exploit the market, and the trust system and network acted as motivation to force the intermediate process change. This led to the innovation of institutional environment regardless of whether the process worked in a subversive way or by conversion. This is a standard, albeit abbreviated, depiction of entrepreneurs as change agents and innovators (Tsai 2007,

p.208). Hence socio-cultural diversity can be described as a pool of alternative options for regulation and organisation, and as opportunities for all individual and societal protagonists. Wulf states:

“individual or societal identity emerges from difference (...). Societies and people constitute themselves throughout processes of coping with alterity... and [socio-] cultures play an important role.” (Wulf 2005).

Institutional subversion began in Sunan, when peasant entrepreneurs and local cadres ignored the formal institutions during the early reemergence of petty entrepreneurship. Institutional conversion occurs when the above actors appropriate formal institutions to serve their own ends. (Thelen, 2000) As mentioned above, ownership ambiguity caused many problems in Sunan, such as asset stripping and leaders' corruption. Entrepreneurs may unintentionally have transformative effects on formal institutions in their entrepreneurial activity. However, their interactions with one another and with local bureaucrats can nonetheless have major political impacts (Tsai 2007, p.208). To have more autonomy is a precondition for peasant entrepreneurs to be more flexible on micro-management.

4.5.2.1 More Autonomy of Micro-Management Units in Sunan

The reform from below supplied Sunan TVEs with more autonomy for micro-management. Firstly, the local government acted as an agent in resource accumulation to reduce transaction costs. Local authorities had considerable power in decision-making and resource allocation. In the 1970s Sunan TVEs continually enjoyed cheap production factors, which facilitated the primitive accumulation. Their start-up capital came from the collective's accumulation, banks, and credit cooperatives. Because China was so populous and migration to cities was restricted, a huge labor surplus existed in rural areas. Cheap labor forces became a major advantage for TVEs and for the development of rural collectives which had jurisdiction over land use (Lin 2003, p.178).

Hence Sunan enterprise managers often preferred remaining in the collective sector instead of founding private firms. They liked to deal with town leaders, who were often friends or kin. If their firms remained collective, rather than becoming legally private, they had better official cover against the demands from more centralist government agents. Compared to managers in cities, rural executives were more

powerful and independent. Town leaders only involved themselves with rural businesses indirectly. The government never interfered with the daily affairs of enterprises (Interview P7 and P12).

Secondly, there were the flexible policies for absorbing foreign investment to stimulate local economic growth in the 1980s. China's economic reform is a process from bottom to top. The demand from the rural entrepreneurship enhances the government's role in economic development as part of the comparative-advantage-following strategy. China's central government and reform policies provided favorable macro-contexts for the development of certain coastal areas after the TVEs' initial stage at the beginning of the 1970s, especially in the fields of fiscal policies on foreign investment, lower tax rates and flexible labor practices. Central government encouraged counties to establish inter-regional business relations with cities, thereby fully utilizing urban resources. In 1984, the state government shifted the process to urban reform, and as a result foreign investment and trade were permitted by the central government. In the 1980s the number of Sunan districts increased to seven cities. Sunan TVEs obtained more decentralization and open policies from provincial and central governments by promoting local advantage and utilizing local networks. Sunan became the most generous place with investment incentives on the Mainland outside the special economic zones (SEZs). TVEs enjoyed more favorable government policies than state-owned enterprises (SOEs) such as lower tax rates and flexible labor practices.

Furthermore, in order to have more autonomy of micro-management units, Sunan emphasizes local state's initiative in creating institutions. How to improve the local institution building in Sunan? The next section discusses the TVEs' ownership reform in Jiangyin, Kunshan and Wujiang.

4.5.2.2 TVEs' Ownership Reform in Sunan

In order to solve the problems of ownership ambiguity and asset stripping, local governments were forced to reform TVEs radically, and by the late 1990s most TVEs had been shut down to be transformed into private and joint ownership forms. At the end of 2000, 85,000 TVEs transferred their "collective" ownership into "private" or "joint-stock" enterprises, corresponding to 92.3 percent of the whole

TVEs in Sunan. Alternative forms of ownership had been introduced into TVEs, including shareholding systems and joint ownership with foreign and private sectors (Interview P5). The process of innovation was painful, and to a certain extent led not only to the loss of collective assets but also to a slower industrial growth rate (Wei 2002, p.1740). However ownership reform had brought about some substantive changes, such as the increase in decision-making autonomy, diversification of ownership structure, and the adoption of managerial and employee stake holdings.

In the majority of cases, one of three forms was adopted during the ownership reform in Sunan: shareholding cooperative enterprises, private enterprises or leased enterprises. A shareholding cooperative enterprise has the characteristics of cooperatives or firms that offered shared-ownership participation to employees (Nongyebu Xiangzhen Qiyeju, 1998). These enterprises were originally middle- to large-scale TVEs. Small enterprises were sold off, i.e. privatized. The objective of transforming TVEs into leased firms was to implement the risk-deposit contract responsibility system (Interview P12).

The above three forms of reform exploited TVEs in ways of property rights and advanced management. Eighteen TVEs in Jiangyin County were transformed into public companies. In Kunshan County many TVEs absorbed large amounts of foreign investment to improve technology and competitive ability to trade with foreign joint venture enterprises (Interview P7). In Suzhou, an internal party document specified privatization procedures through 2002 and until April 2003 when public auction was made mandatory. Up to that date, local authorities had the option to proceed by “internal transformation” (neibu gaizhi) or by “internal agreement” (neibu xieyi) which allowed them to negotiate individual settlements with preferred clients. Since April 2003, in this local instance, a reserve price for assets had to be established on the basis of an asset evaluation, and investors were invited to submit their bids. The ensuing auction had to be repeated at least once if the reserve price was not reached. Only in exceptional cases were local authorities allowed to deviate from this procedure (Krug, 2004).

This ownership reform experienced diverse forms in the process of reform. By looking at the ratio of collective capital to total capital (zibenjin, gubenjin or gujin) after the reforms, it can be seen that the collective capital was almost completely

withdrawn from TVEs. The basic policies of the TVE reforms in Wujiang were a complete withdrawal of collective capital and a concentration of shares in the hands of management executives. In Wujiang City, the political standard applied was that the share of management executives' capital should exceed at least 20 percent in the firms after the reforms (interviews in Wujiang City Rural-Work Department, 22 September 1999) (Fan, 2000). However, there were firms in which collective shares accounted for the majority, and firms in which the ownership of the stocks was widely distributed among employees. The vast majority of the share-holding cooperative enterprises in Sunan were in effect private enterprises. Some firms were registered as a collective enterprise and running profit-oriented business out of government offices. No clear relationship exists between the capital scale and the collective capital share of the firms, so it cannot simply be said that the withdrawal of collective capital was advancing faster in firms which operated on a smaller capital scale.

In 2002 Mr. SHEN Wenrong, the CEO of Jiangsu Shagang Group Co., Ltd. became one of the richest Chinese businessmen. In 2009, he won the "New Fortune 500 richest Chinese" award with a net worth of US\$2.0 billion for the second time. Mr. SHEN worried about being the top richest man on the "Hurun richest list". Such kind of "caution" is popular among Sunan entrepreneurs. Compared with the successful businessmen in Wenzhou, Mr. SHEN was reluctant to be well-known as a rich man. Recently many debates have been raised about Shen's story. How was a collective TVE transformed into a private steel group? How could a former director become the richest man? Before answering the questions, it is better to know how the entrepreneurs play as agents and innovators in the transformation of the ownership in Sunan. Therefore it is not difficult to understand why Mr. SHEN and other entrepreneurs do not want to be publicly regarded as the richest business men (Interview P 8, P12).

4.5.2.3 Analyzing the Background of Taking a Mixed Type of Ownership in Sunan

The above empirical evidence shows that the reform of TVEs by itself was insufficient because it was constrained by the slow process of diversifying the collective ownership into the hands of high-stake non-collective owners and the slow development of rule-based market institutions. To establish effective corporate

governance Sunan enterprises took on a mix between private and public ownership as a new form in restructured enterprises. Why?

Firstly, the problems of ownership ambiguity and asset stripping which were caused by the strong powerful centralization in Sunan were hardly eliminated. The influence from the upper level could hardly be removed or reduced after ownership reform, and the transfer in social capital helped them to remain in power. Their leverage could continue its influence on the decision-making processes. Empirical evidence in Mr. REN's story indicates the difficulties for a private enterprise in the transformation of rural entrepreneurship in Sunan. As a result Mr. REN could not escape from his troubles until he gave up his property rights.

Secondly, to solve the problems caused by collective ownership, such as corruption, asset stripping and inefficiency, the enterprises needed to delegate decision-making authority and link rewards to performance. Choosing private ownership was a curious innovation which needed strong property rights, which were guaranteed by the rule of law. On the basis of a contract responsibility system at the management system level, ownership reform is a successful practice of decentralization in the Sunan model, even though only partial.

Thirdly, in order to improve the management, many of the rural factories switched to new managers in their villages. A group of villagers who had long been active in the factories with more technology began to assume more important roles. They were capable of seeking much wider markets for their local production. They had "great authority" (da quan) to distribute profits, hire workers, and award or punish them. Knowledge exchange should not be confined within the TVEs and the region. People's attitude to property rights had been changed, the spatial cooperation with Shanghai and other international enterprises helped to stimulate local, often informal, knowledge flows and spillovers. In particular in the case of young and emerging rural entrepreneurship, such as in the Shagang Group case, the insertion into national and international networks and collaborations is of utmost importance. (Interview P8 and follow-up Interview P7)

Fourthly, in 1994 a new company law was promulgated to facilitate solving the mixed problems of privatization. In this document the private persons and firms

were acknowledged as rightful owners of capital assets in legislation. It offered the possibility to incorporate companies either in the form of limited liability companies or with corporations. TVEs began to reform their ownership structure through developing a joint-stock cooperative system.

Finally, information asymmetry is another factor that forced the separation between party and enterprises. In the 1990s, most of the TVE managers were not government officials. Their job mobility was limited and they had few chances of promotion. However, long-term management over the same TVEs enabled them to accumulate valuable information on behalf of the enterprises. At the same time, marketization grew rapidly. Non-collective enterprises mushroomed, providing job opportunities for those who were good managers. Finally, the increased number of TVEs and their expansion in scale made it impossible for community governments to obtain full and detailed information about the TVEs' operation. Hence, direct supervision became ineffective. The local authorities then needed a stable institutional arrangement to gain a comparatively stable share of surplus from the TVE's profits. The result was a rapid diffusion of the joint-stock cooperative system (see Figure 4.1).

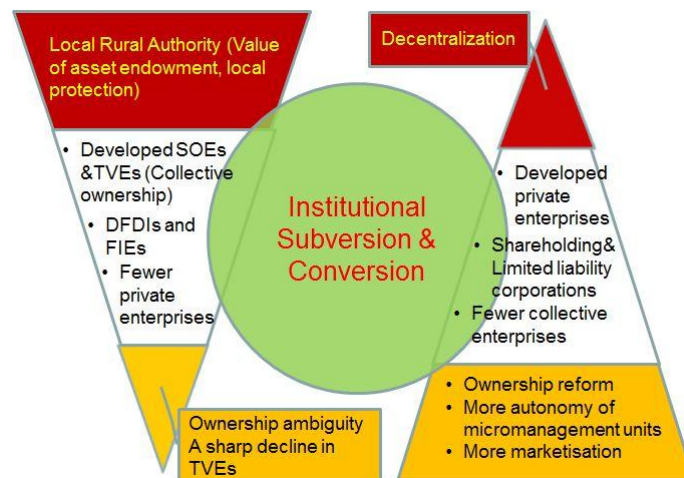


Figure 4.1 The Transformation of the Sunan Business Models

In summary, Sunan's innovation of the type of collective ownership was associated with a lot of institution subversion and conversion. Centralization in Sunan meant a high degree to which political actors coordinated the economic, political and social activity in a society. Innovation in taking mixed types of ownership showed the impact of entrepreneurial firms as agents to improve the political environment and to become more adaptable to the marketization.

The centralized political environment supplied little freedom for entrepreneurs to start their private enterprises at the end of the 1970s. Everyone knew that the legality of such a measure was questionable. How was it possible to provide a legitimate cover for people to engage in activities that may not be officially sanctioned?

Firstly, decentralization of power is considered the first step to break the institutional barriers. The reform of TVEs in the 1980s was a mixture of official elite reformers' initiative and private entrepreneurs' spontaneous action to break institutional barriers in Sunan. To establish and maintain a business, they have to be resourceful in navigating bureaucracies and markets. When neither exists for the purpose at hand, entrepreneurs participate in creating them. The barriers from the collectives were that the power from party leaders covered the entrepreneurs' function. The acquisition of information about entrepreneurial opportunities and the free exchange of information about these opportunities are based on political freedom. The entrepreneurs had to get permission and support from the upper level for their entrepreneurial activity.

Secondly, from the 1980s to the beginning of the 1990s, the independence of the TVEs was advanced by promoting a contract responsibility system at the management system level, leaving the type of TVEs' collective ownership untouched. Therefore when the TVEs director responsibility system was introduced and began to be implemented throughout the TVEs sector, the contract listed the terms, profit-sharing and the responsibility for the entrepreneurs, (some of the TVEs were changed into management buy-outs by experienced managers). Many managers were required to have several thousand yuan as a guarantee before they could be appointed or could apply to be managers. In Zhangjiagang and Wuxi, the directors of the TVEs had to pay 10 percent of the planned enterprise [annual] profit before they could become formal managers. If managers could not achieve their quota, they had to pay for this incapability (Interview P7 and P12). On the other hand, the local governments gave high rewards to managers who showed good performances. If they fulfilled their plans, they were paid salaries of up to three times above the average wage of the workers.

Thirdly, property rights were only vaguely defined. More often than not a total renewal of the whole regional innovation system and considerable institutional

innovations were needed to effectively foster the emergence of industry clusters in regional settings with weak conditions in high-technology sectors. The decentralized political environment only supplied Sunan entrepreneurs with the freedom of being subject to the will of others; this did not lead to full private ownership by the manager. Officially, TVEs were collectively owned enterprises located in townships (or villages). All the people in the township or village that “set up” the TVE owned the firm collectively. A township government was regarded as the “representative” of the people in the community, and thus it was the executive owner of the TVEs in the community. Typically, the control rights of TVEs are partly delegated to managers through a contract (officially called the management responsibility contract). It was common for employees of a TVE to collectively sign a contract with the executive “owner”, the township government. Therefore the adoption of a mix between private, usually through the manager controlling majority shares, and public ownership became the dominant form of firms. Finally the reform made a vague reply on the property rights which may have caused problems on the legitimacy of the private enterprises.

4.6 Conclusion:

In this part I have discussed the different transformations of the Sunan models. The first period was from the rise of collective enterprises in the 1970s to the rapid growth in the 1980s. Benefitting from the better-developed industrial foundation, Sunan peasants developed the towns and villages enterprises at a high starting level under the protection of the local authority. However the value of asset endowments under the type of collective ownership caused many problems, such as ownership ambiguity and asset stripping in the TVEs. This hindered the further development of entrepreneurship, caused sharp contradictions between the rights of ownership and the responsibility of the management in the TVEs. In a weak political environment, the leaders from the county had the opportunity to devise and enforce rules that served the interests of the politically advantaged. Compared with these TVEs the private enterprises could hardly survive faced with such discrimination since there was no guarantee of decreased transaction costs for them. In such a situation, the Sunan model entered into its second stage, the ownership reform on TVEs, which began in Jiangyin, Kunshan and Wujiang in the mid-1990s, and then gradually extended to all the TVEs in Sunan. The collective capital was almost completely

withdrawn in the TVEs, and the share of management executives' capital became much higher after the reform and many small enterprises were completely privatized. The political environment was improved to catch up with the development of entrepreneurship. The decentralization of power processed on in the form of institutional subversion and conversion. Institutional entrepreneurship was promoted in Sunan. The empirical studies testify the influence of the development entrepreneurship on the transformation of institutions.

CHAPTER FIVE: The DEVELOPMENT OF IMMIGRANT ENTREPRENEURSHIP IN SHENZHEN

5.1 A Brief Introduction: Location and History of Shenzhen

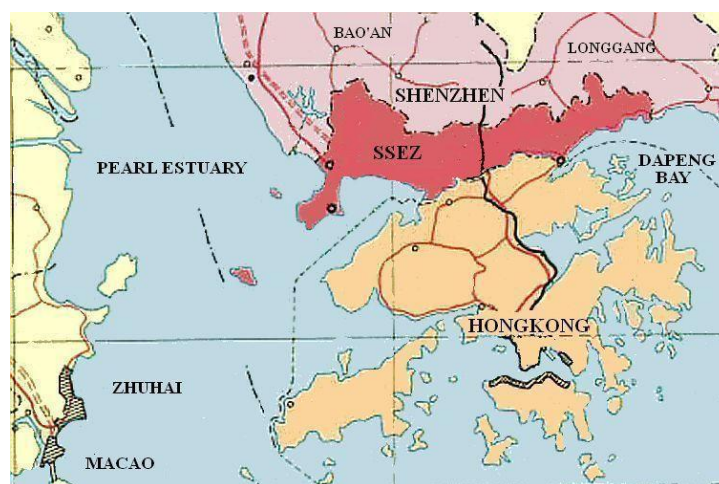
Shenzhen is a peninsula situated on the east side of the Zhujiang estuary in the Guangdong Province. It covers an area starting some miles north of the Shenzhen River and extends down to what was later to become known as Hong Kong Island in the south. The Shenzhen River forms a natural boundary between Shenzhen and the New Territory of Hong Kong (Map 5.1).

According to historical accounts, humans began inhabiting this peninsula approximately six thousand years ago (Shenzhen shi bowuguan 1990, 1993). The area came under Chinese control in 214 BC during the 33 years reign of the first Emperor of Qin. From the fourth century onwards, the Chinese began inter-marrying with the local inhabitants. The name “Shenzhen” was first mentioned in 1668 during the Qing Dynasty. At this time another minority, the Hakkas (Kejia) immigrated from the northern part of China into the area.

After the Opium Wars, the Nanking Treaty was signed in 1842. China ceded Hong Kong Island to Britain, thus reducing the area's size by more than 1,000 sq. km. In 1860, the First Convention of Peking was signed, by which also the southern tip of the Kowloon peninsula, Tsim Sha Tsui, was ceded to the English. In 1898, the Second Convention of Peking was drafted and the land south of the Shenzhen River, the New Territories (Xinjie) along with 23 named islands, totaling 962 sq. km, were leased to Great Britain for 99 years. The Shenzhen River came to form the natural boundary between China and the outside world in the form of the British Crown Colony, Hong Kong. Large-scale emigration to South East Asia took place from the second half of the 16th century until the Opium Wars in 1840. The total number of Chinese emigrants in Asia at this time reached one million (Nie, 2009). Before 1978, Shenzhen and Hong Kong were separated by the Shenzhen River and Shenzhen belonged to the administration of People's Republic of China, Shenzhen has a spatial

advantage between Hong Kong and the Mainland.

In 1978, Yuan Geng, the leader of the China Merchant Steam Navigation Company, Ltd., sent a request to Beijing concerning the establishment of an industrial export zone in Shekou, a peninsula west of Shenzhen, by Chinese merchants. There, the company could take advantage of the cheap land and labor from the Mainland and Hong Kong's high technology and advanced management. In December 1978, at a meeting of the historical Third Plenum of the 11th Central Committee, the new policy "Reform and Opening" was officially approved to replace the old conservative plan. According to the decision taken at the Third Plenum, Deng's plans were to be launched in 1979. In line with this reform, the State Council of the PRC approved the establishment of the Shenzhen Special Economic Zone (SSEZ) as a municipality of the Territory of Baoan County just to the north of Hong Kong (Baoan County had previously belonged to Shenzhen). Shenzhen was now officially opened to the world by the Chinese Communist Party (CCP) and top priority was given to the modernization of China. Map 5.1, illustrates the location of the SSEZ and Hong Kong and how Shenzhen gradually enlarged to the north after 1979.



Map 5.1 The location of Shenzhen SEZ (SSEZ) and Hong Kong

5.2 Evolution of Shenzhen Model

5.2.1 Economic Background of Shenzhen in the late 1970s

Shenzhen was a small fishing village with no more than 350 thousand residents and a few small state-owned enterprises up to 1978. With only a small industrial base, Shenzhen was surrounded by hinterlands less well endowed than those of major industrial cities in the country, such as Shanghai and Tianjian (Wu 1999, p.10). The region had only begun to build its modest manufacturing in the 1960s and 1970s, focusing on a narrow range of light industries including food processing, electronics, crafts, textiles, and paper-making. This provided Shenzhen with agricultural and food products and construction materials.

5.2.2 The Openness of Shenzhen SEZ (Special Economic Zone) in the 1980s

In order to strengthen Shenzhen's power and legitimacy, the central government approved a "Special Economic Zone" for Shenzhen. In May 1980 Shenzhen was formally nominated as a "Special Economic Zone" (SEZ) by the Central Committee of CPC and State Council. Here "special" implies that the zone may not be extended to other parts of the Mainland. Also, "economic" has two meanings. Firstly, it distinguishes itself from China's Export Processing Zones (EPZ) and those in other Asian countries, and secondly, it would not be one of the "special administrative regions" (ibid., p.14).

In 1978, there were few property rights and freedom was almost non-existent in the Chinese political environment. What role does the municipal government play in economic development and how can it help boost such development in Shenzhen? This part discusses how an institutional environment was created in Shenzhen. This process can be divided into two phases: Firstly, the power and its legitimacy as a SEZ from the center government, and secondly, the autonomy and innovation of the local government. After establishing the SEZ, the government began political reforms. Some of the most important points of the reforms were; the establishment of "Special Economic Zones" where the reforms were to be tested; increased use of foreign capital and know-how through foreign loans and investments, financed with income from growing exports; decentralization which gave more power to local

government and fewer bureaucratic layers; formalization of decision-making processes; laws and regulations instead of ad hoc political decisions, rule of law instead of rule by law; less state-planning on the micro-level where market mechanisms were supposed to regulate the development; legalizing and encouragement of private enterprise and private ownership (Kjillgren 2003, p.91).

The above policies supplied Shenzhen with a unique political environment to shoot ahead of any other cities in China. Shenzhen government was initially provided with: greater economic management authority, then given preferential policies for foreign invested enterprises, and lastly given economic support in terms of preferential finance and tax policies (Beijing Review, no.14, April 8-14, 1991).

5.2.3. Government Investment in Infrastructure in the 1980s

Table 5.1. Investment in Shenzhen's Capital Construction and Infrastructure Development (1979-1986)

Source of investment	1979	1980	1981	1982	1983	1984	1985	1986
Magnitude (US\$ million)	33.3	81.6	154.5	329.5	447.4	555.2	862.9	514.8
State allocation	15.9	21.6	13	24.7	22.1	7.5	13.4	13.3
State ministries and provincial fund	8.2	8.6	14	30.2	35.5	53.5	118.3	81.4
Local government allocation	4.2	6.3	19.5	33.3	39.4	76.1	140.7	92.9
Domestic bank loans	0	4.6	18.1	105.7	168.7	228.5	176.1	73.1
Foreign capital	3.6	35.2	77.3	99.7	112.2	94.6	112.7	93.2
Local enterprise self-financing	1.4	5.3	11.4	26	49	77.7	229	80.4
Other investment	0	0	1.7	9.9	20.6	17.4	72.8	80.4
Share (percent)	100	100	100	100	100	100	100	100
State allocation	47.8	26.4	8.4	7.5	4.9	1.4	1.6	2.6
State ministries and provincial fund	24.5	10.5	9	9.2	7.9	9.6	13.7	15.8
Local government allocation	12.5	7.7	12.3	10.1	8.8	13.7	16.3	18
Domestic bank loans	n.a	5.6	11.7	32.1	37.7	41.1	20.4	14.2
Foreign capital	11	43.2	50	30.3	25.1	17	13.1	18.1
Local enterprise self-financing	4.1	6.5	7.4	7.9	11	14	26.5	15.6
Other investment	n.a.	n.a	1.1	3	4.6	3.1	8.4	15.6

These figures are converted from the Chinese currency (RMB), based on market exchange rates.

Source: Shenzhen Statistical Bureau, Shenzhen Statistical Manual, 1991, WU Weiping, (1999) p.62

To build up Shenzhen's urban infrastructure and industrial base, the Chinese government made enormous financial investment in the region. Between 1979 and 1991, nearly US\$ 800 million was invested in capital construction and infrastructure development by central as well as provincial allocation, state ministries, and other provinces, accounting for about 10.2 percent of the total infrastructure investment in Shenzhen. Shenzhen itself financed about 12 percent of all infrastructure investment between 1979 and 1991 (Wu 1999, p.61). Table 5.1 indicates the capital construction infrastructure investment in Shenzhen.

Shenzhen has benefited significantly from government infrastructure investment. Although the rate of the state allocation declined gradually from 47.8 percent in 1979 to 4.9 percent in 1983, Shenzhen had the best investment environment at the beginning of economic reform, especially in production facilities. Modern standardized factory buildings were constructed and equipped with adequate utilities, ready for leasing to Foreign Investment Enterprises (FIEs). In addition, in the early years Shenzhen's self-financing capacity was also gradually strengthened with the help of government investment. By 1991, close to a third of all infrastructure investment was raised through local enterprise self-financing.

5.2.4 The Success of Absorbing Hong Kong and Other Foreign Countries' Investment in Shenzhen

5.2.4.1 Policy on Financial and Investment Innovation

Financial support measures the availability of new and growing businesses accessing financial resources. The fiscal and monetary policies taken in Shenzhen favour entrepreneurship, because the policies stabilized the economy and in this situation people have more confidence to make entrepreneurial decisions. Financial support includes support of government funding, venture capital funding and other social investment and financial resources. In 1985, when new legislation allowed foreign banks to establish full-service branches in Shenzhen, the banking structure in Shenzhen was profoundly changed and became more efficient (ibid., p.57). Although foreign banks were still subject to approval and supervision by the head office and the respective SEZ branches of People's Bank of China, they could carry out a full range of activities in both local and foreign currencies: granting loans, handling inward and outward remittances, settling of import and export transactions, handling

of local and foreign currency investment, buying and selling stocks and securities, and accepting local and foreign currency deposits. Foreign banks could also provide FIEs with credits and loans via overseas channels. Foreign banks were restricted to dealing only with FIEs, and not with state-owned enterprises. Nonetheless, the opening of the financial services in Shenzhen to foreign banks gave FIEs access to qualified financial services, when the state banking system was still antiquated.

After 1982, branch offices of the state banks in Shenzhen became more willing to support foreign investors with loans, and this opened the door to capital from domestic sources. Up to this point, most investors had to rely on their own sources of capital. In particular, the People's Construction Bank was prepared to support massive land development projects. Banks exercised a supervisory role over their clients, thoroughly investigating a project's feasibility and investor's ability to make a profit before granting a loan. By minimizing the possibility of speculative investment, this process ultimately benefited all parties.

In the meantime, Shenzhen has been a testing ground for comprehensive reforms. As for the policy on investment, in the 1980s a set of liberal investment policies further enhanced Shenzhen's attraction to foreign investors. Such policies include tax concessions, reduced custom duties, relaxed foreign exchange controls, and favourable land usage fees. For example, it was one of the first cities to apply differential corporate tax rates to foreign and domestic firms. While foreign investors paid a nominal tax burden of 15 percent and an actual tax burden of 11 percent, the corresponding figures for domestic investors were 33 percent and 23 percent, respectively. In other words, the tax burden of domestic enterprises was twice that of foreign investors' enterprises. In 2007, the PRC carried out reforms to unify the two tax rates, which eliminated the preferential tax rate of 15 percent for most enterprises. However, this tax rate still applies to the high-tech sector and small enterprises in the city.

5.2.4.2 Hong Kong and Foreign Countries' Investment in Shenzhen

At the beginning of economic reform, most entrepreneurs in Shenzhen were capital constrained, and these financial constraints affected their ability to self-finance their new ventures. Foreign investment had been a major source of infrastructure

investment, making up about a quarter of the total investment. Domestic bank loans made up a similar share. The investment from Hong Kong played key role in the 1980s (see Table 5.2).

Table 5.2 Main Sources of Contracted Foreign Investment in Shenzhen, 1986-94
(millions of U.S. dollars, unless otherwise noted)

Rank Source	1986	1987	1988	1989	1990	1991	1992	1993	1994	1986-1994	Percent
1 Hong Kong	239.5	164.3	333.6	402.1	547.3	984.8	2059.4	4116.7	2450.1	11297.9	78.1
2 Taiwan	0	0	14.1	9.9	48.4	26.5	108.1	219.1	120.8	546.8	3.8
3 Japan	87.9	103.4	67.6	11.3	10.6	79.9	38.6	74.9	26.9	501	3.5
4 United States	10.5	7.8	34.4	22.9	12.5	9.8	47.6	182.9	80.1	408.6	2.8
5 Singapore	50.1	4.3	17.4	3.3	31.3	6.9	21.5	21.3	70	226.1	1.6
6 Britain	36.5	0.2	6	0	7.7	17	53.7	73.5	24.2	218.9	1.5
7 Canada	12	0	1	0.6	1.2	0.3	40.7	72.5	9.2	137.5	1
8 Australia	12.9	0.9	0	0.5	5.5	4.8	32	79.3	0	135.8	0.9
9 Thailand	0.6	1.1	0	25.9	10.9	0.7	0	52.8	14.2	106.2	0.7
10 Switzerland	25	0	0	0	8.1	0.8	0	0	0	33.9	0.2
Total top 10 sources	475	281.9	474.1	476.5	683.5	1131.5	2401.6	4893.1	2795.5	13612.8	94.1
Shenzhen total	513.6	648.9	487.4	489	693.4	1151.6	2517.7	4977.4	2986.5	14465.6	100

Source: Shenzhen Statistical Bureau, Shenzhen Socio-Economic Statistics, 1979-1985 and 1986-1990; Shenzhen Statistical Yearbook, 1992; Ministry of Foreign Economic Relations and Trade, Almanac, 1993 to 1995, cite in WU Weiping, (1999)

The sources of investment in Shenzhen included countries from the developed and the less developed countries and included such countries as Japan, Germany, France, Britain and the U.S.A, Hong Kong, Taiwan, Thailand, and the Philippines. The top ten sources (see Table 5.2) make up a high of 94.1 percent of all contracted foreign investment in Shenzhen between 1986 and 1994. Hong Kong alone signed contracts worth US\$11.30 billion, about 78.1 percent of the total contracted foreign investment.

5.2.5 Reforms in the Labour Market: A Young Migrant City

The population in Shenzhen grew rapidly after the establishment of the SEZ. In 1978, about 314,000 native people inhabited Shenzhen. By 1990 the total population of Shenzhen had reached 1,332,900¹⁴. In 2008 its official population was listed at around fourteen million (including so-called “floating” residents”), and Shenzhen has, for the past 30 years, been the fastest growing city in China.¹⁵ The population

¹⁴ *Shinian jianshe de huihuang chengji*, pp.42-3 1992

¹⁵ http://en.wikipedia.org/wiki/Shenzhen#cite_ref-SZGov_2-0

was divided between the inside of the SEZ and the surrounding area. Table 5.3 shows the growing population in Shenzhen from 1980 to 1999. It was calculated in two parts, the inside and the outside of the SSEZ.

Table 5.3 The Population Growth (Registered Residents) in SSEZ and Shenzhen

Periods	Population Growth in the SSEZ	Population Growth outside of SSEZ	Total Growth in Shenzhen
1980-1989	103,700	72,300	176,000
1989-1992	64,300	166,700	231,000
1992-1995	97,400	183,300	280,700
1995-1997	195,000	53,000	1,725,000
1997-1999	86,000	37,000	123,000

Source: author http://www.tranbbs.com/Techarticle/TPlan/Techarticle_13541.shtml

In the 1980s, Shenzhen became one of the largest recipients of immigrants in China (Zhu, et.al 1998, p.165). It also shows that after Deng Xiaoping's "famous southern investigation tour" in 1992 the population grew quickly again. After 1995 the population in general declined in Shenzhen; however the population in the SEZ grew at twice the rate than that outside of SEZ. In 1999, the total population in Shenzhen reached about 4 million, with around 1.9 million in the SSEZ and 2 million in Shenzhen outside the SSEZ.

The average age of the population in Shenzhen shows the vitality of this young city. Shenzhen has been a home for migrants from across the Mainland, and more and more for migrants from abroad. Migrants account for 83 percent of the total population. Shenzhen's demographic profile favors economic development. For example, in 2008, the average age in Shenzhen was under 30. And among the total population in Shenzhen, 8.49 percent were aged between 0 and 14; 88.41 percent between the ages of 15 and 59; those aged 65 and above accounted for only 1.22 percent of the whole population.

5.2.6 Immigrant Entrepreneurship: the Start-up Companies in Shenzhen

During the 1980s, the official policy encouraged government, party, and even military organizations to generate their own revenue through business activities, and the response was often enthusiastic. The following cases illustrate how entrepreneurs managed in Shenzhen at the beginning of economic reform in the 1980s.

5.2.6.1 The Start of the Huawei Group (Part I)

Mr. REN Zhenfei was one of the founders of Huawei. He was a retired 43-year-old regimental high-ranking cadre of the People's Liberation Army (PLA), and in 1987 he founded Huawei with another seven researchers in an old factory in Shenzhen. Their start-up capital of RMB 20,000 was provided collectively from each of their families.

As a start-up company, Huawei did not possess any core technology of its own. At that time, the traditional telecom equipment market was crowded with all the major players in China. How to survive amid this fierce competition? Mr. REN Zhenfei was a former director of the Center for Information Technology (CIT) within the Information Engineering Academy (IEA), which was responsible for the telecommunication research for the PLA. Based on his experience, he chose to specialize in digital telecom equipment due to the lack of intense competition in this particular area. Mr. REN chose to act as an agent for a company from Hong Kong to introduce program-controlled switches into the Mainland. Huawei became successful by seizing the opportunity at the beginning of the reform in Shenzhen. In the early years of start-up, Huawei sold imported telecommunication equipment under heavy funding from extra budgetary sources. This gave Huawei the opportunity to learn about the high-technology and reduced the uncertainties of technological commercialization. It also created a team of technologists in Huawei for further innovation on related products (Deng, 2003).

5.2.6.2 Shenzhen Tianma Micro-Electronics Co. Ltd.

In October 1983, a Liquid Crystal Display (LCD) production line was purchased on the Mainland China because the quality of the same type of operation in Hong Kong was not good enough. In 1983 the China National Aero-Technology Import & Export Company in Shenzhen and Beijing Electronics Company bought this LCD production line and founded Shenzhen Tianma Micro-Electronics Co. Ltd. From the year 1984 Shenzhen Tianma Micro-Electronics Co. Ltd. invested in technological innovation to expand its production capacity, specializing in producing LCDs and Liquid Crystal Modules (LCM). From producing the very low-end products Tianma developed to become one of the best LCD manufacturers in South East Asia in the

first ten years of operation. On entering the 21st Century Tianma has three LCD plants and two LCM plants, with an annual capacity of 200 thousand square meters of LCD and 50 million pieces of LCM. From the production line to point of sale, Tianma offers a one-package service, including consulting, design, production and the sale of LCD and LCM, with professional technical support throughout. The rate of export reached more than 98 percent and its market stretches across South East Asia, Germany, the United States and Canada (Chinese Letter of Liquid Crystal, 1993).

5.2.6.3 Mr. SHI Yuzhu's Start-up

Start-up in Shenzhen - Mr. SHI's new Career as an Entrepreneur

Mr. SHI Yuzhu was born in the town of Huaiyuan, Anhui Province in 1962. In his twenties he entered Zhejiang University. After graduation with a degree in mathematics, he was assigned to the Statistic Bureau of Anhui Province in 1986. Because of his brilliant work, he was soon sent to Shenzhen University to study a software scientific management graduate course. After graduation in 1989, he was upgraded as a section-level cadre. Most people thought that was a great opportunity for him in politics, but Mr. Shi chose another field.

At the beginning of the 1990s, Shenzhen became a very open city to the world where the entrepreneurial atmosphere was strong and where the most successful entrepreneurs of China assembled. At that time, Shenzhen University was a newly established school with few contributions academically and little academic atmosphere; however it shared the rich entrepreneurial spirit of Shenzhen, and many entrepreneurs were invited to visit the university. Once Mr. SHI listened to a speech made by an entrepreneur in Shenzhen University and was much moved by his career of entrepreneurship. He then began to devote himself to desktop typeset printing system research. After nine months' hard work, he became successful with the desktop typeset printing system M-6401. "M-6401 Desktop Publishing Printing System" is a Chinese word processor designed by Mr. SHI Yuzhu. It was first released in 1989 for PCs running DOS.

Mr. SHI decided to resign from his position in the municipal government. After 1992, cadres more commonly left their official posts to "jump into the sea" of private

enterprise but maintained close personal and financial ties with their former agencies in Guangdong Province. However, in the rural areas of Anhui Province the official policy did not encourage the development of private enterprises and entrepreneurship in the 1980s. On the contrary, in the 1980s Shenzhen became a hot spot for Chinese intellectuals and young college graduates, a great number of people rushed into Shenzhen to start a new life. Mr. SHI became one of them. He quit his job and went back to Shenzhen to seek better opportunities, although his decision was strongly opposed by his leaders and relatives.

That he chose Shenzhen for his start-up city was appropriate. He continued his research at the student computer laboratory in Shenzhen University. By the summer of 1989, the M-6401 system was perfected. In order to get a business license, Mr. SHI Yuzhu contracted with the Tianjin University to run the branches of a computer office in Shenzhen with only RMB 4000 Yuan in his hand. In order to present products to clients, he bought a computer on credit with RMB 1000 Yuan. His problem was how to open up the market for his software.

Gaining the first pot of gold in Shenzhen

Mr. SHI managed to enter the software market. On August 2, 1989 he used the software's copyright as a guarantee to publish advertisements in the magazine "Computer World" instead of paying. After 13 days, Mr. SHI got his first remittance of RMB 15,820 Yuan on his first sale of an M-6401 system. And he had achieved a profit of RMB 100,000 Yuan after one month. Four months later, he had earned RMB 1 million.

Mr. SHI dreamed of owning a private computer company which would be as successful as Blue IBM in the future, he named his company "Giant." However, the company registering organizations in Shenzhen wanted a letter of guarantee from his institution to prove that he did not take part in any activities at the Tiananmen Square Event. In 1989, no organization would provide a guarantee letter for him because he was not an employee. Finally, Mr. SHI opened a private company in Zhuhai City (another SEZ opened in Guangdong Province in 1979). Mr. SHI developed the products M-6402 to M-6405. In July 1991, the head office of the Giant Group moved from Shenzhen to Zhuhai. The number of franchises had increased to 38, which placed the Giant Group as the second national private high-tech company

following Sitong Company (a well-known private high-tech company in Beijing). The new products gave him not only great success but also a great team. Several young men joined and followed Mr. SHI, regardless of whether the company was doing well or not.

In summary, as an early launcher of reforms, Shenzhen had developed a complete system of policies and regulations similar to those in a market system, such as labour management, financial support, government policies and banking services. The above cases indicate that the innovations in the political environment and an open liberal policy are the most important reasons behind this.

5.2.7 Shenzhen's Achievement after Three Decades

Three decades later by the mid-1990s, Shenzhen is one of the most successful SEZs (see Table 5.4). By this time, a large number of companies had been set up in Shenzhen.

Table 5.4 A Comparison of the Indicators in the four Special Economic Zones in China (1994)

<i>Indicator</i>	<i>Shenzhen</i>	<i>Zhuhai</i>	<i>Shantou</i>	<i>Xiamen</i>
Area (square kilometers)	2.021	1.583	2.064	1.516
Population (millions)	3.4	0.6	3.9	1.2
Employment (millions)	2.2	0.5	2.1	0.9
Fixed asset investment (exchange rate in 1994; US\$ billion)	1.86	1.14	0.87	0.60
Gross domestic product (exchange rate in 1994; US\$ billion)	6.71	1.96	2.33	2.24
Gross value of industrial output (exchange rate in 1994; US\$ billion)	11.27	2.85	3.49	3.38
Contracted foreign investment (US\$ billion)	2.99	1.27	1.33	1.87
Utilized foreign investment (US\$ billion)	1.73	0.76	0.77	1.24
Exports (US\$ billion)	18.31	1.49	2.20	3.39

Shenzhen: The original Shenzhen SEZ was 327.5 square kilometers. It was expanded in 1993 to include Baoan County. (see Map 5.1) The population figure for Shenzhen includes both registered permanent residents and temporary migrants.

² Xiamen: Foreign investment data for Xiamen only include foreign direct investment.

³ These figures are converted from the Chinese currency (RMB), based on the 1994 exchange rate of RMB 8.45yuan = US\$1.

Source: Ministry of Foreign Economic Relations and Trade, *Almanac*, 1995; *Business China*, 27 November 1995, p.9; Shenzhen Statistical Bureau, *Statistical Collection*, 1991; State Statistical Bureau, *China Statistical Yearbook*, 1995; *China Urban –statistical Yearbook*, 1995. in WeiPing Wu, "Pioneering Economic Reform in China's Special Economic Zones - the promotion of foreign

investment and technology transfer in Shenzhen". *Ashgate Publishing Company*, 1999.

From 1979 to 1994 Shenzhen became the center of attraction for foreign investment, in Guangdong Province and in the entire country. At the national level, Shenzhen alone accounted for 5.1 percent of utilized foreign investment and 8.2 percent of FDI between 1985 and 1994 (see Table 5.5). Shenzhen is the home of the Shenzhen Stock Exchange as well as the headquarters of numerous high-tech companies.

Table 5.5 A Share of Shenzhen's Foreign Investment in Guangdong Province and in China (1979-1994) (percentage, unless otherwise noted)

	1979	1982	1985	1988	1991	1994	Average
<i>Average size of FDI</i>							
Contract (US\$ million)							
Shenzhen	0.5	2.7	2.8	0.7	1.1	1.3	1.5
Guangdong Province	-	-	1.2	0.8	1.1	1.8	1.2
China	-	5*	1.9	0.9	0.9	1.7	1.4

Note: - not available *. This is the aggregated figure for 1979-1982. FDI-foreign direct investment

Source: WU WeiPing (1999, p.30), "Pioneering Economic Reform in China's Special Economic Zones - the promotion of foreign investment and technology transfer in Shenzhen". *Ashgate Publishing Company*.

Guangdong Statistical Bureau, *Guangdong Statistical Yearbook*, 1985, 1986, 1992; State Statistical Bureau, *Historical Statistics, 1949-1989*; *China Statistical Yearbook*, 1986 to 1989, 1992, 1996.

5.3 Analyzing the Success Factors with regard to the Shenzhen Model

The above has analyzed the factors which contributed to Shenzhen's achievement, such as the special policy framework, government infrastructure investment, the success of absorbing foreign investment, and the reforms in the labour market. In order to know how the top-down policy on building SEZ pushes the local politics to live up to the commitment to reform, the next section discusses the factors that benefit entrepreneurship in Shenzhen. Beginning with an analysis on the economic ties between Shenzhen and Hong Kong, this section goes on to discuss the socio-cultural environment and other preferential policies in both districts.

5.3.1 Analyzing the Close Economic Ties between Hong Kong and Shenzhen

When comparing several investment factors between Hong Kong and Shenzhen, it is noticeable that while Hong Kong had strong advantages in capital, production, management and marketing skills, while Shenzhen's had other competitive advantages. On the Mainland such supplies as food, water, energy and raw materials

cost much less than in Hong Kong. Furthermore, Shenzhen had abundant and inexpensive land, and more particular, a large, low-cost, qualitative and disciplined labor force (see Table 5.6).

Table 5.6 Close Economic Ties between Hong Kong and Shenzhen

Factors	Hong Kong	Shenzhen
Labor force	Severe shortage	A large supply of low-cost and disciplined labor force
Land price and rent	Very high	Abundant and inexpensive land
Government policy on pollution and labor legislation	Tight and restrictive	Not strict and no complete labor legislation in the late 1970s
Capital	Enormous capacity to raise productive capital and syndicated loans	Severe capital shortage in the 1970s
Production and marketing skills	Advanced international experience and large trading network	Lack of experience and trade network
Management	Rich management experience	Lack of management experience
Potential market	Little in Hong Kong	Large potential market

Source: edited by author based on WeiPing Wu, "Pioneering Economic Reform in China's Special Economic Zones- the promotion of foreign investment and technology transfer in Shenzhen". Ashgate Publishing Company, 1999, p.40-42

The close economic ties between Hong Kong and Shenzhen have been strengthened by industrial relocation based on joint production and a division of labor. At the beginning of the economic reform, inflation on the Mainland was low and people expected economic stability; the stable fiscal and monetary policies and the preferential policies encouraged Hong Kong businessmen to be more confident in their entrepreneurial decisions. Shenzhen became an expansion outlet for Hong Kong's industries. Shenzhen helped to keep Hong Kong's exports competitive on the world market. Firms in Hong Kong have therefore moved their labor-intensive production facilities or processes to Shenzhen, and left the more skill-intensive process of design, testing, marketing and technical support in Hong Kong. On the other hand, Shenzhen benefited from the large investments coming from Hong Kong which made Shenzhen's rapid industrialization possible.

5.3.2 Institutional Antecedents of Economic Development

At the beginning of economic reform in 1978, weak property rights were one of the obstacles in exploiting entrepreneurial opportunities in China. Shenzhen was allowed to develop a regulatory scheme that differed in many ways from the rest of country that of legalizing private enterprises and private ownerships. Political environment innovation means not only installing property rights, but also ensuring that the property rights are enforced by a third party to reduce transaction costs, e.g. the rule

of law must be enhanced. The 1979 Joint Venture Law did not specify an upper limit for foreign equity, so in theory foreign ownership could be up to 100 percent. This guaranteed entrepreneurship development in providing the resources to escape the constraints placed on entrepreneurship due to lack of capital and the limited access to high technology. As a result the sizable proportion of wholly foreign-owned enterprises increased from 1979 to 1986. From 1979 to 1982 Shenzhen was characterized by the growth of FDIs and a large number of contractual joint ventures; the strategy of economic reform in the 1980s stimulated many entrepreneurs overseas to invest in Shenzhen. The prerequisite for this was that various types of ownerships in the SEZs were allowed. Based on all this, the entrepreneurs were then confident that their entrepreneurial profits would not be taken away from them arbitrarily (see Table 5.7).

Table 5.7 A Comparison of the Institutional Environments in Shenzhen (1978 to the mid-1990s)

	Factors on opportunity exploitation before 1979	Active factors on opportunity exploitation in the mid-1990s
Economic Environment	A narrow range of light industry under planned economy Low level of technology and personal wealth	Foreign investment enterprises with higher technology Absorbing large amounts of capital Transferring from planned economy to free-market economy
Political Environment	No freedom of economic activity No property rights Centralization	Special policy on property rights and ownership reform Enhancing rule of law Innovation on institutions Transforming to decentralization
Socio-cultural Environment	No social desirability of entrepreneurship No freedom of organizing associations Overseas Immigrant Culture	Enhancing social desirability of entrepreneurship, Presence of entrepreneurial role models Spatial advantage with Hong Kong The Immigrant Culture

Source: based on Personal Interview P 9 , P6 and P10, author

As a result, the amount of utilized foreign investment grew at an annual rate of over 40 percent each year, reaching over US\$ 143 million for the first time in 1983 and peaking at US\$ 489 million in 1986 (Grub, 1985). FDI was the largest component of utilized foreign investment in Shenzhen, and its share remained above 60 percent except in 1979 and 1985 (Wu 1999, p.30). Equity joint ventures became the most common form of FDI. This was partly because the central government strongly encouraged investors to enter into equity investment contracts, which were likely to bind together the interests and risks of the foreign investors and the Chinese, and to provide opportunities for technology transfer (ibid., p.31).

5.3.3 Immigration and Labor Policy in Shenzhen

In 1984 Mr. Deng Xiaoping visited Shenzhen and other SEZs in China, he pointed out, that the local government should “bring advantages not only economically but also in the fostering of human resources” (O’Donnell, 1991). Since then, Shenzhen’s government undertook preferential policies to spur immigration to meet the huge demands for skilled workers and technologists in Shenzhen. Shenzhen, like other SEZs, enjoyed a privileged status in recruiting labor and sourcing materials. In May 1983 and March 1984 the Shenzhen government even sent recruiting teams to major cities with the aim of finding professionals, technicians and educated laborers for Shenzhen (Colin Mackerras, 1994). Furthermore, Shenzhen enjoyed more preferential and flexible policies than other cities on the Mainland. For example, FIEs in Shenzhen were free to recruit their employees through job advertisements and screenings before submitting them to the Shenzhen labour bureau. Enterprises were allowed to recruit senior management and technical personnel from throughout the country. This enabled Shenzhen to overcome, to some extent, the problem of labor immobility and to gather the most talented workers from across the country. The problem was that Shenzhen had no wage controls. FIEs were free to set their wages according to their own assessment of the nature of the enterprise, type of work, level of skill, and performance.

Table 5.8 The Structure of the Labor Force in Shenzhen in 1991

<i>Labor category</i>	<i>Total number of personnel</i>	<i>Proportion</i>
Agriculture and Forestry	13,203	2.03%
Industry	342,090	52.72%
Geological Surveying	736,000	0.10%
Building Industry	45,108	6.95%
Transport and Communications	32,404	4.99%
Commerce	91,479	14.10%
Real Estate and Citizens' Advisory Services, Tourism	50,912	7.88%
Health and Social Services	11,689	1.80%
Education, Culture and Broadcasting	19,559	3.01%
Scientific Research and Technology service	1,968	0.30%
Finance and Insurance	11,658	1.80%
State and Party Organs	28,049	4.32%
Total	648,855	100%

Source: Shenzhen tongji nianjian (Statistical Yearbook), 1992, pp. 412-13

Table 5.8 indicates that the industry, especially light industry, employed the most, whereas the proportion of employees working in scientific research and finance is much less than in industry. In Shenzhen the population structure polarizes into two opposing extremes: intellectuals with a high level of education, and migrant workers with poor education.¹⁶ Starting in 1992, to protect the legitimate rights of its migrant

¹⁶ Shenzhen Government Online, Citizens’ Life (Recovered from the Wayback Machine)

workers, Shenzhen was quick to promulgate new laws and regulations to start reforming the civil service. Shenzhen was among the first cities in China to bring migrant workers into the municipal social welfare system. Because some of the companies (mainly in the construction industry) didn't keep their promises to pay the peasant workers on time, the migrant workers had had problems in receiving their wages. The government supported the migrant workers in claiming their back payments since 1997. For instance, in 1997 about RMB 237 million (US\$29.2 million) were retrieved for the workers.

5.3.4 The Establishment of the Entrepreneurship Garden on High-tech R&D

With the objective of absorbing high-tech projects and specialist knowledge from the world, Shenzhen became one of the first cities in China to build an Entrepreneur Garden. The infrastructure was completed with preferential policies for financial support, for qualified government programs and research and development transfer with organization services. For instance, the entrepreneurs with high-tech patents could receive an initial capital amount of RMB 300 thousand (free of charge) for a start-up in Shenzhen Entrepreneurial Garden, and with a funding capital of RMB 500-1000 thousand for further R&D. This sum of money was supplied by the Shenzhen government (Tang, 2007).

From the year 1992 to 2007, Shenzhen municipal government sent five recruiting teams abroad to recruit scholars and students to Shenzhen. The projects touched many new research fields, such as within the IT industry, finance and logistics. The preferential policy and effective government service absorbed many graduates who came to Shenzhen from not only from abroad but from other urban or rural areas in China. It was reported that over 20 percent of China's PhD's worked in Shenzhen. Company Huawei and Netac Technology Co. Ltd. (products include computer & peripherals, electronics & electrical appliances) are two of the most successful enterprises which were incubated in the Entrepreneurship Garden in Shenzhen in the 1980s.

All these factors, such as the preferential policies in Shenzhen SEZ, institutional innovations, financial support, and the building of the Shenzhen Entrepreneurship Garden favored young entrepreneurs getting started in Shenzhen. However, as one of

the important items in the institutional environment, an analysis of the socio-cultural environment should not be neglected.

5.3.5 Culture Values in Shenzhen and their Influences on Entrepreneurship

In comparison with other cities, Shenzhen had a more rapid growth of immigrant population and the average age of the population was much lower than elsewhere. Several researches on the analysis of the individual characteristics have provided much to explain entrepreneurial activity in general. The research on personal characteristics highlights several prominent factors which facilitate entrepreneurial behavior such as being relatively young (Rees and Shah, 1986; Reynolds, 1997), willingness to bear uncertainty (Knight, 1921), and the desire for achievement (Baum et al., 1993; Busenitz and Barney, 1997).

My questions are: Were there any other prominent cultural factors which helped to shape Shenzhen into becoming the most successful SEZ? And how did the entrepreneurs in Shenzhen capitalize on resources and assets located in social networks for instrumental actions. The next section will discuss this in detail.

5.3.5.1 Personal Achievement and Self-realization

The labor market reforms and preferential policies of Shenzhen attracted large numbers of young entrepreneurs from all over China to Shenzhen to start their nascent entrepreneurship in the early 1980s. Each came to Shenzhen with their dreams, and they sought to achieve these dreams. They were not being pushed but were willing to be in the “uncertain” circumstances in Shenzhen. For example, Huawei president Mr. REN Zhengfei served in the army before he started his company; Mr. SHI Yuzhu worked as a cadre in a State Bureau in Anhui Province before he went to Shenzhen (see §5.2.6.3). The founder of Quanshun Human Resource Company, Mr. ZHANG Quanshou came from a poor rural area and became a successful entrepreneur in Shenzhen (see §5.5.3). These cases show the innovative spirit of the city that stems in part from its vibrant and strongly motivated migrant community.

5.3.5.2 Strong Risk-taking Intention and Team-working Spirit

When I asked an entrepreneur the question “Why did you move to Shenzhen?” He replied: “I searched for something different and new in my life” (Interview P6). The

search for something different and new is a strong motivating factor in entrepreneurship. Feeling frustrated and dissatisfied with an old egalitarian system, the people moved to Shenzhen with their dreams. The excitement of not knowing exactly what might happen encouraged young migrants to take the risk. They believed that if they wanted to do something, it had to be done now, while they were still young! (Interview P.10, author). Even though, once there, the excitement often wore off quite rapidly.

Were the youth in Shenzhen frightened of failure? The question could hardly be explained with a simple “yes” or “no”. The market economy, in order to function well, needed people to believe in their chances of success in Shenzhen, to believe in the meritocracy and fairness of the system. Comparing the people who live in Shenzhen with those in other parts on the Mainland, the people in Shenzhen seemed to have more of a say in their future and could somewhat rightly think of themselves as being the architects of their own fortunes.

Furthermore, the emergence of multicultural communication and competencies produced more opportunities for entrepreneurs to have start-up. Shenzhen people seemed to have more tolerance, harmony, unity and mutual assistance among themselves. They kept the “win-win” disciplines while doing business with their partners (Interview P 7, P10). Even now Shenzhen people are famous for their cooperation in their entrepreneurial activities. So to compete in a cooperative way is an important value of the entrepreneurial culture in Shenzhen.

5.3.5.3 Flexible and Liquidity Preference

Usually pragmatism has the upper hand on rationality. The catchword of Deng Xiaoping was that: “It does not matter whether it is a black cat or a white cat, as long as it catches rats, it’s a good cat.” And this seems to have been adopted by the entrepreneurs of Shenzhen. Irrationality and sentimentality would seem to have no place in Shenzhen culture. Instead of getting upset, one thinks of the easiest way to overcome or avoid the problem. This is a matter of being flexible, another one of Shenzhen’s favorite characteristics in their regional culture (Kjellgren 2003, p.257).

According to the State Population Yearbook in 2004, Guangdong Province had the largest floating population in China. Since the late 1980s a large and growing number

of migrants (including immigrants) poured into Shenzhen, at the same time many Guangdong natives left Guangdong Province to find new opportunities around the world. Compared to the whole of China, the rate of the Guangdong natives' floating population reached to 11.04 percent within Guangdong Province (China Population Annual 2004). The flexible and liquidity preference benefits the entrepreneurs to find opportunities and improve the information flow in their entrepreneurial activity.

5.3.5.4 Emphasis on Money-making

The strong motivation of entrepreneurship is influenced by the entrepreneurial values. Opposite to the social ideology in a communist society, between 1978 and 1979 Deng Xiaoping's thought about the honor of becoming rich began to present itself in the media, and Shenzhen began to emphasize money-making officially. In order to solve the problems of insufficient investment, the municipal government highlighted the values of pursuing money and had to find money themselves. People went to Shenzhen for the same reason: to advance in life and to make money (Sönne 1999, p.149). And they became valued for the money they earned. Hence both the local government and the individuals searched for money. Shenzhen was a place where money could be made on a large scale, and this was not possible in the rest of the China during the 1980s. For example, peasants who were willing to work on construction sites or on assembly lines in Shenzhen could earn up to ten times the amount they would earn in other parts of China. An entrepreneur described: "In Shenzhen to become rich indicated more social power and prestige, so the important aspect of work is no longer what you do, or even how you do it, but how much you do" (Interview P 10). People respected the careers of businessmen and entrepreneurs. This challenged the traditional values in the thoughts of Chinese Confucianism.

5.3.5.5 Shenzhen Speed and the Spirit of Hard Work and Sacrifice in the 1980s

In the late 1970s, many government leaders came to Shenzhen and were deeply impressed by the speed at which Shenzhen developed. A leader explained after his visit to Shenzhen: "They (the people in Shenzhen) were busy earning money; they spoke and walked quickly, and made decisions quickly. The city was a vivid city" (Interview P7). Shenzhen speed was one of the symbols to describe the different type of life in this city.

Another two symbols that distinguished Shenzhen from other cities in China was its hard-working and sacrificing spirit. In the 1980s large labor forces were needed to construct Shenzhen. About 20,000 soldiers in the corps of engineers were transferred to Shenzhen. They had rebuilt Tangshan after the earthquake in 1976, which was China's largest urban construction project. When the fundamental work was finished in 1983, the corps was demobilized but many ex-soldiers stayed on in the zone and made up the core of the building force for years to come. Twenty years later, some of them still lived in the so-called "settled-areas" with their family and had no Shenzhen permanent resident identification (Kjellgren 2003, p.119). The peasants came to Shenzhen and worked there for several years, then some of them went back to their hometown and some stayed in Shenzhen. They had many dreams, such as a house for themselves, capital for private enterprise and fashionable clothes.

In summary, this part has discussed the different values in respect of entrepreneurial spirit in Shenzhen, such as the desire for personal achievement, strong risk-taking intention, team work and on money-making. Every society creates, intentionally as well as unintentionally, an environment of its own including economic, political and legal institutions, which influence people's attitudes towards entrepreneurship. Shenzhen set up a stage for entrepreneurs, either within the free political environment, economic environment or in the socio-cultural environment. In particular, Shenzhen immigrants shaped its cultural values to enhance the social desirability of entrepreneurship.

5.4 Barriers to Shenzhen Entrepreneurial Development

The factors discussed above had contributed to the successful development of Shenzhen entrepreneurship; but despite these factors barriers still emerged to constrain the development of entrepreneurship in Shenzhen. The next part analyzes the reasons for these problems.

5.4.1. Failure to Absorb High-Tech Investment from Developed Countries

Shenzhen had succeeded in absorbing large amounts of foreign investment since the 1980s, Shenzhen however, failed to absorb high-tech investment from developed countries. On the one hand, Hong Kong, Japan and the U.S were the three main sources of foreign investment in Shenzhen in the 1980s. The investments from all three sources (Japan, the U.S. and Hong Kong) were largely concentrated at the low

end, labor-intensive manufacturing such as electronics, consumer electronics, chemicals, metal products, textiles & dyeing, garments, machinery, rubber & plastics products, and glass products (Wu 1999, p.35). On the other hand, after establishing the Shenzhen SEZ, three other cities were approved by the State Council of the PRC to become SEZs later in 1979. These were Zhuhai, Shantou and Xiamen. They joined Shenzhen to become the first group of “Special Economic Zones” (SEZs) on the Pearl River Delta in China. At the end of the 1980s, Shenzhen’s role in attracting foreign investment at both the national and provincial levels began to diminish. The decline was mainly the result of the gradual opening up of fourteen other coastal cities after 1984, which meant Shenzhen no longer enjoyed an exclusive, privileged status (ibid., p.27).

How would it be possible to continue to absorb high-tech investment from abroad? The key point was how to protect the intellectual property rights. This was the dispute between many foreign investors and the Chinese government, since such protection would be central to effective technology transfer. This topic will be discussed in part (§5.4.4).

5.4.2 The Influence of the State’s Policy Making to Shenzhen’s Development

China’s economy influenced much of the State’s policy in the transformation from a planned economy into market economy. Policy-making has sometimes advanced and sometimes frustrated China’s economic development. As a result the local economic policies were influenced by the terms of releasing and holding back, as being different characteristic of different reform periods. For instance, when the economy was strong, it supplied more opportunities for nascent entrepreneurship. Since explosions of reform brought unwanted effects such as high inflation, increasing unemployment and social instability, this became a threat to Chinese social stability, and as a rule, it is followed by a period of holding back. Influenced by the State’s policy, Shenzhen’s reforms have not formed a straight line. In a recapitulation of Guangdong’s reforms during the same period, Mr. WANG Zhuo speaks of no less than six campaigns alternating between releasing and holding back the illustrated unstable institution environment in Shenzhen (Wang, 1992). As a result, high inflation and instable economic conditions made it very difficult to make forward-looking decisions.

5.4.3 Unbalanced Development on Institutional Environment in Shenzhen and other Mainland Cities

The fast speed of economic reform enabled Shenzhen to get ahead of other cities. This, however, led to many problems. When varied ownership was allowed in Shenzhen in 1994, the political institutions remained static in the northern part of China. In Shenzhen the reform process had become much more inclusive and accessible to private entrepreneurs, but the other cities continued their discrimination against the private entrepreneurs. This caused at least two obstacles: One was the unbalanced development on organizational structures between the improved institutional environment in Shenzhen and the old institutional environment in other parts of the Mainland. The other was the lack of freedom to make decisions which would only benefit Shenzhen by means of its organizational structure. If a particular level in the bureaucratic apparatus did not have corresponding units to those found on higher levels, problems arose with unclear power relations and difficulties in communication, etc. (Sönne 1995, p.155). At the end of the 1980s, Far Eastern Economic Review reported that "Setting up a foreign enterprise in Shenzhen still requires approval from more than 30 governmental departments" (Far Eastern Economic Review, 1989). These institutional challenges created a highly insecure business environment with increases in both uncertainty and transaction costs for foreign investors compared to those involved in making investments in their own institutional environment.

5.4.4 The Weakness of the Legal Framework

The SEZ regulations made it clear from the very beginning that wholly foreign-owned enterprises were welcome in the SEZs. Foreign invested enterprises (FIEs) indeed enjoyed many policy advantages, including tax breaks and preferential access to land. Domestic firms were subject to a tax rate of 33 percent, but FIEs enjoyed a concessionary rate of 15 percent for their first three years, followed by a two-year tax holiday after they started to report profits. With the purpose of absorbing more foreign investments to Shenzhen, the Chinese government made some efforts to strengthen the law in this area, issuing the 1982 Trademark Law, the 1985 Patent Law, and the 1990 Copyright Law (Beijing review 1991, p.31). However these laws were criticized by many Westerners as being incomplete. For instance, the Patent Law did not include the pharmaceuticals and the chemicals industries because of the conflicting interests of many domestic enterprises. This is

one of the reasons for the failure of absorbing high-tech technology in Shenzhen. Many investors took advantage of Shenzhen's weak legal system. For instance, they did not invest as much capital as they stated in their contracts (Interview P 6, P 10, author). The government was therefore forced to adopt rules and regulations to control these problems.

As a result, anarchy or the arbitrary rule of men and the weak legal framework could not give the state a monopoly on justice and set objective standards by which all citizens including political leaders must abide by. This led to the expansion of the government apparatus as well as to the explosion of corruption in China in the 1980s. A successful entrepreneur argued that "private entrepreneurs need to have a better understanding of their rights and of the legal system," (Interview P 10, author).

In summary, Chinese transition economies represented an appropriate laboratory in which to examine the relationship between institutional change and the development of entrepreneurship. On the one hand, it critically assessed the role of the state as an agent of institutional change, with regard to entrepreneurship. On the other hand, it examined the role of entrepreneurship and its contribution to the improvement of institutions. To protect against anarchy or arbitrary management, a high degree of enforcement of property rights must exist, and the rule of law is also required. The puzzle was how the Shenzhen municipal government managed to implement radical institutional self-transformation without self-destruction and how it built up a decentralized market system which enabled entrepreneurs to make better decisions. The next section discusses how institutional subversion and conversion helped to innovate the institutions in Shenzhen.

5.5 Institutional Subversion and Conversion

5.5.1 Decentralization

Centralization is inferior to a market system, because the central actor attempts to make all decisions instead allowing the invisible hand of the market forces. Therefore centralization restricts the incentive for entrepreneurship. In Shenzhen centralization was a key factor in coordinating the economic, political and social activity in society, hence decentralization was the only way to liberate Shenzhen from the constraints of the traditional institutions, to show the capabilities of Shenzhen as a society to

guarantee transparency in the process of economic transactions and the ability to enforce commercial contracts. Entrepreneurial innovation challenges conservative power, and the following two cases indicate how institutions were created and how the development entrepreneurship impacted the transformation of institutions.

5.5.1.1 Case Study: The Establishment of the Service Centre for Foreign Investment Enterprises

In the 1980s, domestic and foreign investment enterprises were still highly dependent on the functioning of the public administration even though dependency on redistributive state agencies for goods and services had decreased in Shenzhen. FIEs needed to obtain approval from different governmental departments, registration forms for their workers, licenses, supplies, and so on. Too many steps in the approval procedure made investments very time consuming. In October 1995, the government managed to establish the Service Center to simplify the formalities for FIEs. Why had such a centre not been established earlier? Because any attempt to take power away from some people and place it in the hands of others was met with resistance. In September 1992, in Shenzhen *Tequ Bao* wrote that “To some leaders, decentralization means that they will get no more privileges.” (*Shenzhen Tequ Bao* 1992, p.57) This was one of the reasons why it, firstly took such a long time to realize what had to be done and, secondly to actually make the necessary steps.

The establishment of the Service Centre helped to raise confidence in the local government amongst foreign investors. It made people feel more comfortable and satisfied with the government. For instance, the new and growing firms could get most of the required permits and licenses within a few weeks; it was easy for FIEs to get good, professional legal services in the Service Center; taxes and other government regulations were applied to new and growing firms in a simplified and consistent way (Interview P9).

5.5.1.2 Case Study: Shenzhen’s successful Recruitment of Promising Young people

Shenzhen had been allowed to recruit its administrative team on its own from the late 1980s onwards. It then put together a highly educated and qualified local government team. Highly qualified personnel were recruited mainly through civil

service examinations, in which only candidates with a diploma from one of the key universities of the whole country or Shenzhen University might participate.

Furthermore, Shenzhen was granted greater autonomy than other municipalities. Shenzhen also obtained greater autonomy in its relations with many ministries at the central level. Shenzhen received the rights to undertake various economic and administrative reforms. It was allowed to retain fiscal revenues and foreign exchange earnings, to allow foreign investment projects and to give preferential treatment to the foreign invested enterprises. The material and immaterial resources that were granted by the central government to the special economic zones had no precedence in the history of communist China.

These two cases show how institutions offering protection against expropriation of rents in their enforcement of simplifying the formalities for FIEs. This helps by removing some of the uncertainty about whether they will be able to retain the value they create. Such institutions are also likely to facilitate the disciplinary presence of competition by protecting economic freedoms e.g. elimination of statutory barriers to market entry and exit (Lawson, 2008). This encourages profit seeking to take a productive form in which value is created by way of product innovation, as opposed to unproductive or destructive forms in which value is created for customers at the expense of competitors (e.g., rent-seeking through market power or political power) (Baumol, 1990).

5.5.2 The Efficiency of the Local Government

As mentioned above (§ 5.3.5.5), it was during the beginning of the 1980s that people inland talked about the “Shenzhen speed”, not only because of the city’s rapid economic development but also because of the local government’s efficiency. After 1985, the local government expanded the most, and this resulted amongst other things, in a decreasing level of efficiency. Shenzhen immediately took steps to solve the problem and were able to do so because of the political freedom which it had been given by the central government. The case study (in §5.5.1.1) indicates the time needed to make the necessary steps to improve the efficiency of the local government. In 1986, Michel Osborne wrote in an Organization for Economy and Co-operation Development (OECD) report that one of the great advantages of dealing with SEZ authorities was that:

The red tape and bureaucratic procedures are reduced substantially, when compared to other areas of China. The lines of command and authority are clearly delineated, and the SEZ authorities themselves have direct access to provincial and central government officials without passing through the industrial and trade ministries for approval of contracts. (Oborne 1986, p.102)

Finally, Shenzhen indeed managed to remain less complex than most of the local governments in the country. A single transportation bureau in Shenzhen corresponds to seven or eight departments on the Mainland (Li and Su, 1992). In the meantime, many social organizations were established to meet the various needs of the society in Shenzhen. The following is a case study based on social and business entrepreneurs in Shenzhen.

5.5.3 Case Study: Introduction of Quanshun Human Resource Service Company

China's labor market includes not only the professionals and managers, and the headhunters for top executives, but also blue-collar workers. Until 2002 China's labor placement market was opened to private enterprises and the following year, it was opened up to foreign investment. Joint ventures with foreign investment mostly targeted the high-end headhunting market. There were almost no big players in the low-end blue-and grey-collar segment.

Occasionally Mr. ZHANG Quanshou dispatched some of his workers to help his friend in need of a labor force. He found a niche in the labor market and set up the Human Resources (HR) Services. A scholar (Mr. Zhang) stated that:

Generally speaking labor in Shenzhen and in China as a whole was attractive to firms in industrial relocation and offshore assembly in several ways: low wage costs, low social costs in the absence of government regulations, and a lack of organized power. Many firms from industrialized countries decided to relocate offshore partly to avoid unionized labor at home. Some hidden costs, such as housing and welfare subsidies may undermine this advantage. (Zhang 1993, pp.121-148)

In the Pearl River Delta region, the private enterprises needed skilled workers in the productive period while large numbers of peasants were dismissed when the enterprises received no production orders. The peasant workers were poorly educated; and they found it difficult to adapt to working in enterprises. Many enterprises refused to employ peasant workers. In such a situation, the law was

insufficient to safeguard the migrant workers' rights and security (see § 5.3.3). The migrant workers rights were so weak due to the lack of an enforcement body, and it was easy for enterprises to infringe what little rights the workers had. In the 1980s the government began to issue a series of regulations, mandating a 16-year minimum age for hiring, an eight-hour workday, labor protection, and the installation of social welfare benefits when applicable. However, it was not until the spring of 1991 that regulations banning the use of child labor were issued.

In short, the main problems of the peasant workers were: no security of food and accommodation; no health insurance; no job security and no laws to protect their rights. Mr. ZHANG, the founder of Quanshun Company, experienced the hard life as a peasant before he succeeded in Shenzhen. He decided to employ peasant workers. He was labelled as "the commander of immigrant peasants" by the media in China. Because of his trustworthiness, more and more peasant workers came to the Quanshun HR Company looking for employment. Mr. Zhang began to initiate a new management model. It was aimed at preserving the workers rights and interests, and furthermore the model was accepted by his customers. Enterprises were finding it hard to recruit enough skilled workers when orders were received and were starting to turn to HR companies in order to find suitable workers.

Once the peasants registered with the Quanshun HR Company, their board and lodging costs were paid by Quanshun HR Company. An agreement in the name of Quanshun HR Company was signed with the peasant workers, which guaranteed certain elements, such as wages, living standards, personal safety and several other issues. After they had received the necessary training, Quanshun HR Company was responsible for finding work for the peasants. The insurance of the workers if they became ill or had an accident was the responsibility of the Quanshun HR Company.

Under such a model, the training and recruiting of the workers were based on the requirements of the recipient enterprises. Before dispatching the workers to the workplace, Quanshun HR Company signed a contract with the recipient enterprises on behalf of the peasant workers, which stated the interests and rights of the workers. Quanshun HR Company dispatched workers to the enterprises as units of no less than 50 workers each. A foreman in each unit was in charge of the normal management. In order to ensure the income of each immigrant worker, the

enterprises paid the workers salary to Quanshun HR Company directly. This prevented migrant workers being deliberately ill-treated. This also helped to keep the migrant workers working effectively.

During the slack periods, the peasants would get a little sum of money each day and free food and accommodation until they found the next job. Once an employer failed to pay the wages, Quanshun had to pay instead. For example, a boss from Hong Kong ran away without paying the wages of his employees, Quanshun HR Company paid the peasant workers instead of the company.

Quanshun HR Company has managed to supply peasant workers to hundreds of foreign and private enterprises in Shenzhen since the end of 1990s, involving paper products, electronics, toys, plastics, jewelry, shoes, food and many other intensive labor industries. The scope of services crosses Xiamen, Dongguan, Shenzhen, Guangzhou, and other cities in Delta Pearl River. In 2009 after the economic crisis, many enterprises were confronted with a lack of labor force for production; Quanshun supplied thousands of skilled workers to these enterprises. Mr. Zhang has employed over 6,000 migrant workers from the rural areas in Henan Province and others. The employees received education on skills and regulations, cultivated the team spirit and good living and working habits.

Quanshun company's profits came mainly from the enterprises, which paid the extras as fees to Quanshun HR Company. Mr. YU Feng, an Executive Director of a toy factory said: "When the job can be finished in time with a high quality, I will pay an extra 0.5 yuan per hour as fees to Quanshun HR Co.". Another chairman of an electrical factory said that: "Quanshun Company helps us in need of workers, particularly we need not worry about the training and management of the workers and it supplies us the labor forces whenever we need. We should pay for this, and this is a good deal and we believe each other." (Telephone Interview P9).

In summary, Quanshun HR Company succeeded as a model of social entrepreneurship in positioning itself within a niche market in Shenzhen. Quanshun HR Company offered training and management services to the migrant peasant workers, and supplied labor forces to the enterprises. Quanshun gained a competitive advantage over other competitors by taking on the responsibility to protect the rights

and interests of the peasants and by keeping up its good reputation within HR sector. Hence, it developed a long-term partnership with other enterprises in Shenzhen. Now Quanshun management is regarded as a “win-win” innovative model in the HR market. The recipient enterprises are satisfied with Quanshun’s service, the peasant’s rights and interests are protected and Mr. ZHANG has realized his dream of wealth and a good reputation.

5.5.4 The Emergence of Informal Institutions: Trust System and Network Building in Shenzhen

Within a transitional economy like Shenzhen, entrepreneurs have more self-motivation for taking on responsibilities and taking on risks, and there is a greater chance that the financial rewards of running commercial ventures will be achieved. In order to reduce the transaction costs, entrepreneurial activity is considered desirable within a community, including an attempt to transform the established traditional institutional environment. At the same time, China’s institutions were experiencing remarkable transformations, but managed to avoid authoritarian collapse. Kellee S. Tsai argued about the emergence of Chinese institutions:

Millions of business owners and bureaucrats have disregarded or distorted certain rules in strikingly consistent ways. Their resourceful use of adaptive informal institutions has not only contributed to private sector development but also, unwittingly, to formal institutional development. (Kellee S. Tsai, p.210).

As discussed before, the culturally transmitted codes of conduct, values and norms are defined as “informal institutions” (North, 1990). For example, the comparative advantage between Shenzhen and Hong Kong lies not only in the close economic ties, but also in its proximity to Hong Kong and the Mainland areas of China. Because of their familiarity with the culture and business conduct on the Mainland, investors from Hong Kong encountered fewer difficulties than investors from other countries when operating in Shenzhen. On the other hand, Shenzhen acted as a transfer post to connect Hong Kong and the Mainland by the approved special policy from the central government and local institutional innovation. Fukusaku and Wall wrote in an OECD report from 1994 that:

There have been consistent complaints that to deal with these [operational] problems and

even to establish joint ventures at all requires considerable effort involving multifarious levels of bureaucracy and political actors. Companies need to join the Guanxi system to facilitate their successful operations....this is one reason why Hong Kong and Taiwan, which are familiar with the Guanxi system, have dominated FDI [Foreign direct investment] in China (Fukusaku, K. and Wall D., 1994, p.41).

Hence, the legitimacy and efficiency of institutions, whether formal or informal, depends on their reproduction by social, economic, and political actors (Powel and DiMaggio, 1991). This paper has analyzed the close economic ties between Shenzhen and Hong Kong. The next section argues how informal institutions, such as the trust system and social capital are produced by the interaction among the social, economic and political actors in Shenzhen.

5.5.4.1 Trust System Building in Shenzhen

When comparing with the trust system in Wenzhou and Sunan, the Shenzhen trust system has two factors. Firstly, structural trust in Shenzhen is valid beyond the individual level. Shenzhen's trust system was built on the basis of modernization and institutionalization of law and state apparatus. Unlike FIEs and FDIs, Shenzhen and Hong Kong shared the same ancestry, and the dialect of Cantonese is spoken in Hong Kong and Shenzhen as well as in Guangdong, but no where else on the Mainland. According to official estimates, ethnic Chinese made up close to 98 percent of Hong Kong's population of 5.8 million in 1988 (Wu 1999,p.45). A large part of the present population in Hong Kong largely came from Guangdong. Cultural proximity prompted many people in Hong Kong to consider investment in Shenzhen as both a patriotic duty and a convenient way to help their relatives or friends.

Secondly, the trust system of Shenzhen belongs also to the relational trust which has developed from the basis of sharing the same ancestry and the same language. The trust system in Shenzhen is heavily influenced by the social relations in Chinese civilization. Social relations in Chinese civilization emphasize networks in which boundaries are not rigid but shift depending on the context, and in which obligations toward others are contingent on the identities in dyadic interactions (Wank 1999, p.164). At the beginning, many young people came to Shenzhen independently without experienced, ascribed or mediated proximity or knowledge of others, so they had no advantage of networks or a trust system as people did in their hometown.

However the lack of a clan trust system was not a negative factor in Shenzhen, on the contrary it facilitated a new trust system without being restricted by family relationships. Because the key point is that social categories of in-group status and identity in Chinese society are more flexible in whom they actually encompass, creating the possibilities for producing trust in a wider variety of interactions and settings. For instance, their trust has been strengthened and expanded within the concept of traditional “family”. *Zijiaren* (my own people) and may include anyone who you want to drag into your own circle, and you use it to indicate your intimacy with them. The scope of *zijiaren* can be expanded or contracted according to the specific time and place. It can be used in a very general way, even to include everyone under the sun is a *jia* (one family) (Fei, 1948).

All in all, on the basis of the interactions described by law, custom and tradition, the in-group category of the family contains the strongest social trust benefit from formalized, institutional structure, and this trust can be more readily extended to other individuals. In Shenzhen, the trust system developed through cooperation and communication processes. Social interaction, negotiations and exchanges open up for the establishment of mutual understanding in spite of unclear or contradictory expectations.

5.5.4.2 Network building in Shenzhen

Informal institutions such as network will enable entrepreneurs to know the values and beliefs of the partners better. They represent a set of culturally constructed dyadic relationships, which are driven by entrepreneurs’ willingness and competencies to engage in ongoing interpersonal relationships. The kinship network can be regarded as a major tool for developing social connections. For example, the exchanging of gifts is regarded by the investors from the West as a form of corruption. The Chinese do not think of it in that way. They got into the habit of exchanging a big gift to do business and to maintain good relations (Lockett, 1987). Through a gift exchange system, either in the material form or by offering services, the existing connections can be reinforced or new ones can be cultivated. By means of building a network on the basis of existing private *Guanxi*, businessmen may get more valuable information, access to higher authorities or a speedy handling of contract negotiation and approval.

Virtually all towns and villages in Shenzhen and southern Guangdong have abundant private connections with Hong Kong. Hong Kong investors have been able to obtain more favorable concessions from the local authorities in Shenzhen than investors from other countries, often not on paper but nonetheless in reality. This indicates the access to business networks and relational governance is on the basis of the mutual understanding and traditional clan systems. The case of Huawei Group indicates the importance of trust system and network creation for a start-up company to survive.

5.5.5 Case Study on High Technology: Huawei Group (Part II)

Huawei started up with agents from a company in Hong Kong (§ 5.2.6.1). Instead of setting up R&D centers in China, most foreign companies retained their core research back home and poured end products directly into the Chinese market. Foreign companies would not develop technology and invest large scale in Chinese market due to the risks involved. They were not a good fit for the poor conditions of the Chinese civilian network. The regulatory framework for technology transfer in Shenzhen was far from adequate; in this case China became a large manufacturer because of its high quality products and cheap labor.

By the end of the 1980s, the chaotic telecom equipment industry in China had arrived at a critical intersection (Bernadette, et.al. 1998). The government began to transfer more advanced switching technologies from abroad and to seek partners to set up joint production ventures under economic pressure from industrialized countries. Being a private company and having experience in the field on switching technologies, Huawei faced choices whether to continue to buy imported products or develop technology locally.

Mr. REN Zhengfei was sensitive to the high technology; he took a risk to invest in technical research. The gamble did not disappoint him: Huawei succeeded in the so called C & C08 switch research. The new production C & C08 switches found a positive market on Mainland China, because the price of Huawei's production was much lower (more than 25 percent) than that of foreign products with similar functions. Mr. REN Zhengfei, the founder of Huawei Group said later: "we were waiting to die at that point; this challenged us to engage in technology innovation"¹⁷

¹⁷ <http://finance.sina.com.cn/110/2004-06-18/378.html>

Being a company in the high-tech industry, Huawei faced many problems. For example, the lack of venture capital and institutional support on technical innovation, low levels of R&D investment by enterprises, and government restrictions on taking firms public. How did Huawei survive as a nascent entrepreneurship entity facing fierce competition? The answers may be found in its unique socio-cultural environment and its independent ownership.

5.5.5.1 Trust System and Network Building

In the telecommunication industry it was very difficult to survive without industry experience and network. Mr. REN and his team accumulated had extensive industrial experience as well as networks before they started their own business. Mr. REN Zhenfei's former experience in the army made it easier to gain connections with top scientists and researchers and more importantly, other army officers (Deng, 2003). This enabled Huawei to complete technical innovations in instances where he lacked venture capital and human resources.

Chinese high-tech companies maintain certain direct/indirect relationships with a few prestigious state-owned institutes. Huawei, as a leading company, also had a partner, the Information Engineering Academy (IEA) affiliated with the General Staff Department of the PLA. Under the support of the IEA, technology was transferred to Huawei. It enabled Huawei to develop the capabilities for further research and innovation on technology.

The trust system between Mr. REN and the IEA enabled Huawei to gain production orders from the PLA. In 1992, Huawei received its first contract from the PLA, in which Huawei was asked to provide key equipment for the Army's first national telecommunications network.

5.5.5.2 The Advantages of Private Ownership

In the Shenzhen SEZ the various forms of ownership were allowed through legislation in the 1980s. Unlike other high-tech companies, Huawei retained its independent ownership. The disadvantages for a private ownership company were

that it could be difficult to get technological and human resource support through the IEA. Huawei had to accumulate its R&D through various other means. However, the private ownership benefited Huawei to be able to deal with problems flexibly; for example, the network building with domestic and international R&D organizations and the support from the local government.

In 2000, with the help of IBM, Hay Group, and the German National Research Institute of Technology, Huawei set up an Integrated Product Development (IPD) system and applied it to all TDT platform products. IPD is an R&D management system in line with the international practices. It divides a product development process into various phases.¹⁸ Multiple checkpoints are set up in each phase to assure quality output. IPD integrates such elements as development, test, market, manufacture, finance, user, etc., into a Product Development Team (PDT). Members of a PDT jointly participate in the whole process of product development ranging from pre-development, design and analysis. Huawei's products and solutions are being used in over 100 countries worldwide and provides services for 28 out of the world's biggest 50 operators and for over one billion users.¹⁹ In 2000, Huawei's overseas sales surpassed US\$ 100 million. It set up R&D centers in Silicon Valley and Dallas (Nie, et al., 2009, p.42).

5.5.5.3 Support from the Local Government

Huawei's success could not be separated from the local government. Huawei gained the support of the Torch Program, which was designed for high-tech industrialization and internationalization supported by the Shenzhen government and the central government in Beijing. This program provided loans with reduced interest and exemption from taxation or a tax-discount. Huawei became one of the key agents in Torch Programs at the beginning of the 1990s.

In the middle of the 1990s, the government issued an explicit policy (Ninth Five-Year Plan) preventing foreign domination of the domestic telecom market (Shi, 1998). In 1996, most state-owned telecommunications companies operated on a small scale compared with Huawei. They could hardly undertake the task of

¹⁸ http://market.huawei.com/hwgg/ec/en/cases/documentation/crbt_ringing.pdf

¹⁹ <http://www.ad-hoc-news.de/global-cooperation-agreement-with-huawei-technologies-co--/de/Unternehmensnachrichten/20087543>

scientific research. Huawei became the first choice to be the partner of the PLA and got high-level state support in all aspects of business. Huawei accomplished an exceptionally steady business performance after 1996.

In the Ninth Five-Year Plan, Huawei was the only listed non state-owned national champion amongst the selected “State Teams” to receive special R&D assistance from the central government. As a member of the protected “State Team”, Huawei ranked high on the agenda of state and local officials in technology transfer, with continuous financial support from the state and local banks. This could not have been realized without the support from the local and central government and the special status of Huawei in the telecommunication industry.

In summary, the theory of institutional environment, decentralization of power increases the level of opportunity exploitation. Private ownership allowed Huawei to take flexible policies to cooperate with partners and react quickly to changes on the market. This provided Huawei, still in nascent entrepreneurship, with a superior institutional environment from Shenzhen municipal government and policies leverage from the central government.

5.6 Conclusion:

In summary, the socio-cultural environment in Shenzhen was desirable and legitimate for the development of entrepreneurship. Firstly, the government’s role in economic development is part of the comparative-advantage-following strategy. The powers and its legitimacy as a SEZ were granted by the central government and encouraged Shenzhen’s local government to innovate on local management. The autonomy and the innovation of the local government provided a flexible institution environment for the development of entrepreneurship. For example, at the very beginning of the economic reform Shenzhen government managed to implement radical institutional self-transformation. Secondly, the preferential policies as a SEZ implemented the political environment for absorbing large amounts of foreign investment. Decentralization and formalization enhance the process of innovation in the institution environment. Thirdly, the development of entrepreneurship forced the innovation on the government management. For example, large amounts of FIEs forced the government to keep the regulations and implement on rule of law. Shenzhen Economic Strategy in the 1980s connected the Mainland with overseas and provided the entrepreneurs with many opportunities. Obviously the development of

entrepreneurship in Shenzhen is a process which blends institutional entrepreneurship, social entrepreneurship and business entrepreneurship and all this participation accelerated the institutional change to make economic growth (see Figure 5.1). In the institutional transformation, a diversified and diversifying “culture of innovative entrepreneurship” (Faltin 2001) can promote sustainability because it is based on the questioning of common business “solutions”. A “culture of innovative entrepreneurship” (ibid.) can alter and transform economic patterns practically, creatively and tangibly. However the problems gradually appeared in the process of entrepreneurship development. That is the paradox present in the government institutional transformation. It also indicates that the entrepreneurial transformation is in need of formal institutions. The political and institutional reform has begun in Shenzhen.

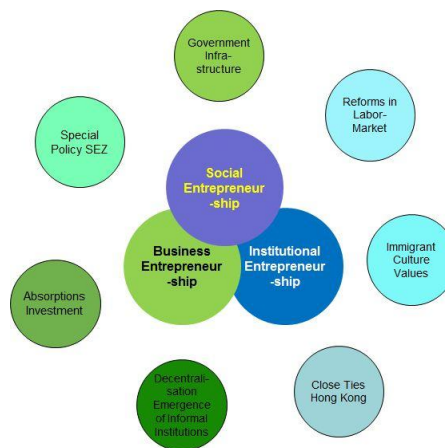


Figure 5.1 The Development of Entrepreneurship in Shenzhen

SUMMARY AND CONCLUSIONS

1. Summary

This study analyzes the development in the three main entrepreneurial regions in China: Wenzhou, Sunan (rural areas) and Shenzhen (city), depicting the picture of the entrepreneurial development at a macro level. It shows the rise of dynamic entrepreneurial initiatives and how they changed institutional behavior in a long struggle. This transformed the Chinese economy incrementally from a planned to a more market economy, region by region. This study describes their evolution in the various institutional environments, analyzes the benefits of institutions in the promotion of entrepreneurial models, discovers how the barriers of institutions hinder the regional entrepreneurial development and reveals the dynamic power of entrepreneurial activities in Wenzhou, Sunan and Shenzhen.

After the introduction, this study is divided into five chapters. In Chapter One of this study I have introduced the theory of entrepreneurship and the concepts and perspectives on the theoretical framework. Focusing on the development of entrepreneurship in China, Chapter Two presents institutional environments and the process of the rural economic reform since the economic reform in 1978. Based on all this, Chapter Three and Four analyze the different forms of peasant entrepreneurship and how the business models in rural areas in Wenzhou and Sunan were transformed. As a comparative study, Chapter Five discusses the changes in Shenzhen in 1979, as the CCP decided to open the city for investors, migrant workforces and entrepreneurs, as it gave top priority to modernization. Finally I will summarize and draw a conclusion of this study. In the following, all six parts are summarized.

Introduction

After the statement of the problem and the introduction of the purpose and approach of this study, in the Introduction I have designed a framework, to be used for this study to discover the relationships between the formal and informal institutional framework, the social capital/culture and the development of entrepreneurship.

Chapter One

Chapter One introduces the theory of entrepreneurship and provides the theoretical framework on environmental determinants of entrepreneurship, with particular regard to Shane's argument on institutional environments and Douglass North's view on institutions. In addition, Chapter One also presents key concepts and perspectives on economic environment, political environment and socio-cultural environment to provide a better understanding of the factors relative to the institutional environment.

Chapter Two

To understand the development of entrepreneurship and the various entrepreneurial activities in China, in Chapter Two I have introduced the consolidated democratic structure in China. This was the base on which to analyze the institutional environment in China. The processes of the rural reform and the policy on economic reform since 1979 are explained as a background to discuss the three business models in China. Entrepreneurship conceptions relative to this study are discussed finally.

Chapter Three

Within the study of the Wenzhou Model, the first part of Chapter Three analyzes the barriers of the economic development in Wenzhou. They are: the low level of industrialization and technology, a lack of state capital investment and instable political environment. However, the social context influences people's willingness on whether to engage in an entrepreneurial activity.

Chapter Three also discusses the impact of Wenzhou's socio-cultural environment and social capital on the entrepreneurial activity. In Wenzhou I found a positive correlation between social capital (such as trust-based local social networks) and entrepreneurial activity. This supported many underground private organizations which operated as informal financial institutions to provide financial support for the private enterprises. The dynamic development of the private industrial clusters since the 1990s was mainly based on the establishment of new ventures in the low-tech industry such as shoe-making, apparel and metal shell lighters. Some of them were good enough to enter the international market, exporting large amounts of shoes, metal shell lighters, and low-voltage electric components; the other enterprises focused on the domestic market, selling buttons, zippers and writing utensils. Some

family enterprises transformed themselves from a family enterprise to a joint-stock company such as the Chint Group. Some advanced their market management like Metersbonwe, which was the first virtual company to establish many franchises in China in the 1980s, and it is now one of the most influential companies in China today.

The improved wealth positively influenced the financing environment in Wenzhou. When peasant entrepreneurs succeeded in their business, their greater wealth provided potential for new entrepreneurs to privately lend money and finance their peer's entrepreneurial activities. This transformation of business activities, which began in the 1970s, was supported by the improvement of the institutional environment e.g. the strengthening of property rights and the legalization of private entrepreneurial financing throughout the next 20 years.

Chapter Four

This part analyzes the transformations of the Sunan model. Benefiting from their advanced industrial foundation, Sunan peasants developed their enterprises in the towns and villages at a high starting level, under the protection of the local authority. The shortage of light industrial products had provided opportunity for entrepreneurial development in rural plants in Sunan. However, the value of asset endowments under the collective ownership caused many problems, such as ownership ambiguity and asset stripping in the TVEs. This hindered the further development of entrepreneurship, caused sharp contradictions between the rights of ownership and the responsibility of the management in the TVEs in Sunan. Compared with these TVEs, the private enterprises could hardly survive facing such discrimination since there could be no guarantee of decreased transaction costs for them. Furthermore in the 1990s the market reform evolved on the Mainland. The liberalization of the commodity market was almost complete and the private sector had grown rapidly in China. The reform of the urban state sector had also advanced. Therefore, the collective-owned enterprises in Sunan faced even stronger competition. FDIs and FIEs developed in Suzhou and many SEZs (Special Economic Zone) were successful in attracting foreign investment. A large number of TVEs lost their advantages in the competitive market and closed rapidly in the 1990s. The barriers to success in Sunan were that because of the ownership ambiguity and asset stripping in the TVEs, the collectives managers could not decide on many

problems and so powerful party leaders in the county wanted to decide on management questions. At the end they had to give back the freedom to decide to the TVE's managers, at the lower level, in towns and villages. In such a situation, the Sunan model entered into its second stage, into the ownership reform of the TVEs. It began in the mid-1990s and gradually extended to all the TVEs in Sunan. The collective capital was almost completely withdrawn in the TVEs and the share of the management executives' in the companies became much higher. After the reform many small TVEs were completely privatized.

Chapter Five

This part researches the development of entrepreneurship in Shenzhen and compares it with the Wenzhou and the Sunan Models. The Shenzhen Model has many advantages that the former two models did not possess. This has been first mentioned in the introduction of Shenzhen's institutional environment. In 1980 Shenzhen was formally nominated as a "Special Economic Zone" (SEZ) by the Central Committee of the CPC and State Council. Then the Central Government has provided a special policy framework for the SEZ with the aim to create a "soft enabling environment" to enhance the city's industrial competitiveness in Shenzhen. The special policy framework gave more power to the local government and had fewer bureaucratic layers; laws and regulations were introduced instead of ad hoc political decisions. These policies supplied Shenzhen with a unique political environment to boost it in front of any other city in China. Apart from this, the government's investment in infrastructure, Shenzhen's success on absorbing foreign investment from Hong Kong and foreign countries, and the policy on the reforms in the labour market, all these have constructed a better economic environment. In addition, Shenzhen obtained greater autonomy in its relations with many ministries at the central level. Therefore, Shenzhen received the rights to undertake various economic and administrative reforms to retain fiscal revenues and foreign exchange earnings, to allow foreign investment projects and to give preferential treatment to foreign-invested enterprises.

After the analysis on these success factors my study focuses on the barriers to Shenzhen's entrepreneurial development. These obstacles exist not only in Shenzhen, but also in other cities and rural areas. They are the weakness in the legal framework, the lack of legalization, and the policy discrimination against private enterprises.

However the power and its legitimacy which was granted by the central government for the SEZ gave approval to innovate autonomously at local management levels. This provided a flexible institutional environment for the development of entrepreneurship. This is the basis for Shenzhen to initiate institutional entrepreneurship, institutional subversion and conversion.

Decentralization and formalization enhance the process of innovation in institutional environments. Shenzhen was granted greater autonomy than other municipalities. The socio-cultural environment in Shenzhen became optimal for the development of entrepreneurship. The emphasis on money-making encouraged more immigrants to start a business, and created a number of opportunities in the fields of HR services, high-tech innovation and in financial services. Quanshun HR Service Company provides services to the unskilled peasants and managed to protect the rights of these immigrant peasants. The Chinese internet entrepreneur, the founder and CEO of Alibaba.Com, Mr. MA Yun said that “because we lacked of good financing service and without credit culture, we need to have a start-up to change this situation.”²⁰ This is the reason why Shenzhen was again selected as a special zone for political reform in China on entering the 21st century. Hence the development of entrepreneurship in Shenzhen is a process which blends institutional entrepreneurship, social entrepreneurship and business entrepreneurship. The legitimacy and efficiency of institutions in Shenzhen, whether formal or informal, depends on their reproduction by social, economic, and political actors. As a result this forced the government to innovate its management.

²⁰ <http://www.youtube.com/watch?v=aEJAGxJn5YI&feature=related>

2. Conclusions and Suggestions

2.1 The Development of Business Models and the Transformation of Institutions

Chinese economic reform started from the bottom up. The government was not able to legitimize grass-roots entrepreneurial activities as the political and legal framework was missing. In this situation, the entrepreneurial rural firms in **Wenzhou** played an important role to stimulate the transformation of the political environment. Nevertheless, entrepreneurs overcame the uncertainty and information asymmetry inherent in this situation as they exploited the opportunities and created the Wenzhou classical model in the 1980s. The relational and pro-contractual trust activities based on personal networks acted as cohesive elements. They enabled the rise of efficient Wenzhou business models and the smooth path of economic change. Local cadres protected the private ownership and the evolving decentralization of power made Wenzhou a pioneer in political institutional reforms, reducing legal discrimination.

Wenzhou might still be a small poor city today without the creation of a competitive organizational form (the Wenzhou business model) and the entrepreneurial activity supported by the Yongjia Doctrine (Wenzhou's regional culture based on the trust in the individual, its fast business intuition and hard work, emphasizing that doing business should be encouraged and thus accumulating social capital). This result supports the H1: in the absence of access to the formal power structure and banks, informal institutions (social capital and culture) will have a significant, positive effect on the process of entrepreneurship in China. As the Wenzhou Model developed, institutes were subversive against the central Chinese government and converted themselves to support the peasant entrepreneurs to exploit entrepreneurial opportunities fast. This supports the argument in H3: the development of entrepreneurship will have a positive effect on the transformation of institutions.

In the discussion on the transformation of the **Sunan** Models, the political environment improved to catch up with the development of entrepreneurship. The decentralization of power resulted in institutional subversion and conversion. The institutional entrepreneurship was promoted in Sunan. This is the key for the success of the Sunan Model. The analysis of the Sunan model shows that the results do not support Hypothesis 1(H1); I predicted that informal institutions (social capital and culture) would positively correlate with the likelihood of being an entrepreneur in

the absence of access to the formal power structure and banks. Due to the weak entrepreneurial culture and the lack of experience, Sunan became a large processing manufactory in the 1990s. This is because **Sunan**'s trust system and social network were constrained by the local hierarchy structure in the 1980s. So this result supports the H2: The variety of institutional environment influences the types of business models. A better-developed industrial foundation and the advantages as a collective ownership contributed to the success of the Sunan business model. Under such circumstances, peasant entrepreneurs sought to get support from the local leading cadres and local government and lost their opportunities to gain information for the establishing of start-ups. However, a gradual rise of institutional entrepreneurship is clearly observable in the structure of the new Sunan models in the past years. Several factors continue to exert a hampering influence (such as the influence from the authority powers).

Summarizing the political aspects, during the early years of economic reforms since 1978, the individual household business (the beginning of the private ownership) in Wenzhou, TVEs in Sunan and the FDEs and FIEs in Shenzhen were new in China's economic landscape. They took part not merely in the market competition but, in a more important sense, they were the new partners of the political institutions.

In the 1980s, the SOEs and TVEs were the only two legitimate types of business organizations in China's economic system. The reasons for the rapid development of TVEs in **Sunan** in the 1980s were their institutional affinity to collective and state-owned enterprises.

However the rapid growth of TVEs in Sunan in the 1980s testifies the advantage of collective ownership in response to the incentives that a given institutional system offers. For instance, under the hierarchy of power in the system of collective ownership, TVEs faced fewer risks than private enterprises did in the initial stage of their entrepreneurial process. On the contrary, TVEs had lots of opportunities to increase the value of their asset endowments, like seed capital, cheap labor force, low-cost land and information and talent management pools. The development strategies on spatial conditions (cooperation with big cities like Shanghai, Nanking, etc.) and foreign investment promoted the development of entrepreneurship in Sunan. However the value of asset endowments under the type of collective ownership

caused many problems, such as ownership ambiguity and asset stripping in the TVEs. After entering into its second stage, the ownership reform of TVEs as the collective capital was almost fully withdrawn from the TVEs; many small enterprises were completely privatized. Institutional entrepreneurship was promoted in Sunan. This verifies that the organization of entrepreneurial activities should get support from the political environment, such as the legalization of property rights and the respect of rule of law. Otherwise the development of entrepreneurship would be constrained by problems of the ambiguity of property ownership. This study also indicates that the entrepreneurial activity should be based on trust between the individual and society; otherwise the social capital cannot be beneficial for the entrepreneurship. The studies in Sunan testify that the improvement of the entrepreneurship transforms the institutions and supports the premise H 3: the development of entrepreneurship has a positive effect on the transformation of institutions and the regional culture. This shows the informal institutions as dynamic entities. The transformation from the old to the new Sunan model indicates that the informal institutions work in the social context of businesses and can be activated according to the different needs of the entrepreneur and the enterprises.

The development of entrepreneurship in **Shenzhen** can be traced back to the establishment of SEZ in 1978. FDEs and FIEs were not directly controlled but supported by the state. The power and its legitimacy for the SEZ granted by the central government approved Shenzhen's local government to allow the local management more autonomy. The innovation of the local government provided a flexible institutional environment for the development of entrepreneurship in Shenzhen. Shenzhen's economic strategy in the 1980s connected the Mainland with overseas and provided the entrepreneurs with many entrepreneurial opportunities. The development of entrepreneurship forced the innovation of the government to check old regulations and implement permissive laws. Many private high-tech enterprises such as Huawei Group took flexible policies to cooperate with their partners and to react quickly to the market. In Shenzhen, the government's role in the economic development is part of the comparative-advantage-following strategy. During the 1990s many organizations were established in response to the incentives that the institutional system offered such as the establishment of entrepreneurial technology parks for high-tech R&D, service centers for foreign-invested enterprises, etc.

However, influenced by the state's policy, no less than six big campaigns against private ownership and market mechanisms were initiated by the Guangdong party leadership in **Shenzhen**. As a result there are few property rights and a weak sense of freedom in the contemporary Chinese political environment. High inflation and instable economic conditions make it very difficult for the entrepreneurs to enact forward-looking decisions. The experience in Shenzhen indicates that the building of SEZs without political reforms causes the centralization of power. The markets are the most efficient means by which self-interested actors reallocate their resources to achieve their highest value. The development of entrepreneurship in Shenzhen needs more support from a free political institutional environment. The practically oriented regulations have been politically less fundamentally controversial than the ideological struggles but they were also less transparent, coherent and consistent as well.

2.2 Comparing the Influence of the Socio-cultural Environment on the Three Business Models

Wenzhou pioneered in entrepreneurship in China for the regional socio-cultural environment. The "Yongjia" doctrine in Wenzhou was quite different from the national culture of Confucianism. It argues to learn skills which could be used in daily life and it suggests that "to do" is better than "to talk". "Jing Shi Zhi Yong" highlights personal ability and innovation in daily life. It emphasizes "individual" action and not only "collective" activity as the opposite of what is emphasized in Confucianism. The Yongjia doctrine suggests that material gain is as important as righteousness (Yi) and each profession should be treated equally. Wenzhou people have the habit of doing business, they shared their experiences and valuable information with others, and this provided Wenzhou peasants' talent for business intuition, calculated risk versus chance, and to improve the motivation for entrepreneurship. In addition, Wenzhou peasant entrepreneurs have two typical individual characters when compared with entrepreneurs in Sunan and Shenzhen: the risk-taking and team-working spirit. The political and institutional innovations in property rights went ahead of other cities on the Mainland, which were a precondition to start family workshops in Wenzhou. Furthermore, relying on the relational trust system and networks, Wenzhou entrepreneurs could find market

opportunities for exploitation and got underground financial investment. **Wenzhou** is focused on international trade; hence they have international competition on prices. Therefore profits drop. Wenzhou entrepreneurs acted as organizational architects not only in identifying market opportunities but also in effective designing and in efficient organizational structures. These were the creation of the entrepreneurial models and the transformation from the old household into the new, in industrial clusters organised and internationally competitive production and export model.

This is why I think entrepreneurship has expressed itself in the private sector in the most impressive way in **Wenzhou** in China. It is the ultimate agent, incessantly destroying the old economic structure and incessantly creating a new one. Without the institutional entrepreneurship, there would be no business entrepreneurship in China.

Influenced by Confucianism, culture in **Sunan** worships Yi (Righteousness) and knowledge. “Wu” culture emphasizes collective harmony; this leads to a lack of daring and individual courage to start nascent entrepreneurship, when compared with Wenzhou. However they are still open to new things and insist on the processes of observation, reflection, assessment and adjustment as lifelong cultivation practices. Instead of hard work (compare with Wenzhou), they emphasize the long time development of structures. **Sunan** is focused on education and new technology, which always generates high profits. In Sunan many famous entrepreneurs were not satisfied with the success of their entrepreneurial activities. They emphasized the design of a future version of the regional development and the rising competitive ability of their companies. So their enterprises could survive in the economic crisis in 2008. The socially oriented community advocates sustainable development of the whole community and geographical cooperation with neighboring cities and enterprises, building flexible ownership ventures. A knowledge based society, which develops high-tech and high value products and services, has better chances in **Sunan**.

Shenzhen had a huge migrant labor force from all parts of China and overseas. They met with different local conditions, different understandings of the underlying ideals, different ways of implementations and different motivations. All these contributed to the contingent status of private businesses. **Shenzhen** has developed its

entrepreneurial culture very similarly to Wenzhou with a balanced view on profit orientation and social entrepreneurship.

2.3 Recommendation:

To complete and verify my theoretical framework for a variety of sustainable entrepreneurial models, I conducted twelve interviews with entrepreneurs and businessmen/women from the above regions in China and overseas. I learned how they found opportunities and organized their entrepreneurial activities, what problems they met on nascent entrepreneurship and how they managed to improve their business. What impressed me most was their optimistic attitude towards life, risk-taking, the tolerance of failure and their hardworking spirit. On the basis of the interviews I found that social capital and the local institutional environment are key factors which influence entrepreneurs' decisions.

The empirical research has two results:

Firstly, it provides vivid empirical data on how entrepreneurs make use of formal and informal institutional rules for the benefit of their entrepreneurial activity. The study shows that in the absence of access to the formal power structure and banks, entrepreneurs rely on the informal institutions to get entrepreneurial opportunities and financial support. Secondly, the entrepreneurs and their entrepreneurial activities are much influenced by their regional culture.

These case studies show how institutions dominate the "rules of the game" under which the organizations and entrepreneurs operate. This does not mean this study neglects the effects of individual attributes on the decisions to pursue entrepreneurship; on the contrary, the case studies in this paper discovered individual differences and influences in the entrepreneurial process, such as psychological and non-psychological factors. This will be a source of inspiration to further research on entrepreneurship education.

Here I suggest two solutions to take entrepreneurship education a step further.

Firstly, in lack of formal academic programs and maintenance of student interest in the academic programs, our understanding of entrepreneurship education should go beyond the conceptualization of most business-schools, according to which entrepreneurship is basically a process of discovering business opportunities,

identifying new markets, and creating organizations - and then mobilize resources for production. We should teach, additionally to the business aspects, also about the institutional framework. Such innovative courses and curriculum need to be designed, developed and teaching materials should be produced.

Secondly, such a curriculum should have a special focus on the culture and its effects on entrepreneurial activities. In the face of globalization, entrepreneurship education is challenged both in theory and practice. For instance, in the course of conducting entrepreneurship activities, an entrepreneur has to negotiate and cooperate with his partners. How to communicate and understand the partners is a key point in building up an entrepreneurial team. In the research of entrepreneurship education we lack solid theoretical foundations upon which pedagogical models and methods could be built, which would make clear;

- how to make use of the three business models in a curriculum to explain how to do business in China,
- how to deal with different models influenced by regional culture and social capital,
- how to integrate new programs with established entrepreneurship education systems that were nurtured in the West and in China.

These questions are interesting and valuable impulses for further research on entrepreneurship education.

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ZUSAMMENFASSUNG

Diese Studie analysiert die Entwicklung in den drei wichtigsten Wirtschaftsregionen in China: Wenzhou, Sunan (ländliche Gebiete) und Shenzhen (Stadt). Sie beschreibt die Entwicklung dynamischer, unternehmerischer Initiativen und wie diese in langen Kämpfen das institutionelle Umfeld veränderten. Die chinesische Wirtschaft entwickelte sich dadurch allmählich, Region nach Region, von einer Planwirtschaft zu einer Marktwirtschaft.

Die Studie gliedert sich in fünf Kapitel. Kapitel eins liefert das theoretische Rüstzeug zur Diskussion von Umgebungseinflüssen auf das Unternehmertum, mit spezieller Berücksichtigung von Shanes Argumenten hinsichtlich institutioneller Randbedingungen und Douglass Norths Beschreibung von Institutionen. Speziell im Hinblick auf die Entwicklung des Unternehmertums in China beschreibt Kapitel zwei verschiedene institutionelle Umgebungen und die Entwicklung der ländlichen Wirtschaft nach der Wirtschaftsreform von 1978. Es diskutiert eine Dreiecks-Struktur, welche in dieser Arbeit benutzt wird um die Wechselbeziehungen zwischen formellen und informellen institutionellen Rahmenbedingungen, sozialem Kapital und der Entwicklung des Unternehmertums aufzudecken. Basierend auf dieser Grundlage analysieren die Kapitel drei und vier die verschiedenen Formen des Unternehmertums der Landbevölkerung und wie die Geschäftsmodelle in den ländlichen Gebieten Wenzhou und Sunan sich entwickelten. Im Vergleich dazu diskutiert das Kapitel fünf die Veränderungen in Shenzhen ab 1979, nachdem die CCP sich entschloss der Modernisierung erste Priorität zu geben und die Stadt für Investoren, Wanderarbeiter und Unternehmer zu öffnen. Den Schluss bildet eine Zusammenfassung und Diskussion der Ergebnisse dieser Arbeit.

Diese Arbeit analysiert in drei Kapiteln die Entwicklung von drei Wirtschaftsmodellen in drei verschiedenen Regionen Chinas: Wenzhou, Sunan und Shenzhen, wobei sie ein Bild der unternehmerischen Entwicklung auf einem makroskopischen Niveau liefert. Sie beschreibt ihre Fortschritte unter verschiedenen institutionellen Rahmenbedingungen, analysiert den Nutzen von Institutionen bei der Förderung unternehmerischer Modelle, deckt auf wie institutionelle Hindernisse die regionale unternehmerische Entwicklung beeinträchtigen und schildert die dynamische Wucht der unternehmerischen Aktivitäten in Wenzhou, Sunan und

Shenzen.

Um meine theoretischen Aussagen für verschiedene unternehmerische Modelle zu ergänzen und nachzuprüfen, habe ich zwölf Interviews mit Unternehmern und Geschäftsleuten aus den obengenannten Regionen in China und in Übersee durchgeführt. Ich habe dabei gelernt wie sie Geschäftschancen fanden, ihre unternehmerischen Aktivitäten organisiert haben, mit welchen Problemen ihre jungen Unternehmen zu kämpfen hatten und wie es ihnen gelang ihre Geschäfte zu verbessern. Was mich am meisten beeindruckte war ihre optimistische Einstellung hinsichtlich des Lebens, der Bereitschaft Risiken einzugehen und Fehlschläge zu tolerieren sowie die Bereitwilligkeit zu harter Arbeit. Auf der Basis dieser Interviews fand ich, dass das Sozialkapital und die lokalen institutionellen Randbedingungen Schlüsselfaktoren sind welche die unternehmerischen Entscheidungen beeinflussen.

Die empirische Forschung hat zwei wesentliche Resultate. Zum Einen liefert sie lebendige empirische Daten wie Unternehmer formelle und informelle Regeln benutzen zum Vorteil ihrer unternehmerischen Aktivitäten. Diese Arbeit zeigt, wie die Unternehmer bei fehlendem Zugang zu politischen Machtstrukturen und zu Banken auf informelle Institutionen angewiesen sind um unternehmerische Möglichkeiten und finanzielle Unterstützung zu bekommen. Zum Anderen zeigt sie, wie stark die Unternehmer und ihre unternehmerischen Aktivitäten durch ihre regionale Kultur beeinflusst werden.

Diese Fallstudien zeigen wie die Spielregeln, unter denen die Organisationen und Unternehmer operieren, von den Institutionen dominiert werden. Das bedeutet nicht, dass diese Arbeit den Einfluss individueller Verschiedenheiten auf die unternehmerischen Entscheidungen vernachlässigt. Im Gegenteil: Die Fallstudien in diesem Papier zeigen die Auswirkungen individueller Unterschiede – psychologische und nicht-psychologische - auf die unternehmerischen Entscheidungen. Ein wichtiger Gesichtspunkt für die Ausbildung zukünftiger Unternehmer.

ERKLÄRUNG

Ich versichere: Ich habe die Dissertation selbständig verfasst. Andere als die angegebenen Hilfsmittel und Quellen habe ich nicht benutzt. Die Arbeit wurde nicht schon einmal in einem früheren Promotionsverfahren angenommen oder abgelehnt.

Berlin, 06.June 2012

CURRICULUM VITAE

Mein Lebenslauf wird aus Gründen des Datenschutzes nicht online veröffentlicht.

APPENDIX: LIST OF INTERVIEWEES

Personal Interviews

- P1 Interview conducted on May 18, 2005
- P3 Interview conducted on June 04, 2006
- P4 Interview conducted on July 15, 2008
- P6 Interview conducted on July 16, 2008
- P7 Interview conducted on June 16, 2008
- P9 Interview conducted on April 08, 2009
- P10 Interview conducted on May 09, 2010
- P11 Interview conducted on March 18, 2010
- P12 Interview conducted on June 16, 2011

Telephone Interviews

- P2 Interview conducted on May 18, 2006
- P5 Interview conducted on September 15, 2008
- P8 Interview conducted on September 16, 2008

Follow-up Interviews

- P2 Telephone Interview conducted on June 03, 2006
- P7 Telephone conducted on October 16, 2008
- P6 Personal Interview conducted on July 16, 2009
- P5 Personal Interview conducted on July 28, 2009
- P11 Personal Interview conducted on April, 28, 2010