

Chinese Entrepreneurs Go Global

Daniel Zhou

“Entrepreneurs and small and medium enterprises often go global in response to the state of their domestic market environment.”

Neuman F. Pollack
Dean, Florida Atlantic University, USA

China may be on the tipping point of explosive global growth. In response to changes in the global economy and an economic slowdown domestically, hundreds of thousands of Chinese SMEs are being encouraged to “go global” by their central and local governments. To a Chinese company, going global requires the expansion of its existing business in other countries or the development of new ventures with partners operating in other countries. Explosive growth in China may be possible, but it will depend on an appropriate strategy for going global.

For a country that has firmly established itself as an international manufacturing hub, going global requires a shift in its entrepreneurial capacity, which is the focus of this article. We first assess the current situation in China to understand its current entrepreneurial focus and capacity, as well as the impetus for change. Next, we contrast the Kirznerian and Schumpeterian views of entrepreneurship to illustrate that – to go global – Chinese entrepreneurs must shift from an emphasis on exploiting pricing inefficiencies (i.e., Kirznerian entrepreneurship) to an emphasis on innovation (i.e., Schumpeterian entrepreneurship). Finally, we examine unique characteristics of the business environment and culture in China, which are likely to impact the ability of Chinese entrepreneurs to go global.

Introduction

China has experienced strong, steady growth over the past 30 years, with its gross domestic product (GDP) increasing annually at a rate around 10% since Deng Xiaoping became leader and started to introduce economic reforms in 1990s (tinyurl.com/6gv4rnu). China is now the world’s second-largest economy (tinyurl.com/y2pn7u) and the world’s largest exporter (tinyurl.com/37qb83).

China’s 42 million small and medium enterprises (SMEs) have played a very important role in the growth of its economy (tinyurl.com/7p3fl23). In 2009, SMEs contributed to 58.5% of GDP, 50% of tax revenues, 68% of exports, and 75% of new employment (tinyurl.com/7wcrhtg). Over the past few decades, these SMEs have helped China successfully position itself as the “world’s factory”. Many developed countries such as the United States and United Kingdom have transferred their man-

ufacturing operations to China to gain the advantages of cost and scale of production when products are “Made in China”. This positioning helped China become the world’s second-largest economy at a time when the global economy was healthy.

However, when the current global financial crisis began in 2008, the situation in China also began to change. As world stock markets fell, large financial institutions collapsed (or were bailed out) and a European debt crisis developed. Global manufacturing demand fell, causing a predictable decline in China’s export growth (tinyurl.com/7f7guej). The world’s largest exporter has seen its trade surplus in September 2011 decreased by 12.4% from a year earlier (tinyurl.com/8ysvfbe). China’s GDP growth dropped to 9.1% in the third quarter of 2011 from 9.5% in the second quarter and 9.7% in the first quarter, and this downward spiral is expected to continue in 2012 (tinyurl.com/7234wxs).

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High inflation and pressure on the foreign exchange rate make life difficult for Chinese SMEs during the economic slowdown. The Chinese government has made significant efforts to control inflation over the past few years by increasing interest rate and constraining lending (tinyurl.com/3rv7sho). However, these tightening measures became a double-edged sword for many Chinese, leading to an increased rate of bankruptcy, particularly in coastal cities (tinyurl.com/767ftyb).

Helping SMEs survive and become more competitive in the global market is essential for economic growth in China. The central and local governments of China have adopted a new series of policies and measures to promote the rapid launch and growth of SMEs in the global market. These efforts include increasing the export tax rebate of some labor-intensive products, offering greater financial support to SMEs and providing knowledge assistance for SMEs to go global (tinyurl.com/7nwjbuz).

The challenge for many Chinese SMEs that contribute to the “World’s Factory” is that they lie at the bottom of the global value chain. This means that Chinese SMEs rarely go global in the sense of competing in the global market; rather, they usually fill the role of manufacturer. Moreover, while pressure on the Chinese Yuan increased, so did the cost of manufacturing goods that are “Made in China”. Other emerging countries, such as India, increasingly began to erode China’s manufacturing dominance. In response to the global financial crisis and the corresponding slowdown in the Chinese economy, it is time for China to reduce its dependence on a low-cost labour strategy and shift the “Made in China” model to a “Designed and Made in China” model.

In this article, we examine China’s changing entrepreneurial capacity as one factor that will determine whether it can successfully move up the value chain and achieve growth amid tough global economic challenges. First, we compare two types of entrepreneurship and discuss the need for China to shift its dependence from one type of entrepreneurship to another as a success factor for going global. Next, we discuss unique attributes of Chinese entrepreneurship that will also affect the ability of Chinese entrepreneurs to go global. Finally, we offer conclusions.

Schumpeter and Kirzner

Joseph Schumpeter and Israel Kirzner are two notable 20th century economists who have made significant contributions to our understanding of entrepreneurs. However, Schumpeter and Kirzner held distinctly different perspectives on entrepreneurs and the role of entrepreneur in a capitalist economy. In this section, we examine the views of Schumpeter and Kirzner to allow us to characterize Chinese entrepreneurship in the past, present, and future.

Schumpeter viewed entrepreneurs as innovators who actively create opportunities by recombining information or resources into new products or new methods of production (Schumpeter, 1934; tinyurl.com/6nkwrjd). Schumpeter’s entrepreneurs are agents of change that are the source of the creative destruction. They introduce new production processes; they produce new products or produce old products in new ways. Schumpeter’s entrepreneurs generate a temporary gap between the price of the inputs and outputs, thereby creating profits for their organizations. The action of the Schumpeter’s entrepreneur can be thought of as a process that moves the economic system away from equilibrium. As such, Schumpeter’s innovation entrepreneur usually exists in rapidly growing markets and creates new products and services to satisfy future needs.

In contrast, Kirzner emphasized an entrepreneur’s ability to identify and exploit gaps in the existing economic system (Kirzner, 1973; tinyurl.com/6t87n3w). To exploit an opportunity, a Kirznerian entrepreneur does not innovate, but rather spots pricing inefficiencies that others have missed and thus exploits an information advantage for profit. To Kirzner, entrepreneurs are individuals who spontaneously discover. Kirzner’s entrepreneurs discover previously unnoticed profit opportunities in an existing market and capitalize on this imbalance – an act also known as “arbitrage”. Unlike a Schumpeterian entrepreneur, a Kirznerian entrepreneur focuses on exploiting existing gaps to meet today’s needs and makes no long-term impact on economic growth. The action of the Kirznerian entrepreneur moves the economic system towards equilibrium. As such, Schumpeter’s alert entrepreneur usually is the strong player in an existing market.

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Schumpeterian and Kirznerian entrepreneurs lie at opposite ends of a spectrum and yet they can coexist. In the following section, we describe the dominance of one type of entrepreneur in China's economy over the past few decades and then argue that the other entrepreneurial type may need to play an increasingly important role for China to successfully go global.

China's SMEs Go Global

In the late 1980s and early 1990s, the second stage of Chinese Economic Reform (tinyurl.com/72uv9vu) set the stage for Chinese entrepreneurs to exploit the labour cost difference between Western countries and China. China became the world's largest low-cost manufacturer in the global market. Low labour costs allowed Chinese manufacturers to adopt a straightforward and simple business model based on pricing inefficiencies. Thus, Kirznerian entrepreneurs became the main driving force for China's economic growth.

While China's GDP grew significantly, many problems appeared: an inefficient and corrupt banking system, high levels of pollution, poor quality public health services, increasing extreme poverty, and inefficient state-owned enterprises (Morrison, 2009; tinyurl.com/6qb67aa). As the gloomy global economy continues to impact China, many Chinese SMEs that provide low-cost labour are suffering from business downturns, resulting in workforce reductions and factory closures; about 72,000 SMEs closed in Wenzhou alone in 2011 (tinyurl.com/767ftyb).

The central government of China has begun to implement policy changes and new initiatives to maintain economic growth and address the problems described above by helping SMEs go global. As stated by the National Development and Reform Commission (2011; tinyurl.com/7s3c2z6): "We will thoroughly implement the 'go global' strategy. We will improve fiscal, taxation, financial and insurance policies to help Chinese enterprises 'go global.'" These initiatives are reflected in China's 12th Five-Year Program (2011; tinyurl.com/8xpc8k3), which includes five primary missions relating to SMEs:

1. Improve the capacity for establishing business and creating new jobs
2. Optimize the structure of SMEs
3. Boost the development "new, distinctive, specialized and sophisticated" industries and industrial clusters

4. Upgrade enterprise management levels

5. Refine the service system of SMEs

The success of SMEs will also depend on their capacity to innovate. China is expected to lead the world in innovation by the year 2020 (tinyurl.com/7u2jtxl). Already, China has made significant strides in its capacity for research and innovation. In 2005, China submitted 2,452 international patent applications; this represented a 44% increase over the previous year and brought China into the international top 10 for patent applications (tinyurl.com/7nghlyn). Further, the total number of degrees granted per year in China nearly doubled from 2004 to 2007, according to the Ministry of Education of the People's Republic of China (tinyurl.com/89joczz). These substantial strides indicate that China has already begun to increase its capacity for innovation and that this precondition for a shift in entrepreneurial types – necessary for China to go global – is already being established.

SMEs that can develop and commercialize new technologies in the global market can China compete in the global market. In the near-term, China can benefit by promoting Kirzner's entrepreneurs to maintain its competitive position in labour-intensive industries, while promoting Schumpeter's entrepreneurs to commercialize new technology globally. In the long run, China's go-global strategy will increasingly depend more on Schumpeter's entrepreneurs than on Kirzner's entrepreneurs. However, as Chinese businesses attempt to go global, their success will also depend on their ability to harness the unique attributes of Chinese entrepreneurship, as will be discussed in the next section.

Attributes of Chinese Entrepreneurship

Two important attributes of the context in which Chinese entrepreneurship is embedded are familism and social capital, also known as *guanxi*. To go global, Chinese SMEs will need to search for ways to succeed in Western countries, where they will encounter contexts that are quite different than their own. Familism and *guanxi* represent unique challenges and opportunities for Chinese SMEs.

Familism refers to a social structure where the needs of the family are more important and take precedence over the needs of any of the individual family members (Gao and Kotey, 2008; tinyurl.com/7nv7nuj). Familism has great influence on business decisions in Chinese soci-

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ety, particularly since many of China's SMEs are family based. Familism affects the management of China's SMEs as well as the foundation of new firms given that start-up capital is often provided by family members, who are accorded influence over decisions in the venture and its operation. As more and more family members expand their footprint overseas, a family-owned business can take advantage of a wide network of trust, which further helps family members and their business go global.

Guanxi relates to personalized networks of influence, and it is a "central idea in Chinese society" (tinyurl.com/cogo9d). In China, social capital is also very important in business. Chinese society is tightly bundled with informal interpersonal ties and relationships, including relationships with the Chinese government in almost every aspect of social interaction. Most entrepreneurs in China have transferred their informal interpersonal networks into their firms to strengthen inter-organizational ties. These relationships and their associated exchanges of favours contribute to information sharing and partnerships, which have positive influence on financial performance (Zhang and Zhang, 2006; tinyurl.com/8278ezj). For example, with proper guanxi, some firms are more likely than others to be approved for loans, or they may receive import/export licenses sooner than other firms. Because guanxi is known as the most powerful force in Chinese culture, it can be considered as a special type of currency in China. Without proper guanxi, it is very difficult for new ventures to go global.

Conclusion

Chinese SMEs are going global. To accomplish this goal, China's SMEs should embody the spirit of Schumpeter's entrepreneur and focus on innovation. Few Chinese SMEs are able to produce independent innovation now, but China's capacity for innovation is increasing and its ability to go global will improve substantially in the near future. In addition to an increasing role for Schumpeterian entrepreneurs in the Chinese economy, we should also expect that guanxi and familism will play a critical role in the success of Chinese entrepreneurs as they attempt to go global.

About the Author

Daniel (Dongyang) Zhou is a software designer at Ciena Networks; prior to this, he has worked at a variety of technology-based companies, including Alcatel-Lucent and Nortel. He is also a Master's student in Carleton University's Technology Innovation Management program. His interests include open source business, strategic planning for technology-based SMEs, and international business between China and North America. Daniel was born in China and came to Canada in 2001, which gives him perspectives on both Canadian and Chinese cultures. He graduated with High Distinction in Electrical Engineering from Carleton University in 2007.

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