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Lecture

# The Chinese Economic Reform and Chinese Entrepreneurship

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## Abstract

In the last few years, China has had a spectacular economic development and has come to play an increasingly important role in the world economy. For a long time, the Chinese economy was a centrally-planned economy in which all companies were owned by the state. In 1978 China started an economic reform. In the beginning, in the late 1970s and early 1980s, trade was opened to the outside world and the Contract Responsibilities System was implemented in agriculture. By the end of the 1980s China had almost solved its food shortage problems. Around 1990 six special economic zones were established, including the Shanghai Pudong zone, which was a pioneer attracting foreign capital.

The reforms of the late 1980s and early 1990s focused on the creation of a pricing system, which was achieved using a dual track pricing system, and on decreasing the role of the state in resource allocations. Increasingly competitive sectors, such as distribution, were opened to private enterprise and foreign capital. Overall, the Chinese economic reform has been a spectacular economic success which has generated rapid economic growth over two decades and the country has moved from a centrally planned economy towards a market economy, especially since China became a member of the WTO. The reform has brought about an increase of industrialization, a higher population concentration in urban areas, and has solved the shortage problems.

Before the reform, all companies were state owned. In fact, there were no entrepreneurs. After 20 years of growth, company ownership has experimented unprecedented changes. On the whole, non-state-owned companies can now be more involved in sectors that used to be monopolized by state-owned companies. Except for the sectors of electricity, telecommunications, oil and even the defence industry. Current Chinese entrepreneurs come from four types of companies: state-owned companies, former state-owned companies turned into stock companies, private companies, and foreign fund companies or joint-ventures. They are a new emergent class, which was difficult to forecast; but, as Den Xiaoping said, "Be the cat white or be the cat black, it is the clever cat who will catch the mouse." Our goal is success.

In spite of background differences, Chinese entrepreneurs have many things in common. They are familiar with the business situation in China and with Chinese culture. They are firm, resolute and persistent, and they are eager to learn. They also have some flaws: Some lack training in marketing and business administration skills. Some are still trying to learn how to set up a modern company instead of the old family business based on a craft industry.

The Chinese economy has started an era of change. Structural adjustments are needed and there are many issues to solve. Among others: 1/ the economic growth model, from an extensive economy to an intensive one; from large investment and high consumption of resources to a high technology model, high added value and low consumption of resources. 2/ The distribution of mineral resources and the energy shortage. 3/ The environmental issues, like the pollution of rivers. 4/ Exchange rate reform. 5/ Differences between the rich and the poor. 6/ Differences between eastern and western China. 7/ Growth and peace. 8/ The creation of a harmonious society.

## Keywords

entrepreneurs, Chinese economic reform, special economic zones, market, enterprise, problems in the Chinese economy



## Moderator

Li donaríem la paraula a Vicky perquè ens presenti la seva empresa. [to Vicky] Vicky, you can go ahead.

## Introduction

### Vicky Hu

Thanks a lot. First of all I would like to thank professor Nueno and Caixa Manresa, who have given me this opportunity to visit Barcelona and Spain again, as well as this beautiful city. I am well aware that Manresa is another city. I'm visiting this place for the first time, and would like to take this opportunity to thank IESE and the CIBS. I'm very proud to be a student of these two schools and to participate in them, and proud also to be the wife of my husband.

In this speech I will talk very little about my own company, that is, the company that belongs to me and my husband. When I was preparing this talk I realized that you might be more interested in knowing more about the Chinese economy instead of hearing about our company, so maybe at some other time I will talk in more detail about it. I will only mention a few basic facts about it. We established it almost ten years ago, and currently the total assets are valued at US\$ 0.5 billion. So it's a small success. We invest in different fields, including real estate, mineral resources and high-tech. It's a high-tech company that also includes wire broadband communications.

The Chinese economy and its Chinese entrepreneurs, which is what I will focus on now, is a fairly large topic. I will divide it into three parts: the Chinese economic reform, Chinese entrepreneurs and problems in the Chinese economy.

## The Chinese Economic Reform

### First Steps

The history of the Chinese economic reform is a very large topic which would take us all day, so I will only outline it briefly. In recent years China has achieved a spectacular success in its economic development, and little by little has been playing an important role in the world economy.

In the recent past, the Chinese economy was based on long-term centrally-planned system. From 1978 onwards, China began an economic reform, whose goal was to

generate sufficient surplus value to finance the modernization of the Chinese economy. The first reform in the late 1970s and early 1980s consisted of opening trade to the outside world, instituting the contract responsibilities system in agriculture, by which farmers could sell their surplus crops and place them on the market. We established the Township-Village Enterprises.

### Special Economic Zones

By the end of the 1980s China had almost solved its food shortage problems. At the same time, China established special economic zones, which included, as we all know, the Shanghai Pudong zone, which has become the dragonhead of the Chinese economy. The reforms of the late 1980s and early 1990s focused on creating a pricing system. This was finally achieved using a dual track pricing system and increasing the role of the state in resource allocations. The diversified enterprise ownership system emerged, followed by more and more areas of the monopoly being open to private business and foreign capital.

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The reforms of the late 1990s focused on closing unprofitable enterprises and dealing with insolvency in the banking system. At the start of the twenty-first century there has been an increased focus on bridging the gap between the rich and the poor. I have some boring figures for you.

### Assessing the Reform

I believe that in general the Chinese economic reform has been an economic success which has generated rapid economic growth over two decades. In 2004 the GDP per capita was US\$ 1267. In Shanghai this figure reached US\$ 6671. Industrialization, open organization and internationalization was the tendency that helped move towards a market economy. In 2004 GDP increased by 9.5% up to US\$ 1.647 trillion, which makes China the sixth biggest economic body in the world. Opening to the outside remains essential to China's development.



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China continues to attract large investment inflows. By the end of 2004 China had become the biggest FDI developing country. In 2003 foreign fund and enterprises produced about 45% of China's exports. By comparison, China's imports and exports account for 5.3% and 5.8% of the world's, respectively. Foreign exchange, on the other hand, totaled about US\$ 609.9 billion in 2004. This appeared in the IMF report of 2004. More than 20% of the world increase in trade was contributed by China. China emerged as the third biggest trade body, after the US and the European Union.

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So, over the past two decades of reform, the Chinese economy has achieved world-shaking changes. The market, this invisible hand, became a basic way of allocating resources, while enterprises played a key role instead of economic activities. In the past, before the China's economic reform, only the government played an important role in activities. Now it is enterprises that do so. Since China's entry into WTO in 2001, the role of the Chinese central government derived from spontaneous economic forces and the conscious decision by reformers to replace direct central government involvement with indirect labor in the market, plus increased local decision-making.

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## The Chinese Entrepreneurs

### Entrepreneurs Before the Economic Reform

The second point I want to talk about is the Chinese entrepreneurs under the economic reform. Before the

Chinese economic reform all enterprises were owned by the government in a planned economy framework. The heads of the enterprises were designated by officials, not based on performance, but on how lucky you were. They were not efficient entrepreneurs. Following a gradual and on-going shift from a planned economy to a market system, unprecedented changes of ownership in enterprises were carried out. Entrepreneurs, who constituted an emerging class, were at the forefront of economic activities, and even of political affairs. This would have been hard to imagine under the planned economy system.

So, a new law called "the non-state-owned economies" comprising 36 items was enacted in March 2004. There will probably be more and more private businesses soon and foreign capital will get involved in the monopoly industry, for instance in the electricity sector, in financial services, the banking industry, telecommunications, petroleum and even in the defense industry.

### Types of Chinese Entrepreneurs

Regarding current Chinese entrepreneurs, they mainly come from four kinds of enterprises. The first is the state-owned enterprise. In these kind of enterprises the entrepreneurs are designated by a specific bureau which is called State Property Managing Council. The entrepreneurs are not shareholders of the enterprise. They only receive a salary depending on their performance. Many went through the shift from planned economy to market system, which means they were acquainted with the specific cultural characteristics of state-owned enterprises. Besides this, the experts in professional skills as well as modern management had an international vision.

In recent years, an elite that had studied in Europe, including at places like IESE or Harvard, has started to emerge, and the US holds an important position in large state-owned enterprises. Recently, the first world-wide recruitment of executives for large state-owned enterprises, including the Bank of China in Hong Kong, has started to embark on this cruise.

And the second part is the stock company, converted from the state-owned company. These enterprises with some percentage of shares retained by the government were a better incentive system. The leaders who manage these enterprises usually possess some shares. Of course, this is done using a legal approach, including MBO. These enterprises, including TCL, the company who bought Thomson a short time ago, and which is famous in Europe,



and Lenovo which is a manufacturer of PCs which bought IBM's PC business recently. Also the China Container Group.

The third part is a private business, such as my company. These kind of enterprises are market-oriented enterprises right from the very start, as opposed to the state-owned enterprises, which are excessively protected by the government. Private businesses have had to face fiercer competition and unfair initial conditions when applying for a loan from the state-owned bank.

As we all know, almost all the banks are owned by the Chinese government, but some stock banks have emerged recently, which last year they created wide alliances to operate with RMB businesses, but their volume is still very small in comparison to the state-owned bank. Their function is to help private businesses face competition and unfair initial conditions in applying for loans, as well as helping with policies, such as preferential tax and admittance to a specific industry. Many have failed, but some have achieved a great success.

In 2004 private businesses made history again. The growth-rate of employment in private business was 1.5%, which is 0.8% higher than the overall employment growth rate. Private business accounts for more than 82% of non-service industry. They have evolved into one of the pillars of the economy. Among them are some companies you may not be familiar with, as well as some new stars, which we call the Chinese stars, which grabbed a window of opportunity in the IT boom. Some were listed in Nasdaq several years ago, including an online-gaming company. They earn a lot of money.

The last kind of company is the foreign fund enterprise, which includes joint ventures and wholly foreign-owned enterprises. Chinese market-oriented reform has been accompanied by a steady expansion of the country towards the outside world. With an enormous quantity of foreign capital pouring into China, a group of local talent has been fostered. They combine professional skills with the traditional Chinese character, and they have grown into the backbone of Chinese entrepreneurship in the course of enterprises taking root in China. Notwithstanding the different backgrounds that Chinese entrepreneurs have, they do share at present some common characteristics.

When we talk about the reason of China's enormous continuous rapid economic growth, among all the prominent features we have to pay more attention to those other countries do not possess, namely initial conditions. In particular, structure characteristics, such as surplus, similarly unlimited agricultural labor, and the potential domestic market, which has been referred to as the primary cause of growth. This together with policies and a high desire for

authority to create a regional economic jump, pushed the Chinese economy ahead at a high growth-rate of 9% annually.

Apart from these economic and political features, to some extent the Chinese agriculture could be seen as the cluster of cultures from different regions. This is similar to how it is in Europe, that instead of it being a single country it is a union of countries. We have many different regions and almost forty nationalities, plus many different languages. In some cases Chinese cannot understand other Chinese who live just across the river. Understanding the diversity of Chinese culture and the relationship between the central government and local governments goes a long way to understanding business in China.

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The core of an enterprise is human, which means that the essence of management is how to motivate. Apart from the institutional framework, an influential leader with a strong character is crucial for building a company that lasts long. This is especially true when facing drastic changes in the social and economic system. I believe you need persistence, integrity and perspective, as well as the risks that are characteristic of all entrepreneurs worldwide. I believe Chinese entrepreneurs are more courageous and resolute, and they adore their work. Most of them see entrepreneurship as a life-long responsibility and a pleasure. This is why they have time to think more about how to attain effective communication with the employees, besides managing them by giving them the necessary recognition within a sound system. I think Chinese entrepreneurs are more eager to learn. They learn by experience and they apply management innovation and technological innovation. This is what we call experimenting. Some social scientists call it pragmatism. Reform in China has been a gradual adaptive process without clear blueprints. The reason is that we don't really know how we should do it, and so have to rely on learning by doing. In the words of Deng Xiao Ping, our great leader and designer of the reform, it is like "crossing a river by feeling for stones". So it is very interesting. We have a very pragmatic saying, which is "Be the cat white or be the cat black, it is the clever cat who will catch the mouse." So, success is our goal, regardless of the approach.



## The Flaws Chinese Entrepreneurs Share

Chinese entrepreneurs as a whole share some character flaws. In general, the percentage of Chinese entrepreneurs who are well educated is still small. There are few who have worked in an internship in foreign enterprises, as this has only been possible since the reform took place. Many do not accept systematic training of management and the acquisition of professional skills. Too many rely solely on experience, rather than combining it with theoretical analysis. For example, professor Pedro Nueno invited me to this conference because I speak English. There are many entrepreneurs who are much more successful than me, but they cannot speak English. That's the only shortcoming.

So, in part the Chinese market economy is immature, although we have to bear in mind that it is only two decades old and we will need more time for this Chinese market-oriented reform. Entrepreneurs have to face internal and external challenges in the short term. China is not only a country, but also part of the world. How should we use capital market abroad? Or merchandise market? This is a big issue for Chinese entrepreneurs. Four years ago we were talking about the Chinese entering the WTO. I remember reading in the press the headline: "The wolf is coming", which I found funny. This means we have to face more and more drastic challenges from the outside, especially from the European Union and from the United States. You are more powerful, and have more skills in management and in the market than us, but in the short term we have to face this; we have no choice.

## The Chinese Economy

The last thing I want to talk about is the problems that appeared in the Chinese economy during the transition to a market-oriented economic system. China's economic model to some extent was a surplus plus shortage economy, instead of shortage economy, throughout the central plan era. So, the Chinese economic system is facing a structural issue.

## Environmental Issues

On the other hand, China has environment concerns. We'd like to shift China's current energy mix from a heavy reliance on coal, which accounts for 75% of China's energy, towards greater reliance on oil, renewable energy and nuclear power. Since 1993 China has been a net importer of oil. Today, imported oil accounts for 20% of the processed crude in China. Net imports are expected to rise to 3.5 billion barrels per day by 2010. A harmful byproduct of China's rapid

industrial development has been increased pollution. Every time we come to Europe we Chinese are impressed by your clean and clear blue skies. Almost all our nation's rivers are polluted to some degree, and half of the population lacks access to clean water. Fortunately, in recent years China has strengthened its environmental legislation and made some progress in stopping environmental deterioration.

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## Exchange Rates

Another hot topic is the exchange rate. The exchange rate is not only an internal issue but also an international one. Regarding this issue, we need to resolve two problems: Whether we need to adjust the fluctuating Yuan or just revalue the RMB. From my point of view, the government probably will do it in two steps. In one word, a stable and flexible exchange rate system is essential for the economy. It is the need for sovereignty. But also for the regional and worldwide economy. To some extent, China achieved high economic growth at a cost of income distribution. According to the World Bank, the Gini coefficient of China was 0.403, which is slightly above the internationally-recognized danger level. Some relevant measures have been taken by the new governments, such as abolishing agricultural tax to improve farmers' income which has helped narrow the gap between rich and poor, who are then ones who pay. This is essential for a stable system.

There are still a lot of obstacles that need to be overcome on the way to a full Chinese reform. China is not only the market of Chinese but also of the world. We believe the problems that exist in the economy will finally be resolved. At least we hope so and we believe so. That's all. So thanks, thanks very much, thanks again. [applause from audience].

## Questions from the audience

### Moderator

Thank you Vicky. I didn't invite you because you could speak English. I invited you because you show better the energy and



the potential of Chinese entrepreneurs and also because you clearly show that it is possible to find friends in China. And by the way, [takes out a newspaper] this is the *China Daily* of the day before yesterday. So... [opens newspaper] There is a photo of Rafael Nadal and a big article on him. There is a big article here on gastronomy and it's about Sánchez Romera who has a restaurant in San Andrés de Llavaneres, as the article explains. So, I thought that I was reading my favorite newspaper *La Vanguardia* but it was Shanghai, so the world is flat.

Vicky, are there still opportunities in China? *Tenim encara oportunitats a Xina?*

### Vicky Hu

Do we have opportunities in China? Of course, I think that the opportunities are always there, especially in China's economic system, and with the tendency to the globalization in theory there's always a lot of opportunity there. But the most important thing is the potential domestic market. China has a potential domestic market. We call it the effective market, which means that China, as we all know, has a huge population, but it doesn't mean that the market is as large as the size of the population. But, after so many years of growth, the growth of the Chinese population has been growing together with the growth of the economy. So, I think that there is a potential domestic market that is waiting to get in. So, I think there are a lot of opportunities.

And the second point is that China has his own advantages, including the cost of labor, which is still much lower than in Europe. So the best thing is if you have a foreign-fund company that can benefit from this cost of labor. Besides, Chinese culture always emphasizes the education of its teenagers. We call this "talent pool". This is also an advantage for establishing a company in China, because, as I said in my speech, this is what we call the humanist essence of the company. I think there will be more and more opportunities in China, but apart from these opportunities with private businesses of local companies and foreign fund companies we have to face more and more challenges in China, because not all the cities and regions are so developed and have an effective government as in

Shanghai. So, my suggestion is, if you want to get involved in the Chinese market, the first step is maybe in Shanghai or the area around Shanghai, rather than the internal areas in China, because the gap between the regions in China is still very huge. It's much more complicated regarding regulations and local government relationships.

### Moderator

I la Vicky li voldria preguntar que de debò sigui molt objectiva i que ens digui tres raons de pes per invertir a Xina. Tres.

### Vicky Hu

I have more than three strong reasons to invest in China. The first one is the market itself, and secondly the cost. I mean the cost of manufacturing the materials and the labor cost and the true talent cost of local executives who are very familiar with the regulations and the management skills and various other skills. So, they earn much lower salaries than the Europeans. I have a class mate who is also a student of professor Pedro Nueno. We had dinner last night. Luis has a subsidiary in the US. They have twelve factories in China, and all the heads of the factories are local. So this could be the second reason, right? And I will have to think about a third reason.

### Bert

I will give you the answer: You can make big money there, and that's all that matters.

### Vicky Hu

Big money is always the goal.

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## Vicky Hu

### President of HD Biosciences Co.

President of HD Biosciences Co., Ltd., Shanghai, since 2002. CEO of the China Capital Investment Group Co. Ltd. (CCIG) since 1999. Former Managing Director of Shanghai King City International Co, Ltd., Guangdong, (1997-2002). Operations Department Director of the Zhuhai International Trade Exhibition Group Co. Ltd., Guangdong, (1994-1996) and Marketing Department Assistant Director of Ocean Food Co. Ltd., Guangdong, (1990-1994).