Into Their Own Hands

- By Justin Chan

After years of growing governmental support, entrepreneurial spirit in China has now reached a fever pitch. Opportunities are everywhere but diligent research, the right strategy - plus passion and luck - are the factors determining boom from bust.

If you need proof that China is now one of the most capitalistic countries on the planet, consider the dramatic shift away from giant state-owned enterprises (SOEs) toward small and medium enterprises (SMEs) over the past 30 years. In 1978, SOEs contributed 78 percent of China's total industrial output, a figure that dropped to 26 percent just ten years ago. Today, according to a 2006 report commissioned by the National Development and Reform Commission (NDRC) and the Ministry of Commerce, SMEs in China now make up 99.6 percent of total enterprises in China, and fuel nearly 60 percent of the country's GDP.

Although private businesses began their emergence in the mid 1980s (such as the government's experimental approval of private business ownership in Wenzhou, which later spread to other cities), they were not officially granted legal status until the 1988 Amendments to the PRC Constitution. Today, private business ownership is actively encouraged by the Chinese government. While international entrepreneurs generally do not enjoy these new government perks, growing numbers are still entering the China market. They say the main challenge in launching a start-up in China now is simply to be on the right side of the risk-versus-reward equation.

For Shanghai native Dilong Zhao, entrepreneurial opportunity came on the coattails of the large foreign investment inflows entering China. After noting the void of direct assistance for the many foreigners moving to Shanghai, Zhao last March started Black Card Life. The company provides foreigners in Shanghai with one-on-one "instant secretaries" who are trained to handle anything from registering a company to securing a dog license. Clients can purchase annual memberships and are then assigned a designated personal assistant so that each request is handled by the same person and a partnership can develop.

Just one year after opening, Black Card Life now serves 20 major clients including corporations such as Sony BMG and LVMH in addition to fellow entrepreneurs establishing themselves in China. "We are the only company providing this service in Shanghai now," Zhao says.

Zhao is only one of millions of entrepreneurs in China with a success story to share. He spotted an

opportunity and capitalized, which according Lloyd Shefsky, clinical professor of entrepreneurship at Northwestern University's Kellogg School of Management, is a key trait. (Shefsky met with Insight during a January trip to Shanghai.) All entrepreneurs, especially those who are very successful, "have a knack for spotting opportunity, not just once, but many times over."

While such a definition is true for entrepreneurs worldwide, the difference in China right now is that there are so many opportunities to spot: the GDP is growing at double-digit rates; 1.3 billion consumers have money to spend; and most major industry sectors are open to foreign investment. Such a business climate is giving entrepreneurs myriad reasons to invest. They have the spirit and belief that they're on the ground floor of something that will rise up, says Shefsky. "They almost feel as though they could roll the dice in China and whatever they hit, it's going to work, because everything is growing so fast."

Rise of the Chinese SME

The Chinese central government officially acknowledged the importance of the private sector in China's economy in 1997, during the 15th Party Congress. Since that time, the government mindset has shifted toward actively supporting the growth of private SMEs. During the Third China International SME Fair in Guangzhou last fall, Vice Premier Zeng Peiyan called for coordination among government bureaus and an increase in efforts to broaden and regulate market access for small businesses, and the NDRC announced planned legislation promoting the development of SMEs. The preferential policies will include tax breaks, land-use rights, and financing schemes. Meanwhile, the Ministry of Finance announced the launch of a development fund offering free financial aid and loan repayment subsidies for SMEs in October 2006. Many expect SME development to continue in China as new ventures enter and existing companies reposition themselves to take advantage of markets and opportunities that were previously unavailable.

Partly due to increasing government support and partly due to robust overall economic growth, China's SMEs are now flourishing. The number of SMEs (defined by the central government as having less than 200 employees and capital value lower than RMB400 million) totals 39.8 million,accounting for 50 percent of the country's asset value, 60 percent in turnover, and 60 percent in exports, according to a September 2006 report by Professor Jamus Jerome Lim of U.S.-based Centre College, citing government sources.

For now at least, the new governmental support of small businesses is limited to domestic Chinese ventures; foreign SMEs are largely excluded. Also of concern to international entrepreneurs is a recent shift in the Chinese government toward more carefully scrutinizing foreign direct investment (FDI) in many sectors. The Chinese government is beginning to pick and choose which investments to accept. Last September's new mergers and acquisitions (M&A) law, for example, strengthens central government control over deals in China's key industries.

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"During the 1990s and early 2000s, China was focused more on the amount of FDI it could attract," says Timothy Lamb, director of client services for China entry and growth consultancy JLJ Group. "But now, as the government is looking to address a variety of economic, social and environmental concerns, they are becoming more sensitive to the value that new FDI projects provide to the country as a whole, as well as to the locations where they are established."

Next up: Foreign entrepreneurs?

Despite the general bias toward domestic entrepreneurs on one hand and the Chinese government's growing selectiveness in accepting FDI on the other, international entrepreneurs are bravely making headway in China. Even in a wide spectrum of industries and products, one sentiment reverberates among these pioneers: starting a new business in China – where the language, rules and customs are all foreign – ranges from daunting to disastrous.

"It's crucial that [foreign entrepreneurs] find a niche market and then take advantage of it," says Juan Antonio Fernandez, professor of management at China Europe International Business School (CEIBS) in Shanghai and co-author of China CEO. Successful SMEs will often find a market that is marginal or too small for the large MNCs, and then build a business there, he adds. By attacking these niche segments, SMEs can grow markets that were previously considered too small or insignificant.

Knowing how to do this is not easy in an environment where the business laws are not always transparent. "You cannot plan for everything, especially if you're in a foreign place trying to start a business," says Eric Rongley, founder of Bleum Software Outsourcing. "You don't know the rules, and the more you think you know, the more you're fooling yourself."

Kellogg's Shefsky simply calls this process of learning "homework." He says, "It's not just [knowing] the product or service, but everything about it. It's knowing what you know and don't know, and knowing who to go to. One way or another, it's gathering the resources that entrepreneurs do. That resourcefulness is the key ingredient to a successful entrepreneur."

Yet Rongley also advises that, especially in fast-paced China, after planning the best you can, you also have to act. "One has to avoid 'analysis paralysis,'" he says. "It's better to know 20 percent of what's going on and get moving, rather than wait until you know 80 percent and opportunity has passed you by." MNCs operating under Western standards entering China may not be as quick to adapt to the different systems and business models in China, so SMEs on the ground in China should also take advantage of their smaller size and flexibility to adapt where large corporations hampered by bureaucracy cannot.

Time and money

Foreign entrepreneurs who are China-ready must then seek financing, which is still a major obstacle. According to Fernandez, most foreign SMEs in China today are funded by the entrepreneurs themselves. For now, many believe the government limits assistance to foreign entrepreneurs in order to encourage financially-strong projects, while the venture capital and angel institutions in China lack the structure and organization of their counterparts in the U.S.

Recent WTO banking reforms should not affect foreign borrowers, so the difficulty in securing loans from banks and limited venture funding means most foreign entrepreneurs must rely on their own networks for financing. Zhao, who provided the seed money for Black Card Life himself, says that "most firms here won't invest just for good ideas. Even if a venture is already making money, they still focus on later stage developments."

Glenn McCarthy, managing director of Shanghai-based InfoPower (an information analytics provider to Fortune 500 companies in the Asia Pacific region), believes that while "bootstrapping" by using only one's own money can lead to sacrificing technology and limiting competitive advantage, it also forces start-ups to develop "an intense focus on the market," which can make the company succeed commercially. McCarthy financed his venture with founder Michael Zhang and seven other partners from industry.

According to Rongley, development in Asia comes in waves. Like the software wave he's now riding, many other waves will hit China in the future. "And China is a great place because the people are very ambitious, they're well educated and they're going to do well," he says. "It's no secret. China is a huge engine for the future."