

The Development of Private Enterprise in the People's Republic of China

After more than two decades of sustained reform, the economy of the People's Republic of China (PRC) bears scant resemblance to the erratically performing command economy that preceded efforts beginning in 1979 to re-introduce market principles. Twenty plus years of growth at around 9% a year have quadrupled gross domestic product and made the PRC into a trillion (US) dollar economy. To a very large extent, the driving force behind the PRC's spectacular economic gains has been the re-emergence of a dynamic private sector.

Exactly what comprises the "private sector" in the PRC is murky, and a lack of clarity is evident in the data on economic performance provided by the State Statistical Office.³ What is entirely clear, however, is that the PRC's ability to sustain fast growth and continue to improve the welfare of its people depends overwhelmingly on how effectively the resurgent private sector performs. But, in investigating what policy and other changes would help the private sector to continue to perform well, governments at all levels need to recognize that, no matter how well-meaning they are, changes to laws, regulations, institutions, and policies that stifle entrepreneurship and impede competition will erode the dynamism of the private sector and harm the country's economy.

This report expands earlier work that documents the growth of private enterprise in the PRC, and identifies the policy, institutional, and other constraints that threaten the ability of private firms to thrive. In particular, it builds on the analysis found in an earlier study by the International Finance Corporation (IFC),⁴ as well as on a new survey of private enterprises in the PRC conducted for this study by faculty and students of the School of Economics and Management of Tsinghua University (see their report in Annex 2). The study is funded under Technical Assistance Grant No. 3543-PRC "Private Sector Development" (TAR: 33447-01) by the Asian Development Bank (ADB). The main beneficiary of the technical assistance project is the China General Chamber of Commerce (CGCC), also known as the All-China Federation of Industry and Commerce (ACFIC). The objectives of the project are: (i) to assist CGCC in identifying and promoting appropriate policies and conditions for private enterprise development and (ii) to enhance CGCC's business support services.

Section 1: Private Enterprise in the People's Republic of China

Two notable events in 2001 contributed to a significant improvement in the climate for private enterprise in the PRC. The first was the speech by President Jiang Zemin on 1 July that extended membership in the Communist Party of China (CPC) to the owners of private businesses.⁵ Of the people interviewed for this study, officials and entrepreneurs alike interpreted this development as an important elevation in the status of the private sector, and one that remains controversial with hardline party members. The second event was the PRC's long-awaited accession to the World Trade Organization (WTO). With accession at hand, senior officials, especially in Beijing,

³ See *China Statistical Yearbook*, various editions, as well as Annex 1, which discusses the data available on enterprises according to ownership structure.

⁴ See *China's Emerging Private Enterprises: Prospects for the New Century*, IFC (2000).

⁵ See the speech made by Jiang Zemin, General Secretary of the Central Committee of the Communist Party of China (CPC), at the Meeting celebrating the Eightieth Anniversary of the Founding of the CPC.

increasingly realized that the PRC soon would be obligated to extend to foreign privately owned ventures rights and privileges that have been denied to domestic private firms. Membership in the WTO will oblige the PRC to revise countless rules and regulations to eliminate distinctions made on the basis of the nature and location of ownership. As one official of the State Economic and Trade Commission (SETC) observed: “The current concern is to level the playing field for all enterprises: domestic, foreign and private.” Nothing is being done specifically to favor private firms, which would be “a recipe for discrimination;” change is designed to improve enterprise performance. “We don’t care about ownership. We care about efficiency and competitive ability.”⁶

That is the only sensible view to take as private activity already comprises the predominant share of the PRC economy, with that share lying somewhere between one-half and two-thirds depending on how narrowly one defines the term “private” (See Annex 1 for a detailed discussion). In its report, the IFC estimated the composition of the PRC economy by ownership in 1998.⁷ Based on official statistics and assumptions about ownership shares in seven sectors (agriculture, industry, construction, transport, post and telecommunications, wholesale and retail trade, and others), the IFC study estimates a share of 62% of total gross domestic product (GDP) in the nonstate sector. Of that, twelve percentage points are estimated to be contributed by truly collectively owned enterprises (with another eleven percentage points contributed by firms that are nominally collectively owned, but really are “red hat” firms, owned and managed by a small group—which might have just a single member—of private individuals). In its *2001 White Paper*, the American Chamber of Commerce in the PRC estimates the size of the nonstate sector at two thirds of GDP in 2000.⁸

There is no need to repeat the IFC exercise to infer that in 2002 the share of PRC GDP produced in the nonstate sector exceeds two-thirds, with the share produced by truly private activity comprising comfortably more than half. This inference would follow from a continuation of the trend growth observed through 2000, and the reclassification of firms that either have been sold or otherwise transferred to private owners, or have removed their red hats.

How Ownership Classes Contribute to Output and Employment

The State Statistical Office presents data for seven different classes of enterprise ownership: individual ownership, private ownership, foreign ownership, joint ownership, shareholding corporations, collective ownership, and state ownership.⁹ Unfortunately, information is not uniformly available for these classifications for all of the indicators of interest to analysts; frequently, some of the ownership categories are aggregated as “other types of ownership.” Moreover, there are breaks in the series due to changes in composition of the reporting firms and to periodic clean-up of data series (as, for example, in 2000) that show in a single year events that clearly occurred over an unknown number of prior years. As Annex 1 indicates, there can be problems with double counting as well.

Since 1985, the private sector has been the most dynamic source of industrial output growth. As Figure 1.1 illustrates, “private and individual ownership,” together with “other

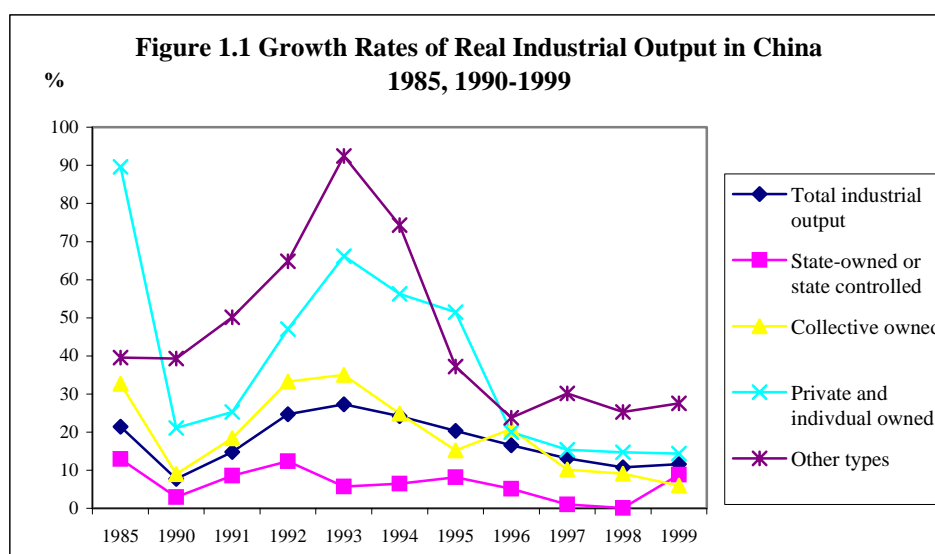
⁶ Conversation with official of the SETC, October 25, 2001.

⁷ See IFC, *op.cit.* Table 2.3, page 18.

⁸ *2001 White Paper: American Business in China* The American Chamber of Commerce, People’s Republic of China 2001. See page 30. The same source estimates that defining the private sector narrowly as comprising *siying qiye* firms (see below) would lower the estimate to about one-sixth of GDP.

⁹ There is also an additional, undefined classification: “Other,” which is small enough to be disregarded here.

ownership types,” which mostly comprise foreign-funded firms and shareholding corporations, have comprehensively outpaced the state-owned sector and even the collectively owned town and village enterprises (TVEs) in the past 15 years. The persistent growth differentials have translated into a significant shift in composition of the level of industrial output by ownership types (see Figure A1.a in Annex 1). Until 1990, state-owned and collectively owned firms produced more than 90% of gross industrial output. Since then, the shares being produced by private firms, broadly defined to include foreign and shareholding firms, have risen rapidly, reaching 44% in 1999, when the share of state-owned firms was only 28%, a far cry from the almost two thirds of gross industrial output produced by state-owned firms in 1985.



Notes:

1. “Private and individual owned” include *siying qiye* firms and *getihu*.
2. “Other types” include foreign-funded firms and non-state-controlled shareholding corporations.
3. Since the *China Statistical Yearbook 2001* does not report total industrial output by ownership (it does so only for firms with revenues of 5 million yuan or more), this figure presents growth rates only up to 1999.
4. The gross output data are adjusted using GDP deflators.

Source: *China Statistical Yearbook*, 2000.

The sustained more rapid growth of the private sector strongly suggests that *productivity growth* is also higher in the private sector, and that inference seems all the more likely when one recognizes the evident advantages that foreign-funded firms possess in technology, management practices, and information of all kinds. Table 1.1 presents several indicators, for firms with annual sales exceeding five million yuan¹⁰, from which we can infer comparative productivity across some ownership types. Unfortunately, Table 1.1 excludes information on private and individual ownership, both of which ownership classes (as Table 1.2 shows) tend to concentrate in industries that typically exhibit higher labor intensity (e.g., such service sectors as retail trade and restaurants). Potential confirmation of the rising competition that small private ventures confront in these sectors might lie in the gradual decline in their very high concentration in trade and food services, combined with their rising presence in manufacturing and social services.

¹⁰ This is one of the areas where the *China Statistical Yearbook* provides less than fully comprehensive data.

Table 1.1 Selected Indicators for all State-Owned or State-Controlled Firms and Nonstate-Owned Firms with Sales over 5 million yuan in 2000

Item	National	of which:			
		State-owned State-controlled	Collective	Shareholding corporation	Foreign- funded ¹
Number of enterprises (in billion yuan)	162,885	53,489	37,841	5,086	28,445
Gross industrial output	8,567	4,055	1,191	1,009	2,346
Industrial value-added	2,539	1,378	307	358	609
Total paid-in capital	3,294	2,016	231	376	908
Total assets	12,621	8,401	963	1,493	2,568
Total sales	8415	4,220	1,080	982	2,255
Total profits (in million yuan)	439	241	45	125	128
Assets per firm	77	157	25	294	90
Profits per firm	2.7	4.5	1.2	24.6	4.5
Return on assets (%)	3.5	2.9	4.7	8.4	5.0
Value-added/gross output (%)	29.6	34.0	25.8	35.5	26.0

Note: Foreign-funded firms include those funded by investors from Hong Kong, China; Taipei, China; and Macau.
Source: *China Statistical Yearbook*, 2001

Another assessment of the potentially superior productivity of firms under private ownership is found in a study by Li and Rozelle (2000),¹¹ who analyze the impact of a transfer to private ownership on the performance of a sample of rural collectives, or those collective firms that have taken off their red hats. They find that financial indicators—the ratios of revenue to employment, revenue to capital, profit to employment, and profit to capital—serve as partial measurements of efficiency, and that such data provide insufficient evidence for superior efficiency of privatized firms. However, by explicitly modeling the production functions and correcting for selection bias, they demonstrate that firms that have been privately owned for 2 years or more produce from the same inputs 7% more output on average than rural collectives. They also find that, although privatization brings productivity gains after 2 years, its immediate effect on productivity may be negative. In the year in which they are privatized the firms' performance can deteriorate by 11–17%. In all, one can surmise that there are credible reasons to associate higher productivity with private firms, but the evidence is inconclusive with more research needed to establish the facts.

¹¹ Li, Hongbin and Scott Rozelle (2000) "Saving or Stripping Rural Industry: An Analysis of Privatization and Efficiency in China," *Journal of Agricultural Economics*, v23, n3, pp. 241-53.

Table 1.2 Shares of Total Urban Private Employment in the PRC, by Industry

Year	Share of Total (%)						
	Total (millions)	Trade and Restaurant	Manufac- turing	Social Services	Transport, Storage, Post and Telecom	Construction	Others
1985	4.5	72	11	9	5	1	1
1990	6.7	64	14	14	5	1	2
1991	7.6	64	17	10	6	1	1
1992	8.4	66	15	11	6	1	2
1993	11.2	64	15	11	6	1	4
1994	15.6	63	17	11	6	1	2
1995	20.4	62	17	12	5	1	3
1996	23.3	61	17	12	6	1	3
1997	26.7	61	17	12	6	1	3
1998	32.3	59	17	12	6	1	4
1999	34.7	58	17	13	6	2	4
2000	34.0	57	19	13	5	2	4

Source: *China Statistical Yearbook*, 2001.

Individual and Privately Owned Ventures

More comprehensive output and employment data are available on individual businesses and privately owned enterprises that are wholly owned by domestic residents. The predominant form of ownership by frequency is **individual businesses** (*getihu* 个体户). Table 1.3 shows that in 2000 the PRC had almost 26 million such enterprises employing more than 50 million people, impressive figures that nevertheless represent a sharp decline from corresponding figures of almost 32 million enterprises and more than 62 million employees in 1999. The main reason for the decline was an exercise that the State Administration for Industry and Commerce (SAIC) conducted during 2000 to remove data on individual businesses that were no longer in operation. Millions of new small ventures start up each year in the PRC, but just as in other countries many of them fail to prosper. After initial registration, not all of the individual businesses have been monitored closely, hence the need to adjust data in 2000 to reflect events occurring in several earlier years. Officials observed in conversation that some *getihu* successfully make the transition to larger entities that are registered differently, but individual businesses increasingly tend to fail due to the heightened competition they face from larger enterprises, especially in retailing and food outlets where larger “chains” and “supermarkets” are emerging rapidly in all large cities.

Simple arithmetic shows that most of the individual businesses are single person or husband/wife endeavors. But their vitality is astonishing nevertheless; even with the data corrections in 2000; since 1993 the number of such undertakings has increased by more than half, and those employed in them by more than two-thirds.

Table 1.3 Individual Businesses (*getihu*) Development Since 1993

Year	Number of Businesses			Employment		
	Number (millions)	Growth Rate (%)	Absolute Increase (millions)	Number (millions)	Growth Rate (%)	Absolute Increase (millions)
1993	17.7			29.4		
1994	21.9	23.8	4.2	37.8	28.5	8.4
1995	25.3	15.6	3.4	46.1	22.2	8.4
1996	27.0	6.9	1.8	50.2	8.7	4.0
1997	28.5	5.4	1.5	54.4	8.5	4.2
1998	31.2	9.4	2.7	61.1	12.4	6.7
1999	31.6	1.3	0.4	62.4	2.1	1.3
2000	25.7	-18.6	-5.9	50.7	-18.8	-11.7
Average		5.5	1.1		5.6	3.0

Notes:

1. The dramatic decline in 2000 is due to the removal of registered but inactive businesses.

2. The average growth rates are computed as the compounded average annual growth rates.

Source: *China Statistical Yearbook*, 1994-2001.

Firms owned by Chinese residents that employ eight or more persons are termed **privately owned (*siying qiye* 私营企业)**, and this is the class of firms that is often meant in official references as the "private sector." Though dwarfed by the absolute number of *getihu*, *siying qiye* firms as a class have expanded much faster since 1993 (Table 1.4), growth that has been sustained throughout the period with no sign of the apparent sharp slowdown in numbers exhibited by *getihu* since the mid-1990s.¹² There were more than 1.7 million privately owned firms by 2000, employing more than 24 million people, with the number of firms and people employed by them growing annually, respectively, at 33% and 31% over 1993–2000.

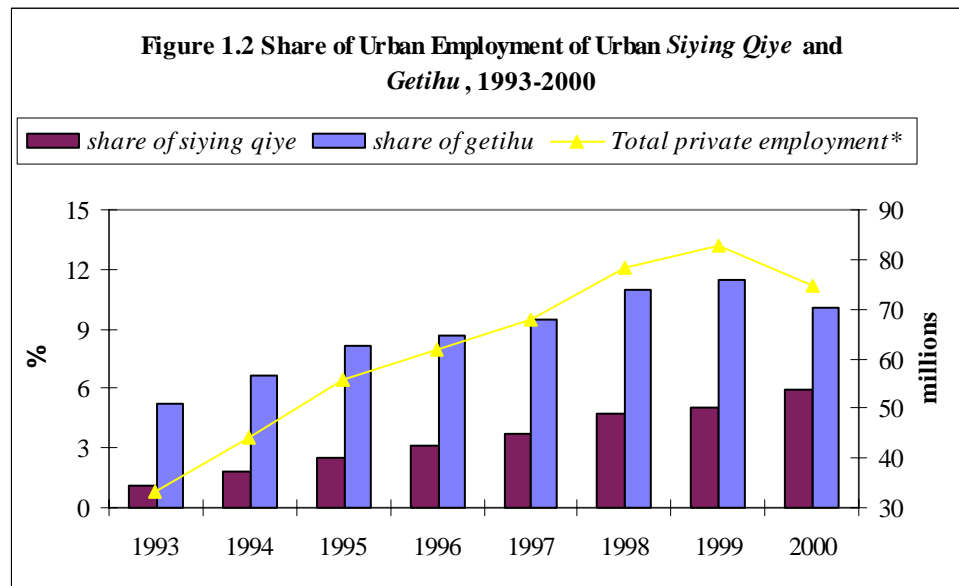
Together, private firms and individual firms accounted for almost 11% of total national employment in 2000 (more than 16% of urban employment), compared with 5% in 1993 (at 6%)—see Figure 1.2 and its notes. The faster growth of *siying qiye* firms saw their share of total employment in the PRC's narrowly defined private firms rise from a ninth in 1993 to a third in 2000. One can observe, however, that employment by the average *siying qiye* firm is still very low—fewer than 14 workers per enterprise. Given that some of the enterprises are sizeable (see Annex 3), the clear implication is that the vast majority of *siying qiye* firms are also very small. An important issue for policy makers is to foster conditions under which these firms can accelerate their growth and create many more jobs. That is all the more needed as governments push ahead in restructuring the government and enterprise sectors, and the collectives also restructure themselves to compete more effectively.

¹² The data make no allowance for reclassification of enterprises as a result of either the conversion of state-owned or collectively owned enterprises to private ownership or the registration of firms as private that might have existed but was unregistered before the constitutional amendment of 1999 that legitimized the key role of the private sector in the "socialist market economy" of the PRC.

Table 1.4 Privately Owned Enterprises (*Siying Qiye*) Development Since 1993

Year	Number of Firms			Employment		
	Number (thousands)	Growth Rate (%)	Absolute Increase (thousands)	Number (millions)	Growth Rate (%)	Absolute Increase (millions)
1993	238			3.7		
1994	432	81.4	194	6.5	74.0	2.8
1995	654	51.4	222	9.6	47.4	3.1
1996	819	25.2	165	11.7	22.5	2.2
1997	960	17.2	141	13.5	15.2	1.8
1998	1201	25.1	241	17.1	26.7	3.6
1999	1509	25.6	308	20.2	18.3	3.1
2000	1762	16.8	253	24.1	19.0	3.9
Average		33.1	218		30.7	2.9

Note: The average growth rates are computed as the compounded average annual growth rates.
Source: *China Statistical Yearbook*, 1994-2001.



Notes:

1. The decline in *getihu* employment in 2000 is due to the removal of registered but inactive businesses.
2. Total private employment includes employment by all *siying qiye* and *getihu*; total national employment rose from 664 million in 1993 to 712 million in 2000, at a compounded annual average growth rate of 1%.

Source: *China Statistical Yearbook*, 1994-2001.

That conclusion is supported by the extraordinary growth in employment in the *getihu* and *siying qiye* in combination. From 1993 to 2000, total employment in the PRC increased by 48 million to 712 million, with 37 million of those new jobs being located in urban areas, which saw total employment expand from 176 million in 1993 to 213 million in 2000. During the same period, employment in *getihu* and *siying qiye* ventures grew by almost 42 million, implying that, aside from creating employment opportunities for new entrants to the labor market, the narrow

private sector is also providing job opportunities for workers shed by the shrinking state sector. Between January 1998 and September 2000, 21 million workers have left the state sector, 13 million of whom have found re-employment.¹³

Regional Dispersion of *Siying Qiye*

Data are available on the location of privately owned firms defined narrowly to comprise *siying qiye*. Table 1.5 shows that both the numbers and the employment in these firms in the coastal region continue comfortably to exceed the numbers for the central and western regions combined. For all regions, though, the numbers of firms have grown rapidly, contributing more or less proportionately to the overall rapid growth noted in Table 1.5. If anything, the numbers are growing somewhat faster in the central and western regions. An interesting observation is that, in 1993, the average employment in *siying qiye* firms in the central and western regions, though small at 17 and 18, respectively, was considerably higher than the 15 for the corresponding indicator on the coast. In all regions, the average employment per firm fell by two by 2000: private firms countrywide are employing fewer workers on average. Clearly, new entry by firms of very small size offsets the growth of some firms to the much larger size observed in the survey of five cities described in Section 2.

Table 1.5 Distribution of Number of *Siying Qiye* Firms and Their Employment by Region

Year	Coastal ¹			Central ²			Western ³		
	Firms	Employment (‘000s)	Share of Total Employment (%)	Firms	Employment (‘000s)	Share of Total Employment (%)	Firms	Employment (‘000s)	Share of Total Employment (%)
1993	159	2,351	63	45	769	21	34	606	16
1994	285	4,055	63	91	1,478	23	56	952	15
1995	433	5,998	63	138	2,182	23	84	1,379	14
1996	530	7,231	62	178	2,742	23	112	1,737	15
1997	611	8,211	61	211	3,189	24	140	2,093	16
1998	759	10,365	61	250	3,835	22	193	2,892	17
1999	933	12,453	62	276	4,237	21	240	3,527	17
2000	1,185	15,774	66	293	4,160	17	284	4,132	17

Notes:

1. Coastal: Liaoning, Hebei, Beijing, Tianjin, Shandong, Jiangsu, Shanghai, Zhejiang, Fujian, Guangdong, and Hainan.

2. Central: Heilongjiang, Jilin, Shanxi, Henan, Hubei, Anhui, Jiangxi, and Hunan.

3. Western: Inner Mongolia, Shaanxi, Ningxia, Gansu, Qinghai, Xinjiang, Tibet, Sichuan, Chongqing (from 1998 onward), Guizhou, Yunnan, and Guangxi

Source: *China Statistical Yearbook*, 1994-2001.

Private Ownership and Exports

When it comes to *export activities*, the general perception is that the (narrowly defined) PRC private sector, at least partly due to entry constraints, has yet to play a role in the rapid growth of

¹³ World Bank, “China, Macroeconomic Update,” March 2001.

the country's international trade comparable to its already large contributions to the national output and employment. In the pre-reform era, PRC international trade was effectively monopolized by about a dozen foreign trade corporations (FTCs) that allocated import and export quotas to various industrial ministries, as dictated by the plan.¹⁴ Since then, the PRC's trade regime has gone through substantial liberalization, with the plan gradually replaced (effectively, by 1992) by market prices, which now largely determine the inflow and outflow of goods and services.

The number of FTCs gradually proliferated; as a result, the right to trade internationally became widely provided to branches of the FTCs controlled by the central and local governments. Foreign-funded firms, including the joint ventures between foreign and domestic firms and those located in the Special Economic Zones (SEZs), were granted rights to export their products early in the reform era. By contrast with the purely Chinese owned private firms, the PRC's rapid progress as an international trading power owes much to the export orientation of these foreign-invested firms. More recently, large domestic enterprises increasingly have obtained import and export licenses that enable them to trade with foreigners directly. By 1994, according to a report of the International Trade Center (ITC), FTCs, SOEs and foreign-funded firms accounted for 53%, 17% and 28% of exports, respectively, while collectively and privately owned firms together accounted for only about 1% of total exports.¹⁵ One analyst estimates that in 1998 the share of exports from foreign-funded firms reached 45%.¹⁶ Unfortunately, more recent ITC reports are unavailable. And the *China Statistical Yearbook* includes no breakdown of the PRC's exports by ownership of the originating enterprises.

Some indirect evidence about the role of foreign-funded firms in the PRC's trade might be inferred from the tendency of those firms to be located predominantly in the coastal regions.¹⁷ Table 1.6 displays export data, for 1999 and 2000 (from the Statistical Yearbook), and 2001 (from the Ministry of Foreign Trade and Economic Cooperation [MOFTEC] using customs data). The value of exports is shown for the coastal, central, and western regions,¹⁸ as well as for the provinces (including Beijing) in which the survey cities for this study are located. As the figures show, export performance is extremely concentrated by region, with coastal provinces accounting for 90% of total exports in 2000, when Guangdong alone accounted for 37% of total PRC exports. The customs data from MOFTEC suggest that the corresponding shares are 92% and 36% in 2001, respectively. The same 2001 customs data show that almost two fifths of Guangdong's exports are sourced from Shenzhen alone, a graphic illustration of the advantages enjoyed by the early SEZs, as well as of the benefits they derive from hosting large inflows of foreign direct investment (FDI).

¹⁴ For an outline of the trade liberalization in the PRC, see Martin, Will, Betina Dimaranan, Thomas W. Hertel, and Elena Ianchovichina (2000) "Trade Policy, Structural Change and China's Trade Growth," Working Paper No. 64, Center for Research on Economic Development and Policy Reform, Stanford University.

¹⁵ *Ibid.*

¹⁶ Nicholas Lardy (1999), "China's WTO Membership," Policy Brief # 47, Brookings Institution.

¹⁷ Of course, most Chinese firms that export are also more likely to be located in coastal areas; see the survey information from Nanhai and Wenzhou.

¹⁸ The definitions of the geographical regions are as in the IFC study, *op. cit.* (see notes to Table 1.6).

Table 1.6 Geographic Composition of Exports from the PRC, by Origin and Destination, 1999–2001

Area	Exports	Share of	Exports	Share of	Exports	Share of
	(\$ million)	Total (%)	(\$ million)	Total (%)	(\$ million)	Total (%)
	1999 ²		2000 ²		2001 ³	
PRC	194,931		249,203		266,155	
Coastal ⁴	176,124	90	224,460	90	243,987	92
Central ⁵	10,996	6	14,428	6	13,118	5
Western ⁶	7,811	4	10,315	4	9,050	3
Beijing	6,285	3	7,667	3	11,787	4
Guangdong	78,760	40	93,428	37	95,426	36
Liaoning	8,128	4	10,589	4	11,008	4
Shaanxi	1,019	0.5	1,327	0.5	1,108	0.4
Zhejiang	13,654	7	20,482	8	22,976	9

Notes:

1. Export values in current prices.

2. Exports by origin, not by location of the exporting agent.

3. From Customs data published on the Ministry of Foreign Trade and Economic Cooperation website.

4. Coastal: Liaoning, Hebei, Beijing, Tianjin, Shandong, Jiangsu, Shanghai, Zhejiang, Fujian, Guangdong, and Hainan.

5. Central: Heilongjiang, Jilin, Shanxi, Henan, Hubei, Anhui, Jiangxi, and Hunan.

6. Western: Inner Mongolia, Shaanxi, Ningxia, Gansu, Qinghai, Xinjiang, Tibet, Sichuan, Chongqing (from 1998 on), Guizhou, Yunnan, and Guangxi.

Sources: *China Statistical Yearbook*, 2000 and 2001; Ministry of Foreign Trade and Economic Cooperation website.

Investment and Financing

The PRC's privately owned firms have emerged rapidly despite facing seemingly difficult conditions. Apart from uncertainty about property rights due to the lack of official recognition of private ownership until very recently (essentially, the Constitutional Amendment in 1999), these firms have been effectively excluded from credits from banks. Table 1.7 shows that, although TVEs and foreign-funded firms in recent years have gained greater access to credit, short-term lending received by private firms is still minute, at about 1% of the total. The access of these firms to formal sources of financing is totally disproportionate to their contribution to output and employment.

Given that the PRC's private ownership is still dominated by small firms, raising capital on the domestic equity markets, which until recently were still subject to stringent regulations and quotas for listings, is impossible for most of them. As a consequence, one would expect that the tremendous growth of these domestic private firms has been financed mostly from retained earnings, such informal credit sources as personal networks, and extensive use of trade credit. The capacity to rely largely on self-generated funds for new investment ultimately will limit unnecessarily the speed at which these firms can grow. Table 1.8 shows the sources of financing for fixed asset investment for different ownership types in selected years.

Table 1.7 Loans by Financial Institutions in the PRC at Year-end: 1994–2000

Item	1994	1995	1996	1997	1998	1999	2000
Total loans (billion yuan)	3,998	5,054	6,116	7,491	8,652	9,373	9,937
Total short-term loans ¹ (billion yuan)	2,695	3,337	4,021	5,542	6,061	6,389	6,575
	<i>Shares of total short-term loans (%)</i>						
Industrial, commercial and construction enterprises	78.2	76.1	75.9	65.8	64.7	61.5	55.5
Agriculture	4.2	4.6	4.8	6.0	7.3	7.5	7.4
Township and village enterprises	7.4	7.5	7.0	9.1	9.2	9.6	9.2
Foreign-funded ²	2.9	3.0	3.3	3.4	4.1	4.7	4.6
<i>Siying qiye</i> and <i>getihu</i>	0.6	0.6	0.7	0.7	0.8	0.9	1.0
Other short-term loans	6.6	8.1	8.3	15	13.9	15.7	22.2

Notes:

1. Short-term loans are loans with maturity of no more than 12 months.

2. Includes firms funded by investors from Hong Kong, China; Taipei, China; and Macau.

Source: *China Statistical Yearbook*, 1995-2001.

Table 1.8 Sources of Financing for Fixed Asset Investment by Ownership: 1985, 1990, 1995, and 2001

Item	State		Collective		Private		Shareholding Corp		Foreign- Funded ²		Total	
	1985	1990	1985	1990	1985	1990	1985	1990	1985	1990	1985	1990
Fixed asset investment (billion yuan)	168	299	33	53	54	100	n.a.	n.a.	n.a.	n.a.	254	452
	<i>Financing Sources (%)</i>											
Budgetary allocation	24	13	1	0	0	0					16	9
Domestic loans	23	24	38	27	0	4					20	20
Foreign loans	5	9	1	2	0	0	n.a.	n.a.	n.a.	n.a.	4	6
Self-financing	40	43	60	48	100	85					60	65
Others ³	7	11	0	22	0	12					0	0
	1995		2000		1995		2000		1995		2000	
Fixed asset investment (billion yuan)	1,090	1,650	329	480	256	471	86	406	223	261	2,002	3,292
	<i>Financing Sources (%)</i>											
Budgetary allocation	5	10	2	7	0	0	1	1	0	0	3	6
Domestic loans	24	25	26	12	3	5	30	28	17	22	21	20
Foreign loans	8	2	6	4	0	0	7	5	52	35	11	5
Self-financing	49	45	56	67	96	80	51	47	24	30	67	52
Others ³	15	17	10	10	1	15	11	19	7	13	-3	16

Note:

1. Investments are in current prices.

2. Include firms funded by investors from Hong Kong, China; Taipei, China; and Macau.

3. Unspecified; calculated as residuals.

Source: *China Statistical Yearbook*, 1996 and 2001.

The data show clearly that the share of self-financing for private firms has decreased only modestly since 1985; domestic loans still finance a very small fraction of fixed asset investment. At the same time, when compared with the 1980s, SOEs gradually are being weaned from their dependence on formal budget allocations. And the rise in the share of financing derived from the budget from 1995 to 2000 probably is best attributed to the Government's expansionary fiscal policies to combat deflationary pressure in the aftermath of the East Asian currency crises in 1997. By contrast, the SOEs' reliance on bank lending, much of which can be considered "quasi-fiscal" support, persists. The credit that goes to shareholding corporations, although a small percentage of the total, consistently accounts for about one third of those firms' total fixed asset investment. Foreign-funded firms, apart from their obvious advantage of having foreign investors, have been successful—perhaps somewhat surprisingly so—in obtaining close to a fifth of fixed investment funds from domestic banks.

Summary

This review of national aggregate data supports the observations of the earlier IFC study, as well as the prevailing views of Chinese and foreign analysts. Specifically, private enterprises are becoming an ever more important source of PRC growth and employment, although evidence for their superior productivity is inconclusive. Private firms are still located predominantly in the coastal provinces. Their rapid emergence indicates comparatively free entry into markets, but they remain relatively small. To unleash their full growth potential, these firms continue to need more accommodating policies, especially to raise their access to investment funds. Although foreign-funded firms, members of the more broadly defined private sector, have become leading exporters, domestic private firms continue to focus primarily on supplying the domestic market for goods and services.

Section 2: Findings from the Survey and Fieldwork¹⁹

National statistics convey a broad general understanding of the growth of private enterprise in the PRC and its contribution to the national economy. But there is very considerable regional variation in the influence of private enterprise, as well as in the climate for private economic activity. This study followed the earlier IFC study in also conducting a field survey, in this case, of *siying qiye* firms that are members of the China General Chamber of Commerce. Its objectives were to determine the status of the private economy in five survey cities, and to identify the principal constraints on the development of the private sector. Teams from Tsinghua University (Domestic Consultant—DC) conducted the survey from 15 July to 30 August 2001. Officials of the CGCC and its Local Chapters (LCs) aided the teams in their work. The detailed survey report (including the questionnaires) prepared by the DC is in Annex 2, and supplementary statistical analysis prepared by the International Consultant (IC) is in Annex 3.

The 2001 survey followed the methodology underlying that in the IFC (2000) study in several ways. First, it struck a similar balance between geographical representation and resource constraints by conducting fieldwork in five cities that are representative of the regional differences in private sector development in the PRC. Second, the 2001 survey comprised

¹⁹ For details see Annex 2, *Survey Report: Development of Private Enterprises in China*, School of Economics and Management, Tsinghua University, Beijing, China, September 2001.

structured interviews with chief executive officers (CEOs) from selected firms and a questionnaire covering a much larger number of firms (see appendices to Annex 2). Although the CEO interviews yielded substantial detail for case-based studies, most of the statistics summarized in this section are drawn from the responses to the questionnaire. Third, the design of the questionnaire also drew upon the IFC study; and to the extent that the two questionnaires overlap in content one can glean a sense of the changes in the private sector over 1999–2001.

But there are also significant departures from the earlier survey. The IFC survey was conducted in four cities: Beijing, Chengdu, Shunde, and Wenzhou. The cities selected for this present survey were: Beijing, Nanhai, Shenyang, Wenzhou, and Xi’an. Nanhai and Shunde are both located in the suburbs of Guangzhou, and their geographical proximity should mean that their experiences with reform, especially for their private enterprises, are essentially similar.

Furthermore, for the IFC study, the questionnaire was mailed out directly to a random sample of firms in the database of the State Administration for Industry and Commerce. As a consequence, initial response rates were low and the quality of the data was problematic. The 2001 survey avoided the worst of these problems by sampling only firms that were members of the CGCC.²⁰ Since doing so introduced a sampling bias toward chamber members (and thus toward better established firms), the data from the questionnaire need to be interpreted with that bias in mind. The IFC survey in 1999 suffered from a similar sampling bias toward “the larger, more mature private enterprises.”²¹ In drawing general conclusions, therefore, and in making intertemporal comparisons between the results of the two surveys, the sampling biases must be recognized.

A description of how the data were compiled is in Annex 3. More than 1,000 questionnaires were distributed, and 777 were returned (there was a low response rate to the mail-out questionnaires). In screening the data, 21 returns were eliminated because of questionable data; and in a subsequent round an additional 32 observations were rejected for respondents that had either fewer than eight (*getihu*) firms or more than 10,000 employees. (The rationale for rejecting *getihu* businesses rests on the legal definition of private enterprises. The very large enterprises were eliminated because the survey teams were unable to locate them during the conduct of the field interviews.) The final database comprises questionnaires from 724 firms, and 82 CEO interviews, distributed by location as shown in Table 2.1.

Table 2.1 Geographic Distribution of Firms in the Final Sample

	Beijing	Nanhai	Shenyang	Wenzhou	Xi’an	Total
Questionnaires	143	147	152	148	134	724
CEO Interviews	15	15	20	15	17	82

The International Consultant team supplemented the work of the Domestic Consultant with its own fieldwork in four of the five target cities: Beijing, Nanhai, Shenyang, and Xi’an. In conducting its work, the IC received excellent logistical and other support from officials of the local chapters of the CGCC and local government agencies, as well as from the owners and senior officers of many private firms. The qualitative conclusions in this section derive from the analysis and observations of both the DC and IC.

²⁰ Xi’an was an exception. The limited size of the local chamber meant that, for adequate coverage, non-member firms had to be surveyed as well.

²¹ IFC 2000, *op.cit.* page 5.

The Survey Cities in Perspective

Coastal, central and western PRC vary in the openness of their local economies, and differ considerably in the status of private ownership of enterprises. The five cities covered by the survey represent all three regions of the PRC, with their distinct economic characteristics and different experiences of reform. Beijing is the national capital. Shenyang is the capital of Liaoning province in northeast PRC, the industrial heartland in the pre-reform era. Xi'an, an ancient capital of the PRC and center of history and culture, is the capital of Shaanxi province and gateway to the western region. Wenzhou is an eastern coastal city in Zhejiang province, which is nationally known for the vigorous development of its private sector. Finally, Nanhai is situated about 50 kilometers south of the provincial capital, Guangzhou, in Guangdong province. Of these five cities, Beijing and Wenzhou were also surveyed in 1999 as part of the IFC study.²²

Table 2.2 presents indicators of the economic and demographic weights of the survey cities in their provinces' GDPs and populations; and additional data allow a comparison of the city and province with both their region and the PRC. Clearly, the provincial capital cities, Shenyang and Xi'an, are political as well as economic centers of their respective provinces. Wenzhou, although not the capital of Zhejiang province, is an important economic center. Nanhai, despite its relatively modest share of Guangdong's GDP, is representative of the economically more advanced Pearl Delta area. Its nominal GDP per capita in 1999, at 28,295 yuan (Shunde's was 27,091 yuan), is more than twice the provincial average (11,728 yuan).

Table 2.2 Regional Comparisons of GDP and Population, 1999

Region	Population (millions)	Share of Region (%)	Share of Province (%)	GDP (billion yuan)	Share of Region (%)	Share of Province (%)
PRC	1,242			8,767		
Coast	464	37		4,961	57	
Central	420	34		2,271	26	
Western	358	29		1,535	18	
Beijing	12.6	3	100	217	4	100
Liaoning	41.7	9	100	415	8	100
Shenyang	6.8	1.5	16	101	2	24
Shaanxi	36.2	10	100	148	10	100
Xi'an	6.9			69		
Zhejiang	44.8	10	100	535	11	100
Wenzhou	7.2	1.6	16	73	1.5	14
Guangdong	72.7	16	100	846	17	100
Nanhai	1.1	0.2	1	31	0.6	4

Note: GDP in current prices.

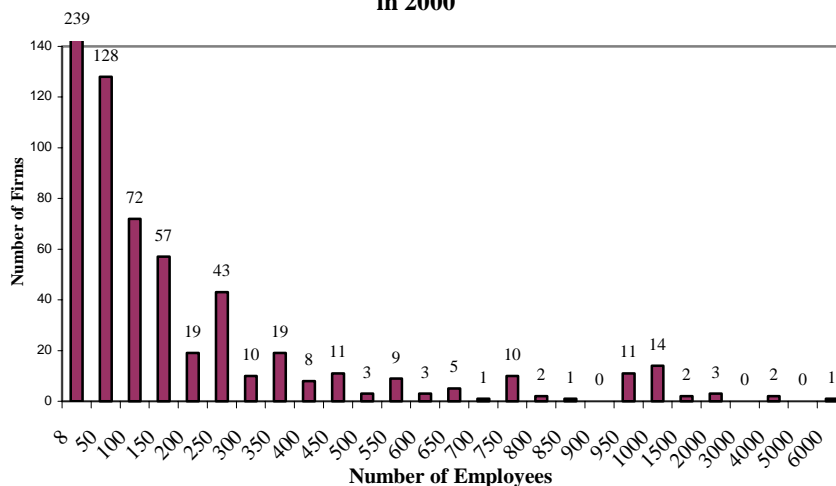
Sources: *China Statistical Yearbook, 2000*; *Beijing Statistical Yearbook, 2000*; *Liaoning Statistical Yearbook, 2000*; *Shaanxi Statistical Yearbook, 2000*; *Zhejiang Statistical Yearbook, 2000*; *Guangdong Statistical Yearbook, 2000*.

²² And, as noted, Shunde, one of the other two cities in the IFC study, neighbors Nanhai; they have similar levels of total and nonfarm populations, as well as total GDP per capita.

Characteristics of the Sample Firms (SFs)²³

Aside from geographic location, which has important consequences for access to domestic and international markets as well as the stage of reform, an issue of central importance to the survey is the firm size. In particular, in analyzing the survey results one has to consider whether the conclusions have broad applicability to all private enterprises in the PRC, or are specific to the sample of members of CGCC that was polled. Figure 2.1 reproduces from Annex 3 the frequency distribution of the sampled firms by number of employees. Although 70% of the respondents employ no more than 200 people, the average number of employees of the survey firms (SFs) is 228; the median is 96. Those are still large numbers compared with the national average employment in *siying qiye* firms of fewer than 14. One can hypothesize that smaller firms would encounter greater difficulty than larger ones in dealing with some market challenges (e.g. obtaining loans, recruiting skilled employees); but the opposite could be the case, with smaller firms being importuned less frequently to pay illicit fees, facing fewer enforceable regulations, and so on. In order to investigate the impact of size on the sentiment of the SFs, the sample has been divided into quartiles based on the number of employees in the analysis of the constraints imposed by access to resources and by the external environment. We also consider other measures of firm size, specifically, assets, and sales.

Figure 2.1 Frequency Distribution of Firms by Employment in 2000



Note: The scale of the X-axis is not uniformly linear.

Age, Ownership, and Governance

Most of the surveyed enterprises were founded after the beginning of the PRC reforms in 1979. The median age of the SFs was 8 years, and the average age, 9.3 years. One firm in the sample had been in operation for 50 years; some had begun operation only in 2001. Comparing the cities, the highest average age of the SFs was found in Nanhai at 10.3 years, and the same city had the highest median age—10 years. Xi'an had the lowest average age at 8.6 years; and Shenyang the lowest median age at 7 years. These differences accord with the perception that Nanhai was an early starter in the development of the private economy, and Shenyang and Xi'an,

²³ More details can be found in Annex 2, and the statistical significance of the results is presented in Annex 3.

being strongholds of state-owned enterprises, are comparative newcomers. But in all cities the samples primarily comprise well-established firms, and the differences in average age across cities are statistically insignificant.²⁴

All of the SFs are privately held, though some began as state-owned or collectively owned enterprises (Table 2.3). More than half of the firms began as individually owned ventures or partnerships; only about one in four was established as a limited liability company (LLC). Now, half of the firms are LLCs, and a noteworthy finding of the survey is that this seems to be the organizational form on which firms are converging, even though a third of the sample firms are still individually held. The share of firms that are already limited liability companies is notably high in Beijing, where SFs report that 30% of them began life as a LLC; at the time of the survey, almost 70% were LLCs.

Table 2.3 Initial and Current Ownership Structure
(%)

Item	Individually owned	Domestic joint venture or partnership	Limited liability company	Foreign joint venture	State-owned	Collectively owned ²
Initial	39.9	15.6	24.0	2.8	1.6	16.2
Current	32.6	9.9	49.4	5.0	0	3.1

Notes:

1. Based on 705 firms that reported both their initial and present ownership structure.
2. Includes other nonstate ownership types.

Notwithstanding this trend, ownership of the SFs is still very concentrated. In the sample, 79% of the firms have individuals as shareholders; among these firms, the shares held by individuals on average comprise 88% of the total. (Box 2.1 describes ownership by legal persons.) Of the 445 firms that also reported the proportion of their shares held by their largest individual shareholder, the average is 59%. The concentration of ownership is also reflected in the internal governance structure of the SFs. The highest decision-making bodies, according to the 692 firms that provided such information, are: the president of the company or the chairman of the board (36%), the board of directors (33%), major shareholders (14%), or shareholders' meetings (13%). In terms of the firms' major decision-makers, in nine cases out of ten they are major and minor shareholders, meaning the firms are still run by the owners themselves, with few firms entrusted to the stewardship of professional managers.²⁵

Sectoral Distribution and Market Strategies

The SFs are comparatively concentrated, with 43% of the sample found in only seven (of 55) industry classifications: retailing (which accounts for 9% of the sample), metal manufactures, industrial machinery and equipment manufacture, food services, other services, textiles, and garment manufacture (just over 5%).²⁶ The survey also identified some sectors with either few or no private ventures: for example, tobacco manufacturing, petroleum processing, and legal

²⁴ A one-way analysis-of-variance (ANOVA) test fails to reject the hypothesis that the average age of the firms in the five cities is the same.

²⁵ See Annex 2.

²⁶ On the other hand, for about a third of the classifications (18), there were at least 20 respondents.

services. There are various explanations for a lack of private activity: in the cases cited, namely, a prohibition on the entry of private firms, extremely high capital requirements of the activity, and a dearth of the required professional technical support among the membership of the CGCC.

The SFs report that other private enterprises and SOEs comprise 60% of their suppliers, and only one supplier in sixteen is foreign. More than half of the suppliers are located within the same province. Their customers are somewhat less concentrated; only half of their sales are to other *siying qiye* firms (29%) and SOEs, and 14% are to joint ventures of domestic and foreign companies. For half of the SFs, other private firms are viewed as the main competitors, with SOEs and foreign joint ventures competing vigorously with 15% and 13% of SFs, respectively.

Box 2.1 What is a Legal Person?

In discussing ownership types in the PRC, the “legal person” is an important legal concept that can cause confusion, because it has no exact parallel in a western company law. According to Chinese law, a legal person is an *organization* that can independently enjoy civil rights and assume civil liabilities. To qualify as a legal person, an organization should be legally established; possess the necessary assets or funds; have its own name, organizational structure, and location; and should be able independently to assume civil liabilities. A legal person is represented by a “legal person representative” who is someone selected according to the law or the organization’s bylaws. A legal person’s residence is the location of its headquarters. The termination of a legal person requires both an audit and the cessation of all of its activities except the audit.

There are two types of legal person: an enterprise legal person and an institutional legal person.

Enterprise Legal Person: All state-owned and collectively owned enterprises, with bylaws, an organizational structure, and the ability to assume civil liabilities, can become a legal person after registering with their supervising government agencies. A foreign joint venture that meets these requirements can also become an enterprise legal person by registering with the relevant administration for industry and commerce. An enterprise legal person can only operate within the realm sanctioned at its registration. It also assumes the civil liabilities stemming from the operational activities of its representative and other employees. A legal person should register and issue a public notice in the case of a divestiture, merger, or any other important change. After a divestiture or merger, the rights and liabilities of the legal person are assumed by its legal successor. The termination of an enterprise legal person can occur due to revocation by law, dissolution, or bankruptcy by law. At the termination, the enterprise legal person should register the termination with the registration authority and issue a public notice. If an enterprise legal person dissolves, it should perform an audit; if it is revoked or has declared a bankruptcy, its supervising agency or the People’s Court should arrange for an audit. Unless the law dictates otherwise, the civil liabilities are limited to the assets granted by the state for a state-owned enterprise legal person; and to the enterprise’s assets for a collectively owned enterprise legal person or a foreign joint venture legal person. If the enterprise legal person engages in one of the following illegal activities, apart from the civil liabilities assumed by the legal person, there could be additional administrative penalties, fines, or criminal liabilities, if applicable:

- illegal operations in areas beyond those registered;
- misinformation or deception of registration and/or tax agencies;
- misappropriation of assets or the evasion of debts;
- disposal of enterprise assets on own accord after the revocation, dissolution, or bankruptcy;
- failure to register (and issue a public notice of) a major organizational change or termination, so much so that other parties incur significant loss; and
- activities prohibited by law or resulting in the loss of public welfare.

Institutional legal person: A government agency, institution, or social organization with independent funding acquires the status of a legal person with its establishment. For some institutions registration as a legal person is required by law.

Overwhelmingly, the SFs sell into domestic markets. Only about 40% of the SFs responded to the survey questions about their exports to sales ratio, and of those that did report two thirds export less than 10% of their total sales. The questionnaire design admits the possibility that many of the firms reporting a below 10% exports-to-sales ratio may not be exporting at all. If this is the case, the sample firms actually engaged in exporting could be fewer than one in six. Comparatively speaking, coastal cities are more export oriented; for the SFs in

Nanhai and Wenzhou, one in three firms has acquired an import/export license, and 17% of them export more than half of their total sales. Of firms surveyed in Shenyang and Xi'an only 15% have an import/export license, and fewer than one in twenty exports more than half of total sales. Among foreign destinations, Southeast Asia (which includes Hong Kong, China; Macau; and Taipei,China) takes almost a quarter of total exports, followed by Europe (16%), Japan and Republic of Korea (13%), and the United States (12%).

The SFs market their products mainly to wholesalers and retailers, either through self-established channels²⁷ or through direct sales.²⁸ Marketing seems in general to be poorly developed among the SFs, which attach little importance to brands as intangible assets. In part, this reflects the sectoral distribution of firms. Almost a fifth of the firms report that they never advertise, and of those that do almost 80% report that they spend annually an amount less than 5% of the value of annual sales. Firms in Beijing seem to attach comparatively more importance to advertising. Nevertheless, competition for sales seems intense.

Adding emphasis to the undervaluation of brand names, the SFs seem equally unconcerned about certifying the quality of their products. About a third of the sample failed to respond to the question, and the respondents were split almost evenly between those that have an ISO9000 certificate (31%) and those that have no certificate (28%). There are other certificates of quality that vary sector by sector, but the proportion of the SFs with these is low. Coastal cities pay comparatively more attention to securing certification of the quality of their products—45% of the respondents from Nanhai and Wenzhou have ISO9000 certification of their products.

In terms of promoting their existing products, more SFs perceive greater opportunity in exploring new markets (49%) than in raising their shares in existing markets (41%). When it comes to positioning their new products, most firms proceed cautiously. About 45% of them will modify existing products; others limit their product development to a single new product line (29%). Only 22% expand into multiple products or markets. Few firms consider their new product strategy from a global perspective (only about 3%).

Management, Investment, and Technology

Most of the SFs (85%) are run by males, and the percentage is even higher in Nanhai and Wenzhou. The educational attainment of managers of the SFs presents a mixed picture, but is generally low. Before running or operating enterprises, 28% of managers were farmers, 24% employees of SOEs, and 11% government officials. Nanhai and Wenzhou have the highest incidence of ex-farmer managers at 46% and 40%, respectively, a legacy of those cities' early experience with TVEs and the rapidity with which collectives were transformed into privately owned ventures. By contrast, almost half the managers of the SFs in Beijing, Shenyang, and Xi'an have college diplomas.

The investment activities of the SFs convey information about their size as well as their sentiment about business prospects. In the three years prior to the survey, to expand their firms' production capacity 36% of the SFs report investing less than a million renminbi yuan, 33% more than a million yuan but less than 10 million yuan, 14% between 10 and 50 million yuan,

²⁷ These are mainly chains that sell an enterprise's products exclusively.

²⁸ Most likely through their own retail outlets, which probably account for most of an average of 13.3 domestic "subsidiaries" reported by the two in five SFs that have them.

and 5% more than 50 million yuan.²⁹ As evidence of the confidence that private firms generally have in the economy, 37% of the SFs plan to invest up to a million yuan in capacity expansion in 2002 alone, 31% between one and ten million yuan, 14% between 10 and 50 million yuan, and 5% more than 50 million yuan. The firms' responses indicate that not much of their capital expansion is debt-financed. For the sample, the average ratio of enterprise debt to assets is just over a quarter, with a low of 22% in Beijing and a high of 30% in both Nanhai and Wenzhou. The DC infers that these figures imply that SFs are generally in good financial health, but also imply that firms might be insufficiently leveraged to take advantage of all of the opportunities for growth. Of course, low debt levels could also reflect primarily difficulty in borrowing from banks. Interviews with the firms' CEOs confirm a general sense of optimism about prospects combined with a reluctance to take on the risks of large liabilities.³⁰

Most of the SFs seem to operate at low technology levels, with some outstanding exceptions, especially in Beijing. Fifty-nine percent of the SFs indicated they have obtained no patents and a further 17% did not respond to the question. A quarter of the sample has obtained a patent, and 42 of those enterprises have international patents. In terms of technology or product licenses, 39% of the sample has no licenses and 22% did not respond. Of the 39% of the SFs that have acquired such licenses, 33 firms have obtained them from abroad. However, these figures seem to understate the emerging interest in and emphasis on technology that private firms display. Although 18% of the sample firms spend nothing on research and development (R&D), this seems mainly because of the characteristics of the sectors in which they operate. Forty-six percent of the SFs spend between 1 and 5% of their annual sales revenue on R&D, and another 37% invest more than 5%. In Beijing almost half of the SFs report R&D expenditures in excess of 5% of annual sales.

Constraints on Enterprises: Resource Acquisition and the Business Environment

The survey employs a five-point scale to measure the surveyed firms' reactions to factors that affect the ease or difficulty they confront in their operations. One can interpret three on this scale as a neutral response, while a score above three suggests comparative ease in coping with an issue, and a score below three suggests the reverse. In addition to evaluating the extent to which specific problems affect the whole sample, there is a clear value in identifying differences in the reactions of firms depending on their size and where they are located. One can measure the size of the sample firms by assets, employment or sales, as well as combinations of these variables.³¹ As Annexes 2 and 3 indicate, the results are insensitive to which indicator of size is used; here we report results using employment as the indicator, but Annex 3 provides similar information for assets and sales.³² Annex 3 also employs the techniques of analysis of variance (Anova tests) as well as t-tests to determine the significance of the results. A general observation is that the standard deviations of the responses are sufficiently large that for none of the questions can one conclude that the response is significantly different from the neutral response (a value of 3.0); but pair-wise comparisons of the responses of individual cities and different size quartiles do reveal significant differences.

²⁹ The remaining firms are believed not to have invested in capacity expansion in the period.

³⁰ See Annex 2.

³¹ Profits could also be considered, but this section (and the report generally) discounts the use of information on profits because the perception of both the DC and the IC is that the SFs have tended to under-report profitability. For data on profits refer to Annex 2.

³² Annex 3, Table A3.2 shows that assets and sales are the most closely correlated of the three indicators of size.

Resource Constraints

Table 2.4 summarizes the response of the SFs in each of the sample cities to the constraints they face in acquiring resources. For each city and each resource, the table gives the mean numerical response and its standard deviation (in parentheses), the same information for the whole sample, and the one-way Anova F-statistic, which tests the differences in means across cities for each resource and its significance level. Although the pooled responses differ significantly from neutral for none of the constraints tested, casual observation suggests that firms tend to be more “positive” about their ability to obtain raw materials, and hire skilled labor and professional services, and more “negative” about the availability of senior and junior managerial and technical staff.

Table 2.4 Perceptions of Resource Constraints by City

	Beijing	Nanghai	Shenyang	Wenzhou	Xi’an	Total	One-way Anova F-Stat
Market/industry/technology information	3.09 (.81)	2.89 (.74)	2.90 (.82)	2.96 (.72)	3.00 (.84)	2.97 (.79)	1.58 [.18]
Policies and regulations information	3.00 (.87)	2.88 (.72)	2.92 (.88)	2.94 (.76)	3.06 (.88)	2.96 (.82)	1.00 [.41]
Technology and equipment	3.15 (.76)	2.94 (.74)	3.00 (.95)	3.04 (.78)	3.29 (.84)	3.07 (.82)	3.66 [.006]
Raw materials	3.46 (.80)	3.41 (.74)	3.30 (.82)	3.38 (.88)	3.42 (.80)	3.39 (.81)	.71 [.58]
Senior technicians	2.66 (.87)	2.55 (.89)	2.73 (.91)	2.57 (.85)	2.74 (.91)	2.65 (.89)	1.32 [.26]
Senior management	2.46 (.80)	2.33 (.94)	2.59 (.98)	2.50 (.85)	2.53 (.87)	2.48 (.89)	1.74 [.14]
Skilled labor	3.29 (.83)	3.11 (.80)	3.30 (.85)	3.25 (.76)	3.44 (.76)	3.27 (.81)	2.96 [.02]
Professional services	3.31 (.79)	3.05 (.83)	3.20 (.81)	3.30 (.77)	3.31 (.79)	3.23 (.80)	2.71 [.03]
Manager/technical staff	2.92 (.83)	2.73 (.76)	2.85 (.83)	2.84 (.63)	2.85 (.79)	2.84 (.77)	1.07 [.37]

Note: Standard deviations in () parentheses and significance level in [] brackets.

However, conducting a series of paired sample t-tests reveals that, for the sample as a whole (and similarly for each city), firms perceive different resource constraints differently (even where the perceptions do not differ significantly from “neutral”). For instance, at the 5% significance level, firms in the sample as a whole perceive “market-industry-technical information” and information on “government policies and regulations” as being equally difficulty to obtain. Similarly, firms regard “skilled labor” and “professional services” as similar in the constraints they impose (or fail to impose). For all other resource pairs, there are

statistically significant differences in the firms' perceptions.³⁵ A similar analysis can test for city-wise differences in the way SFs perceive constraints. It shows that there are significant differences in how SFs in different cities view the constraints associated with "technology and equipment," "skilled labor," and "professional consulting services," but no evident patterns emerge and for no other resources do firms in different cities view things differently.³⁶

The Effects of Firm Size

Whether or not large firms find things easier than smaller ones do is illustrated in Table 2.5, which shows responses for each potential resource constraint for different sizes of firms as determined by the numbers of employees.³⁷

Table 2.5 Resource Constraints by Employees (in Quartiles)

Item	Emp-1	Emp-2	Emp-3	Emp-4	Total	One-way Anova F-Stat
Market/industry/technology information	2.89 (.81)	2.99 (.83)	2.95 (.79)	3.10 (.66)	2.98 (.78)	2.30 [.08]
Policies and regulations information	2.90 (.91)	2.97 (.87)	2.92 (.72)	3.04 (.78)	2.96 (.82)	.837 [.47]
Technology and equipment	3.11 (.90)	3.06 (.88)	2.97 (.79)	3.20 (.69)	3.08 (.82)	2.18 [.09]
Raw materials	3.29 (.84)	3.42 (.83)	3.48 (.83)	3.39 (.73)	3.40 (.81)	1.49 [.22]
Senior technicians	2.73 (.90)	2.69 (.95)	2.49 (.86)	2.67 (.84)	2.64 (.89)	2.26 [.08]
Senior management	2.62 (.89)	2.46 (.92)	2.29 (.94)	2.53 (.79)	2.47 (.89)	3.94 [.008]
Skilled labor	3.27 (.79)	3.30 (.84)	3.24 (.77)	3.29 (.82)	3.27 (.80)	.21 [.89]
Professional services	3.10 (.81)	3.32 (.84)	3.20 (.79)	3.34 (.74)	3.24 (.80)	3.26 [.02]
Manager/technical staff	2.78 (.77)	2.87 (.83)	2.76 (.73)	2.89 (.73)	2.82 (.76)	1.05 [.37]

Note: Standard deviations are in () parentheses and significance levels are in [] brackets.

Once again, the size of the standard deviations implies that all averages are statistically indistinguishable from the neutral response: 3.0, but the Anova tests suggest that size does matter for "senior management" and "professional consulting services." Larger firms seem better able to procure consulting services, and mid-sized firms seem to have greater difficulty in recruiting senior managers. The results vary with different definitions of size as shown in Table 2.6, though

³⁵ See Annex 3, TableA3. 5.

³⁶ *Ibid.*

³⁷ The same information for firm size defined by sales and assets are in Annex 3. Results are qualitatively similar with all definitions, with principal exceptions noted in the text and Table 2.6.

one must note the important qualification that the results are comparative. For example, all sized firms report that raw materials are relatively easy to obtain; the Anova tests show that the ease in obtaining such raw materials is significantly less for small firms.

Table 2.6 Summary of Firm Size and Resource Constraints

Item	Asset	Sales	Employment
Market/industry/technology information	S	S	
Policies and regulations information		S	
Technology and equipment			
Raw materials	S	S	
Senior technicians		M	
Senior management	M	M	M
Skilled labor	M		
Professional services	S	S	S
Manager/technical staff	M	M	

S = small, meaning firms in the 1st quartile; M = medium, firms in the 2nd and 3rd quartiles; L = large, firms in the 4th quartile. Note: This table illustrates how size affects resource constraints, where size does matter. In general, *all* firms perceive raw materials, skilled labor, and professional consulting services as being relatively accessible, and senior technicians and senior management as relatively inaccessible.

How should these results be interpreted? Setting aside the issue of statistical significance, the two broad resource areas that seem to cause the most trouble for firms regardless of their size are (i) access to information of all kinds, and (ii) recruitment of skilled managers and technical staff. The DC reports that the concern about better management skills has emerged recently and is an important problem area for many CEOs. Although local recruitment of personnel is still the predominant form of hiring, firms in Nanhai already obtain more than half of their management and technical personnel from outside the local area. Countrywide recruitment is less prevalent in Shenyang and Xi'an, where there is an abundance of laid-off employees of SOEs from which to choose; but the emphasis on the development of the West of the PRC might explain why Xi'an is the leader among the five cities in recruitment from abroad, which provides nearly one employee in seven for Xi'an's SFs.

Moreover, the fieldwork of the IC similarly revealed that firms are troubled both by their difficulties in recruiting senior officers and by their inability to obtain access to timely, reliable information on everything from current policies and regulations, to tax rates and license fees, to technology options, and to market conditions. Firms in Beijing have the easiest time of it, but even there access to some information (for example, state policies) is difficult to obtain. Sources of information are diverse in all cities: print media and television are most frequently cited (by one in five firms), but when chambers of commerce and own industry associations are combined, they are cited by one firm in four. The Internet is a small but rapidly growing source of information for enterprises.

Constraints in the Business Environment

Using the same one-to-five scale, the survey obtained similar information on the SFs' perceptions of difficulties in the business environment. Table 2.7 summarizes the results of the responses by cities. Once again the standard deviations are large enough to mean that none of the sample means are significantly different from the neutral response at the 1% level, but the SFs exhibit significant differences in how they perceive various aspects of the business environment.

The generally high marks that the SFs give to the posture of the central and local governments, as well as how they operate daily, seem to indicate reliably the positive view of private enterprises about governments. That positive assessment was almost universal, as well, in the interviews conducted by the IC with the owners of private firms. But while the firms gave the governments full marks for effort and for their improved attitude towards private enterprise, they did fault, especially, local governments for inconsistencies in the application of policy from one department to another, and in some cases for ignorance of current policies.³⁸ Table A3.11 of Annex 3 shows the pattern of significant city-wise differences in perceptions about the environment, and identifies Beijing as significantly more upbeat about the attitudes and performance of governments compared to the other cities.

Table 2.7 Perceptions of Aspects of the Business Environment by City

Item	Beijing	Nanghai	Shenyang	Wenzhou	Xi'an	Total	One-way Anova F-Stat
Property security	3.46 (.81)	3.56 (.74)	3.36 (.76)	3.76 (.82)	3.36 (.76)	3.46 (.79)	6.50 [.000]
Contract enforced	3.38 (.78)	3.17 (.82)	3.26 (.91)	3.53 (.77)	3.44 (.74)	3.35 (.82)	4.42 [.002]
Central government function	3.93 (.88)	3.49 (.86)	3.66 (.79)	3.88 (.84)	3.83 (.87)	3.76 (.86)	6.28 [.000]
Local government function	3.71 (.89)	3.33 (.93)	3.44 (.85)	3.64 (.92)	3.54 (.83)	3.53 (.89)	4.10 [.003]
Central government attitude	3.99 (.73)	3.61 (.69)	3.65 (.80)	3.96 (.70)	3.81 (.73)	3.80 (.74)	7.91 [.000]
Local government attitude	3.87 (.87)	3.60 (.74)	3.53 (.92)	3.72 (.84)	3.45 (.85)	3.64 (.86)	5.29 [.000]
Bank loan difficulty	2.13 (1.01)	2.39 (1.13)	2.03 (.96)	3.27 (1.05)	2.16 (.97)	2.41 (1.12)	34.07 [.000]
Nonbank loan difficulty	1.94 (.90)	2.20 (1.17)	1.83 (.85)	2.96 (1.01)	2.30 (1.01)	2.23 (1.06)	24.06 [.000]
Administrative harassment	3.58 (1.11)	3.64 (1.12)	3.05 (1.05)	3.35 (1.18)	3.28 (.98)	3.38 (1.11)	6.42 [.000]
Market competition	1.75 (.87)	1.63 (.83)	2.01 (.94)	1.90 (.85)	2.27 (.91)	1.90 (.91)	10.69 [.000]

Note: Standard deviations are in () parentheses and significance levels are in [] brackets.

Once again setting aside the question of statistical significance, the SFs in all cities uniformly face difficulty in obtaining bank or other loans (or, generally, in access to finance), and also have negative views about the competitive environment. Wenzhou, despite essentially neutral scores on the questions, is significantly more positive about obtaining finance than are the other cities.³⁹ The most frequently cited sources of financing are “individual or household

³⁸ One owner of a large, successful private venture noted that the firm has its own legal staff, one function of which is to challenge unfavorable interpretations of policy by local officials whose knowledge of their own rules and regulations is faulty.

³⁹ Details of the sources of financing for the SFs are shown in Annex 2, Table A2.15. Table A2.16 shows that only a quarter of the SFs meet as much as 10% of their financing needs by borrowing from banks.

investment” by half the firms, and “retained earnings” by two firms in five, with the next most frequently cited sources being “bank loans” (37%) and “internal capital” (32%). About 15% of the survey firms also identify “investment by other private firms” and “loans from relatives and friends” as sources of finance. Conversations with CEOs and officials of all kinds provided strong support for the hypothesis that private enterprises are constrained severely by lack of access to finance. They noted that the constraint is not unique to private enterprise, but is equally severe for small state-owned and collectively owned firms, which explains the Government’s recent emphasis on assistance to small- and medium-sized enterprises (SMEs—see Annex 4).

The SFs’ concerns about market competition are summarized in Table A2.17 of Annex 2. The main concern, expressed by 42% of firms, is “disorder” in market competition, followed by “fake products” (19%), “taxation” (11%), “local protectionism” (10%), and “excessive legal restrictions” (9%). Although some of these concerns point to obvious and immediate action to improve the workings of markets (for example, by preventing local protection of markets, cracking down on fake products, and ensuring that taxes and other payments are both more transparent and better publicized), other remedies are more difficult to identify and, at the same time, less obviously needed.⁴⁰ Vigorous competition has been a primary factor in stimulating the emergence of an efficient, dynamic private sector, and it will continue to be needed to ensure the health of the PRC’s market system. Eliminating “disorder” should not become a prescription for tilting the playing field to favor established firms. Equally, the enforcement of some laws, e.g., to protect the environment, safeguard employees, and enforce contractual obligations, is an essential pillar of the market system that the PRC should be trying to foster.

How Does Size Matter?

Once again, dividing the sample into quartiles by employee numbers produces the information shown in Table 2.8. A striking result is the response about “market competition” where sentiment becomes more negative as the size of the firm increases. Although there are many possible explanations for this, one that emerged in conversation with entrepreneurs was the extent to which firms that establish a market presence then frequently have to contend with newcomers who endeavor to market their own products as if they were produced by the established firm. Besides losing an initial sale, the established firm is at risk of damage to its reputation if the fake products fail to perform up to expectations and are indistinguishable from those of the aggrieved firm.

Other than that, no obvious patterns emerge; Table 2.9 below shows reports for all potential problems in the business environment and the significant differences in size-wise perceptions as derived from the one-way Anova test. (As in Table 2.6, the summary results are shown for all three metrics of firm size; and the details for classification by asset and sales are in Annex 3.) The results establish that, except for market competition, smaller firms do perceive the external environment to be less favorable to them than do larger firms, and that conclusion is fairly robust across the three measures of firm size. Attitudes towards governments vary depending on how size is measured, but, if anything, smaller firms tend to be less enthusiastic about these characteristics of the business environment that firms in general approve. Given that

⁴⁰ Forty percent of SFs either did not respond or reported no barriers to entry into local markets, but those encountering/reporting barriers cited five types of restrictions: government permits, regional protection, individual management, government policies, and market size, with the frequency of citation varying from 25% to 16%.

the firms in the sample are considerably larger than the average private enterprise and that getihu are excluded from the survey, one is tempted to conclude that for access to credit, at least, smaller private firms are generally disadvantaged compared to larger ones.

Table 2.8 External Environment and Firm Size by Employment (in Quartiles)

Item	Emp-1	Emp-2	Emp-3	Emp-4	One-way Anova F-stat
Property security	3.38 (.83)	3.46 (.78)	3.53 (.82)	3.64 (.72)	3.00 [.03]
Contract enforced	3.31 (.77)	3.34 (.89)	3.37 (.85)	3.43 (.71)	.602 [.61]
Central government function	3.78 (.80)	3.78 (.86)	3.62 (.95)	3.89 (.79)	2.73 [.04]
Local government function	3.53 (.82)	3.51 (.93)	3.39 (.97)	3.73 (.77)	4.22 [.006]
Central government attitude	3.81 (.79)	3.79 (.67)	3.70 (.84)	4.00 (.59)	5.03 [.002]
Local government attitude	3.48 (.92)	3.61 (.87)	3.62 (.85)	3.87 (.77)	5.96 [.001]
Bank loan difficulty	2.15 (1.15)	2.33 (1.08)	2.32 (1.10)	2.81 (1.07)	10.59 [.000]
Nonbank loan difficulty	2.11 (1.02)	2.09 (1.06)	2.24 (1.12)	2.41 (.99)	2.81 [.04]
Administrative harassment	3.25 (1.10)	3.32 (1.09)	3.39 (1.15)	3.53 (1.08)	1.75 [.16]
Market competition	2.13 (.93)	1.95 (.94)	1.79 (.84)	1.73 (.83)	6.46 [.000]

Note: Standard deviations are in () parentheses and significance levels are in [] brackets.

Table 2.9 Summary of Firm Size and External Environment

Item	Asset	Sales	Employment
Property security	S	S	S
Contract enforced	S	S	
Central government function		S	M
Local government function	S	S	M
Central government attitude		S	M
Local government attitude	S	S	S
Bank loan difficulty	S	S	S
Nonbank loan difficulty	S	S	S
Administrative harassment	S	S	
Market competition	L	L	L

Notes: This table illustrates how size affects firms' perceptions of their environment, where size does matter. Relatively speaking, *all* firms view the central Government's functions and attitude quite positively, while they perceive the difficulty in obtaining bank and nonbank loans and market competition as particularly worrisome. Also see notes to Table 2.6.

How do Members Value the CGCC?

There is an obvious need for caution in interpreting the results of the portion of the questionnaire that polls SFs on the services they receive from the CGCC, when the survey of CGCC members was conducted with the assistance of officers of the CGCC and its local chapters, and largely within the premises of the LCs. In particular, the opinions of CGCC members might have little relevance to private firms that are not members of the CGCC. But information was obtained as well about the services that members obtain from industry associations (IAs), and the comparison of the two could indicate where the CGCC's comparative advantages, actual and potential, might lie (See details in Annex 2).

In general, the SFs report positively on their interaction with CGCC and its LCs. They regard the CGCC, its LCs, and IAs as important sources of information, especially about government policies (for 85% of the SFs) and markets (70%), and to a lesser extent about technology, and clients, suppliers or strategic partners. Fewer than one firm in six received information about financial services, the only other category with a significant number of respondents, though this type of information was much more readily available from these sources to firms in Beijing. In terms of the information that SFs would like to receive from the three sources, they look to the CGCC for information (in order) on government policies, markets, technology, and financial services; to the LCs, on markets, government policies, technology, and financial services; and to the IAs, on markets (predominantly), technology, financial services, and government policies. The SFs downplay the importance of information they want to receive on suppliers, etc. And only for the IAs do the SFs report the category "others" more frequently than the four most frequently cited classes of information, even though the category includes several seemingly important areas, including "laws and regulations."

The SFs also receive services from the CGCC, LCs and IAs, the most frequently cited being: coordination with governments (63% of the SFs), commercial consultancy services (56%), training (44%), and, less commonly, coordination with financial institutions (14%). Compared with the desire for more information from the three agencies, many fewer firms look to them as important providers of these services, though several firms view LCs as potential sources for training and help in dealing with governments. The outlook is somewhat more positive as reflected in the SFs' willingness to pay the CGCC for its services: 44% of firms would pay for information, 35% for training, 22% for consultant services, 18% for membership, and 13% for facilitation services. The DC interprets these somewhat contradictory results to mean first, that the chief concern of the SFs is to receive better information of all kinds from the CGCC, LCs and IAs; and second, that there is a demand for training, advisory, and other services that firms would pay for if the quality of service delivered by the agencies were better.

Summary

The firm-level survey of CGCC members in five cities reveals an improvement since the IFC report in the SFs' perception of the climate for private enterprise development in the PRC. Probably because the Government now recognizes private enterprises formally and legally, and values their dominant role in the growth of the PRC economy, central and local governments have begun actively to promote the development of the private sector. By comparison with the average private firm (nationally), the average SF is large, employing 16 times as many people; even the median SF employs seven times the national average number of employees in private firms. Notwithstanding the bias in the survey toward larger, better-established firms, the extent to

which the SFs are integrated into national and international markets is still limited—for most of the SFs, their customers, suppliers, and employees remain primarily local.

In the past 3 years, governments at all levels have taken steps to reduce obstacles to the growth of private firms that are both acknowledged and appreciated by the SFs. Nevertheless, private firms still see themselves as disadvantaged by local idiosyncrasies in policy implementation; and they are constrained in their activities by lack of access to formal sources of finance; inadequate information in all areas; difficulties in recruiting highly qualified personnel, especially senior managers and technicians; and deficiencies in the way markets work. Not too surprisingly in a survey of CGCC members, the SFs have a positive view of the contributions of the CGCC, its local chapters, and industry associations. At the same time, they would appreciate, and be prepared to pay for, more and better services from the CGCC and its LCs.

Section 3: Constraints on Growth of Private Firms

The IFC report provided a comprehensive list of the factors that either actually or potentially constrain the growth of private firms in the PRC,⁴¹ grouped according to whether those factors relate primarily to private enterprises themselves, to the financial sector, or to governments. (See Table 3.1) The list builds from the measures that governments have already introduced to promote private enterprise, most notable among which was the constitutional amendment in 1999 that formalizes the private sector role, as well as those that are implicit in the promises made for membership in the World Trade Organization. The sense of the study teams is that all of IFC’s factors continue to impede the development of the enterprises in the PRC, and many are likely to do so in the foreseeable future.

Table 3.1 Issues for the Future Development of Private Enterprise

For Enterprises		For Financial Sector	For Government
Corporate governance	Market entry and competition	Private firms’ access to bank lending	Protection of private property rights
Financial disclosure	Labor relations	Alternatives to bank lending	Openness of markets
Subsidiaries and conglomerates	Financing	Private equity markets	Commercial legislation
Supplier and customer relationships	Government relations	Private firm access to public equity	Rule-based tax system
	Management capacity		

Source: “An Agenda for the Future,” Chapter 6 in International Finance Corporation (2000) *China’s Emerging Private Enterprises, Prospects for the New Century*, pp. 60-73.

For enterprises, the IFC report emphasizes how firms must adapt to their management and governance practices in order to adopt an organizational form appropriate to an enterprise system that will be based on much more formal rules. The survey reported in this study indicates that the private firms are shifting more or less rapidly to limited liability corporations, albeit with a reluctance to forego the tradition of individual ownership, implying only slow separation of ownership and management. The IFC report identifies corporate finance and professional management as areas urgently needing improvement for firms to grow beyond the size that their informal structure can support. It emphasizes standardized accounting practices as an essential

⁴¹ In particular, see IFC, *op.cit.* Chapter 6: An Agenda for the Future, pp. 60-73.

prerequisite for disclosing the true financial situations of firms. Without accounting transparency firms will be unable to finance themselves easily through the financial and capital markets.

The IFC report assigns to governments the responsibility to build market-supporting institutions: that involves safeguarding the security of private property rights, relaxing entry restrictions faced by private enterprises, erecting a transparent regulatory environment, and implementing a rule-based tax administration. To accomplish this, the most important action required is to enforce the rule of law, which in many instances means implementing laws that already exist. In other cases, laws and regulations should be simplified to reduce the scope for bureaucratic discretion in their application. As we have seen, these are areas to which officials at all levels attach greater urgency; unfortunately, however, implementing all of these actions is going to take time, and some will be the work of a generation.

Although the IFC report analyzes almost all potential sources of financing for private firms, it points to bank lending as the area where rapid improvements will provide most impetus to private sector growth. (We agree with that assessment.) The report goes on to recommend measures primarily designed to encourage banks to lend more to private firms. It gives a guarded endorsement of credit guarantee schemes, subject to sound management principles based on international experience, to remove some of the lending risk from the banks.

Some recent research on transition economies indicates that the experience of private firms in the PRC is far from unique. McMillan and Woodruff (2001)⁴² show that, to overcome the lack of such formal institutions as financial markets, courts, and credit bureaus, entrepreneurs in economies making the transition from command to market systems have resorted to extensive use of relational contracting, trade credit, and other modes of self-help. The authors conclude that, in the early stage of the transition to the market, governments can contribute most by avoiding interference with entrepreneurs. But as the private economy matures, governments have to involve themselves more actively in all the areas that the IFC study has identified to develop formal market-supporting institutions.

For McMillan and Woodruff (2001), the most important institutional support required from governments is to create (i) a legal system that ensures the enforceability of contracts, and (ii) formal financing sources that are accessible to small private firms. The findings from the survey discussed in Section 2 strongly suggest that the PRC has reached this stage in the development of its private sector. Private firms still deal primarily with clients in their own locality. They need greater assurance that they can buy and sell in more distant markets without the costly services of intermediaries. And as all of the SFs have indicated, they need greater access to financing from banks.

What Needs to be Done First?

The discussion in Section 2 of the DC's survey of enterprises and the supplemental fieldwork by the IC identified the main immediate concerns of entrepreneurs. Those concerns fall into five categories: (i) access to finance, (ii) availability of managerial and technical skills, (iii) availability of information, (iv) nontransparent and/or inconsistent implementation of policies and regulations, and (v) inappropriate competition policies and other deficiencies in the organization of (aspects of) markets. The first of these—access to finance—is a concern of all

⁴² John McMillan and Christopher Woodruff (2001), "Entrepreneurs in Economic Reform," Working Paper No. 102, Center for Research on Economic Development and Policy Reform, Stanford University.

enterprises, not just those that are privately owned; private entrepreneurs uniformly voice the opinion that lack of appropriate funding is the major obstacle to the growth of their enterprises.

Access to Finance

Inability to obtain financing applies equally to all types of credit from banks, access to both the equity and bond markets, and so on. The immediate priority, however, is to enable small private firms to establish themselves as valued customers of the banks. To a certain extent, the slow development of banking relations is a function of the poor condition of the large banks' portfolios, which has made them reluctant to lend in general; it also stems from the unreliability of many private borrowers, who borrow for one purpose and use the money for something else.⁴³ The Government's reluctance to license more banks, especially foreign ones to conduct local currency business, has also contributed, though the promises made for WTO membership are likely now to change things fairly rapidly.

But the investigations conducted for this study point to administered interest rates as the main constraint to bank lending to private firms. At the time of the fieldwork by the IC, the 1-year term lending rate was 5.85%, with the banks free to vary it up to plus or minus 10% of the mandated rate for state-owned enterprises, plus or minus 30% for small- and medium-sized enterprises, and plus or minus 50% for rural cooperatives.⁴⁴ There is excess demand for credit at even these high real rates—countless entrepreneurs would be delighted to borrow at 130% of the base rate, but banks see the return as inadequate to compensate them for the risks they incur in lending to small private firms.⁴⁵ Hence, banks still direct most loans to state enterprises, a tendency reinforced by the recent introduction of heavy penalties for bank officials who make bad loans, especially to nonstate borrowers.

Enterprises compound their problems by failing to take steps to make themselves reliable clients of banks. They provide unreliable (and unaudited) data on their performance. They disguise profits. They often have ambiguous claims on assets that might be used as collateral or security for loans. As noted, some firms use loan funds for purposes other than those for which banks lent them. In many cases, firms seem to avoid using banks for working accounts, including management of payroll and of day-to-day receipts and payments, which might naturally develop into more extensive commercial relations. To ease the finance constraint, some firms even group together to set up (quasi-legal) "credit cooperatives" to substitute for the services of banks (see Box 3.1). By each of these actions, firms might be trying to avoid providing information that would make them more liable to taxes and fees, but to the extent that they become reliable payers of legitimate taxes they increase their likelihood of becoming attractive clients of banks.

For their part, governments have been tardy in taking steps to clarify property rights and establish timely processes under which creditors can take recourse against delinquent borrowers. They are belatedly emphasizing the need to develop an appropriate "banking culture," which

⁴³ There was a refreshing frankness in the way the owner of one firm stated that this practice had made firms their "own worst enemies" in dealing with bankers.

⁴⁴ The one-year deposit rate at the time was 2.25%. In February 2002, the People's Bank of China (PBC) lowered the one-year lending rate to 5.31%, and the corresponding deposit rate to 1.98%. This was the seventh in a series of interest rate reductions since 1996.

⁴⁵ One branch of a private bank indicated that it would lend to private firms only with the guarantee of a reliable SOE, even if the private firm had satisfactory collateral (as recovery of collateral in the event of default was too costly and time consuming). Another branch of the same bank suggested that it would lend more to small private firms if it could charge fees and interest rates adequate to compensate it for its transaction costs and risks.

Box 3.1 Easing the Financing Constraint

The international consultant visited one local chapter (LC) of the CGCC in a town of some fifty thousand people that illustrated starkly both the impediments to small business development in rural PRC, and the dynamism that private enterprise imparts to the rural economy. Officials of the LC stated that governments underestimated its value: the local government ignores the LC, and there is no official interest in its activities; the LC is uninvited to local policy meetings; and the local Bureau of Industry and Commerce does not take the LC seriously. The LC relies on its members for resources, which are in short supply. With more resources the LC would provide more and better information as well as more training opportunities to the membership.

Lack of finance constrains members' ability to expand their businesses and take up attractive new business opportunities. To ease the constraint, the LC established, in 1997, its own credit cooperative. Initially, it accepted deposits from all comers, and soon had a deposit base of 10 million yuan but when the People's Bank of China prohibited public fund-raising it was constrained to raise resources only from its 88 members (26 enterprises, 62 individuals, with 14 applications for membership pending approval by the county level chapter). At the time of the visit, the cooperative had a deposit base of 4-5 million yuan. Depositors received interest of 5.2% on a one-year term deposit (banks were paying 2.5% at the time); and borrowers paid 90 basis points over the banks' one-year lending rate (then at 7.31%). Loans were for 3 months, with a minimum amount of 1,000 yuan, and a maximum of 200,000 yuan. No fees were charged for loans, but loans could only be made with the guarantee of the largest "shareholder" (depositor). In the event of a default (which has happened at least once), the guarantor is required to repay the loan amount. A staff of three handles day-to-day operations, assisted by some of the LC members, and the services of a lawyer are available for complicated transactions and to settle disputes with people living outside the township.

According to officials of the LC, its articles permit the establishment of a credit cooperative, which has no need for formal registration because its activities are restricted to the membership! The objective of the fund is to help members invest in new ventures or expand existing ones. Project proposals are reviewed by the officers of the cooperative, and voted on by a five-person board of directors, any one of whom can veto the project. The members of the board were elected at the outset from among the largest contributors to the fund. Officials claimed that the board had performed well. The requirement of unanimity in loan approval reduced risks; no complaints had been received from members about the directors' decisions, even from those whose loan applications had been denied. Board meetings took place every Sunday, with attendance compulsory. For missing a meeting, the fine was 200 yuan without notification, and 100 yuan if the other directors had approved the absence.

Despite a good track record, sensible governance arrangements, and the satisfaction of the membership, the risks are obvious. In discussing their business plans, officials indicated that they anticipated acquiring or starting up businesses on behalf of the membership—what might be termed a "collective conglomerate." They would probably serve the membership better by continuing to manage their funds conservatively, and emphasizing the provision of liquidity to members' firms.

would base lending decisions on the fundamentals of banking practice, including sound credit analysis, prudent risk management, appropriate pricing of loans, and so on. Governments have been slow, as well, to develop the legal infrastructure required for banks to base lending decisions on the cash flows of borrowers.⁴⁶ They have emphasized insufficiently the disclosure of accurate information on enterprise performance, and the associated need to adopt adequate accounting standards in preparing financial statements. They have continued, even after dismantling the credit plan, to encourage banks to lend to poorly performing SOEs. To their credit, they have recognized the importance of the activity of SMEs in the economy, and the need to stimulate the flow of formal credit to them, but in our view they have overemphasized the role of credit guarantees in trying to spur lending to SMEs (see Annex 4).⁴⁷

⁴⁶ The absence of the equivalent of uniform commercial code filing, as found in the United States, renders impracticable assignments and pledges of non-fixed assets, and encourages banks to rely predominantly on pledges of fixed assets to secure loans.

⁴⁷ These comments should not be seen as a condemnation of the many positive steps the Government and the PBC have taken to improve the performance of the PRC's banking system. From the scrapping of the credit plan to the introduction of lending bands, which give limited interest rate flexibility, to the establishment of asset management corporations designed to help the four large state owned commercial banks purge their portfolios of

Box 3.2 Why Guarantee Bank Loans to Small- and Medium-sized Enterprises?

Along with the Government's recognition of the invaluable contribution that smaller enterprises make to the PRC economy has come the impulse to help them contribute even more. But, as small- and medium-sized enterprises (SMEs) have thrived on inattention, governments at all levels need to ensure that efforts to nurture such SMEs enhance, rather than impede, competition among them. Although the initiative of the State Economic and Trade Commission (SETC) to support SMEs (see Annex 4) is not designed to promote private enterprise, it certainly could have that effect if privately owned ventures position themselves to take advantage of the programs sponsored by the SETC.

Chief among those programs are measures aimed at facilitating bank lending to SMEs. Establishing small enterprises as reliable and regular clients of banks is an admirable objective. At issue is how best to do it. All banks have been encouraged to set up departments that specialize in lending to SMEs, and the smaller banks are being encouraged to view SMEs as their natural client base. To make that happen quickly, business organizations, local governments, and even individuals are being encouraged to found credit guarantee companies (CGCs) to improve SMEs' access to bank credit. Because banks will be enabled to lower their risk in lending to SMEs by obtaining guarantees from the CGCs on (all or part of) their loans, the Government envisages a rising supply of formal finance to SMEs. For CGCs, in turn, to mitigate risks, options for re-guarantee would be provided, eventually possibly through a state re-guarantee agency.

There are almost certainly more than 300 CGCs already in the PRC and possibly more than 500, although no one seems to know the exact number, in itself a disquieting reflection of the absence of central regulatory oversight. Some of the larger CGCs were established initially under the supervision of the central bank (PBC), and were funded by central and local government agencies. After the supervision of banking and insurance companies was separated, oversight of these pioneer CGCs fell to industry associations.

The PRC's CGCs vary greatly in size, and in the scope and quality of their activities. Through field interviews, the individual consultant (IC) gained the impression that few of them are both sufficiently active and big enough to have a meaningful effect on the volume of bank lending. Although the larger CGCs could have outstanding credit guarantees amounting to several billion yuan; the smaller ones might have outstanding but only a few million. The smaller CGCs have such limited credibility with the banks that they have to use their own cash as collateral to induce banks to lend to them. The larger, more credible CGCs have issued guarantees that are a multiple of their paid-in capital, though the total of guarantees outstanding for any CGC is usually less than five times its capital. Because of the limitations imposed by their capital, CGCs typically offer to guarantee loans only up to 3 million yuan, with the smaller CGCs offering much more modest coverage. The guaranty fees range from 1-1.5% of the guaranteed sum each year.

All CGCs function by providing liquidity to borrowers through the local banks. Most of their guarantees are offered to private enterprises that have sound businesses but lack the assets and/or sufficiently convincing financial records to obtain bank loans independently. Although the CGCs employ project analysis and approval processes that are similar to those of banks, they tend to be more flexible in analyzing investment projects because they seek additional credit information to support their decisions. They sometimes also use local investigative agencies for supplementary information about the potential client.

To the extent that CGCs are more able than banks to evaluate a borrower's creditworthiness, CGCs could potentially improve the intermediation of bank deposits to SMEs, and to private firms in particular. Where that is not the case, the proliferation of CGCs will encourage moral hazard as banks shift the responsibility for due diligence to another agency. Even where the CGCs are thoroughly professional and perform well, if their presence both impedes the development of a commercial credit culture within banks and impairs the incentives for SMEs to prepare reliable financial records and other certification of their creditworthiness, the overall impact could be detrimental to the reform of the financial system. The view of the IC is that giving the banks a policy mandate to lend more to SMEs and supporting them with CGCs predisposes the initiative to fail. In conversation with the IC, officers of the CGCs said that a weeding out of the weaker CGCs and a consolidation of the remainder is inevitable; they expect many CGCs to be forced out of business in the next few years as nonperforming loans emerge and the guarantees are called.

Of course, there are situations in which guarantee agencies can contribute positively, but in a supporting rather than in starring role. Good design will help: the CGCs should cover less than the full amount of a loan; limit the amount of cover they extend to any single lending institution; and apply "sunset provisions" for guarantees to any single enterprise. A more efficient syndication market could improve the sharing of credit risk among CGCs, as the current deal sizes they can entertain individually are small. A national credit reporting (registration) system, to supply better, more timely information to banks and CGCs would help them control their risks, and they would reduce risk further by assisting SMEs to conform to approved standards in preparing reliable financial records to underpin their relations with banks. A national re-guarantee facility could also help with risk control. Finally, sooner rather than later, the Government should assign an agency to regulate and supervise CGCs of all kinds.

nonperforming loans, to the gradual introduction of greater competition from new banks, the Government has given clear signs of its intention to reform the banking system gradually.

Despite evidence suggesting that a few of the PRC's rapidly emerging credit guarantee companies (CGCs) are well designed and enjoying some initial success, the current vogue for guarantees of bank lending to SMEs seems based on a misperception of how commercial relations between small firms and banks usually develop. In addition are the CGC initiative risks introducing even more moral hazard to a banking system that is plagued by it due to the hangover from the credit plan. (See Box 3.2). By their nature, banks are ill-suited to the business of providing venture capital to small private businesses, many of which will fail. They should instead be in the business of supplying going concerns with liquidity, meaning (predominantly short-term) loans for diverse working capital needs, where those loans are secured by adequate collateral (e.g., discountable receivables, bank deposits or other financial assets, land use rights or other mortgageable real property, plant and equipment, etc.) As firms mature and the relations with banks develop (and as banks acquire expertise in project analysis that allows them to lend with confidence to established, reliable clients on the basis of projected cash flow), banks will naturally tend to become a source of some of the funds needed for capital investment and expansion of capacity.

Banks will have little incentive to invest resources to establish the creditworthiness of client firms or to ensure the quality and unencumbered nature of those firms' collateral, if they are able to pass along the risks to credit guarantee agencies, which themselves may be poorly equipped to assess risk in lending to SMEs. This is all the more the case when the interest rates that the banks can charge are insufficient to compensate for the costs of investigating the firms and recovering collateral in the event of a default, as well as for the risks that default will occur. The main rationale for introducing CGCs has to be that they will be better able to assess the creditworthiness of borrowing SMEs than will the banks. Even if this is the case, the whole purpose of reform in the banking sector is to develop in banks a better capacity to intermediate financial savings and, hence, the capacity to direct loans to the clients that will use the money best. Entrusting CGCs with part of the job could threaten the success of banking reform; moreover, one should fear that the performance of the guarantees will be no better than the corresponding loans, and that many of the CGCs will fail.

Recommended Measures

To encourage banks to focus greater attention on lending to private enterprises the Government and the People's Bank of China (PBC) should substantially *liberalize the interest rates* for bank lending to (especially small) private firms. That is a change in incentives greatly to be preferred over mandating lending to small enterprises, including those that are privately owned. Ideally, lending rates should be freed completely, but if that is seen as too drastic a change (because of the well-known risks of asymmetric information and adverse selection, or simply lack of experience and expertise in the banks) the PRC's tried-and-true gradual approach could be employed. Widen the flexible band for lending to SMEs to 100% of the administered lending rate, then monitor to see how lending activity responds.

Officials need to complement this action by encouraging more rapid emergence of an appropriate banking culture. In doing so, they should accept that banks are inappropriate sources of seed capital for small startups. But banks are an entirely appropriate source of short-term financing for all forms of working capital where loans can be secured by collateral.⁴⁸ As an

⁴⁸ Good collateral is a necessary condition for greater lending by banks even at higher lending rates.

alternative to agencies that guarantee loans, the Government might wish to encourage a shift in emphasis to *guarantees of collateral*, essentially a certification of the value of a firm's assets and against which the firm could borrow.⁴⁹ At the same time, banks and guarantee agencies could cooperate to establish a system of collateral registration that could certify that firms had not already pledged assets offered as security for a loan.⁵⁰ Banks would retain the incentive to develop their own capacity for credit analysis, but might be helped in the short term by the existence of agencies that would specialize in the valuation of firms' assets. To contain their risks, banks would determine their own policies on how much they would be prepared to lend as a proportion of the value of proposed collateral. Over time, as banks developed familiarity with particular firms and their payment experience, the proportion could be expected to rise. With sufficient time and familiarity, a guarantee would no longer be needed.

Of course, the value of any firm's collateral can change rapidly, especially for nonfixed assets. Some types of receivables and inventories might be unacceptable as security for even short-term loans because their value fluctuates quickly and unpredictably. But such other assets as production machinery, and construction and transport equipment retain appreciable and predictable value during the life of short-term loans, which might persuade banks to lend against them as collateral. A system of this kind could only work well if the banks and guarantee companies were able to gain title to the collateral immediately following a default. The Government needs to expedite the development of legal procedures, including those that recognize property rights and enforce contracts, to help settle disputes rapidly, transparently and consistently, and so contain costs and help to make small-scale lending an attractive line of business for both banks and guarantee agencies. Once small firms are sufficiently well established, banks increasingly would be willing to help finance capital expansion. To encourage this desirable outcome, firms would help themselves by maintaining an impeccable credit history in servicing short-term loans and by better financial record keeping.

Availability of Managerial and Technical Skills

Among the inputs that firms need, skilled managerial and technical personnel were second only to finance in the list of resources that constrain the development of private enterprise. As the survey indicated, firms in Nanhai and Wenzhou, in particular, commonly recruit for those skills outside the local area, and in Xi'an there is considerable recruitment of Chinese citizens who have been educated or are working abroad. Beijing and Xi'an enjoy a concentration of colleges and universities that assist firms in those cities to acquire well-educated personnel. As a result, the SFs in Beijing report that an average of 20% of their personnel comprises college graduates. The high demand for skills is evident as well in the emergence of a sizable and rapidly growing vocational training industry; there are numerous training centers in every good-sized city purporting to meet the clamor for qualifications in everything from language skills to all aspects of information technology

⁴⁹ An alternative that also might reduce moral hazard is proposed by Xu Jieqin of the People's Bank of China. Following the model of the Small Business Investment Program of the US Small Business Administration, she recommends that credit guarantees be reserved for bank lending to companies that take equity positions in (established) SMEs. See "Support for SME Financing in Transitional China," *mimeo*, March 2002.

⁵⁰ Along similar lines, the PBC and the banks might do well to establish a credit registration system that would allow potential lenders to screen an applicant to determine the status of any existing outstanding loans, as well as the applicant's debt-servicing record.

There are no short-term solutions to the shortage of skills; indeed, skilled personnel will be a constraint to the PRC's development in the foreseeable future. Nevertheless, there are many ways in which the constraints can be eased, specifically, by remunerating skills sufficiently to attract them away from their current employment (for example, in SOEs), and by appropriate training, both through formal courses and on-the-job training. Of course, these are precarious solutions for individual firms. Higher pay can be double-edged, as investment in training often results in employees departing for even more lucrative positions elsewhere. In a situation of general scarcity, firms needing similar skills will have every incentive to bid away talented managers and technical workers. Entrepreneurs can improve their chances by creating an environment and incentive system that rewards merit, which in some small firms requires a change in the prevalent attitude that favors family members for positions of responsibility irrespective of skills. Some skilled workers will also respond positively to the security that firms could provide through attractive pension programs, health insurance, and other nonwage benefits.

Recommended Measures

The longer-term solution to the skill deficiencies that private firms now confront involves sustained emphasis on training, remuneration based on merit, and a withdrawal of noncommercial influence on personnel decisions in all enterprises, irrespective of ownership. As well, there is a need to improve the working of labor markets nationwide, involving the promotion of greater mobility of skilled workers to enable them to move to locations where their skills are in greatest demand. An associated requirement is for flexibility in pay scales, and for non-wage remuneration, such as stock options or other forms of ownership participation, to reward managers for good performance.

Without impeding the dynamism of the emerging capacity to provide vocational and skills training, governments could help by ensuring that self-styled training institutions meet appropriate standards. In some cases, that function could be accomplished best through professional associations. For example, professional accounting bodies could certify that certain training courses meet required standards of course content and quality of instruction, so that those who complete the course would acquire valuable education in book-keeping. In addition, industry associations and local chambers of the CGCC could serve both to establish training programs in association with private training centers and educational centers to respond to the needs of member firms,⁵¹ and to screen the training providers for quality. The equivalent of "better business bureaus" might also emerge to deal with complaints about training services that fail to meet the quality requirements of those who enroll.

Availability of Information

Tackling the problems caused by a scarcity of skilled personnel requires better information about educational options, and the survey of individual firms has pointed both to the value SFs give to information of all kinds and the gaps in existing information that they would like to see eliminated. In broad terms, more and better information is required in two areas: the policies and

⁵¹ In the case of management training, for example, firms that could not afford to pay for a formal degree program still might be able to allow their managers to benefit from instruction from university faculty in shorter courses designed to equip them with specific management skills.

regulations applicable to business activity, and all aspects of relevant market characteristics. The first of these involves easy access to knowledge of the rules that govern the activities of private firms, as well as confidence that individual agencies of central and local governments have the same knowledge and will interpret it consistently in implementing policies and regulations nationally and at the local level (see below). The second area involves information about the availability of resources (including skilled labor, technology, capital equipment, and other inputs), prices of products in different domestic and foreign locations, quality standards required for products, the conditions of entry to domestic and foreign markets, constraints on operation (including local environmental regulations, etc.), sources of finance, the incidence of legitimate fees, levies, and taxes, and so on.

In dealing with the provision of information, two important concerns are: who should be responsible for collecting and disseminating information, and how best to disseminate it. In principle, there is nothing wrong with duplication, and information could be available from many sources, all of which could be equally accurate and authoritative. In practice, as we have seen in Section 2, the SFs obtain information from many sources, with the news media narrowly in the lead as the most frequently cited source, but the SFs still view the supply of information as inadequate overall. In part, this view seems to stem from a lack of awareness of the already rich array of information that is available, and it seems likely to change rapidly as firms become more aware of the potential of the Internet. The State Economic and Trade Commission, for example, maintains an attractive, informative web site, despite which the IC visited several firms and local chapters of the CGCC that were alike in their lack of knowledge of the SETC's major initiative to promote the activities of SMEs (see Annex 4).

Recommended Measures

Clearly, what is needed urgently is better information about where to obtain information! That could begin with better coordination between agencies to exchange information, agreement to allow one agency's information to be disseminated by another, and education of the owners of firms about where useful information can be obtained. For instance, the offices of the State Administration of Industry and Commerce could ensure that, when registering their firms, owners and managers are offered a short course on where useful information could be found, including a tour of web sites. And all relevant agencies (SETC, SAIC, CGCC, MOFTEC, the China Council for the Promotion of International Trade [CCPIT], IAs, financial institutions, taxation bureaus, and so on) could distribute a pamphlet listing sources of information relevant to private enterprises.

The provision of valuable information is a major area for potential expansion of CGCC's services to members. It could be done on a cost recovery basis, probably by providing a subscription service that would give members unlimited access to the CGCC's web site and other publications for a set fee. The CGCC and its LCs already inform members about the Government's directives, and selectively provide more commercially oriented information. Different LCs systematically could provide supplementary information about sources of professional services, training for employees, labor market conditions, conditions in specific input and output markets, changes in policies, laws and regulations governing enterprise operation, etc. Although some of the information would have national relevance and could be supplied centrally by the CGCC, most of it would need to be adapted to local market conditions. To do so, the LCs would need to develop improved capacities to manage and maintain databases, with evident implications for their recruitment and staff training needs.

Better Implementation of Policies and Regulations

Despite the widespread appreciation for the PRC's recent improvements in the business climate for private enterprise, in a host of areas there is plenty of room for further improvement. Two of those areas stand out. The first is the need for consistency in how policies are applied. Central Government officials in the PRC tend to give broad policy guidelines that allow for flexibility in implementation to reflect local conditions. At issue is how to retain that desirable characteristic of policy formulation without creating so much scope for local discretion that policies will become idiosyncratic and nontransparent to entrepreneurs and the public officials responsible for enforcing them. In particular, local officials need to guide the actions of officers of different departments to ensure that they interpret policies, laws and regulations consistently.

The second area concerns the extraction of "illicit" fees and levies from firms by local officials. The DC's survey revealed that illicit payments are common, and, somewhat surprisingly, that firms are not too concerned about them. The IC also observed a surprising degree of comfort with this type of more-or-less informal payment. In particular, firms were slow to brand these payments as "corruption" and indeed, in many situations, the illicit payments might supplement fiscal resources and permit local authorities to supply valued infrastructure or public services.⁵² Nevertheless, there is every reason to replace unofficial payments with formal taxes that are transparent to all and result in revenues that flow formally to the budget, either locally or at the center. To underline the need to reform the bureaucracy, the 2001 survey conducted by the Chinese chapter of the US Chamber of Commerce in Beijing identified bureaucratic inefficiency (1), lack of transparency of regulations (3), and corruption of officials (4) as three of the top five impediments to doing business in the PRC.⁵³

As well, there is need to involve enterprises more actively in evaluating both the need for policies, laws, and regulations and how effectively they are implemented. At the same time, avenues for feedback from firms are needed so governments can be aware of difficulties that firms encounter either because of government measures or because of the way they are interpreted in practice. To ensure more consistent implementation of policies requires better training of officials at all levels, as well as constant attention to how different departments in the same localities interact with enterprises. The current emphasis on training for officials countrywide so that they will understand their responsibilities after the PRC joins the WTO could serve as a model for less momentous policy changes.

Recommended measures

The Government needs to continue its efforts to reduce bureaucracy and to eradicate the ubiquitous corruption of officials. One important way to do this is to reduce, as far as possible, the extent to which the activities of enterprises are regulated, and thereby limit the scope for bureaucratic discretion in implementing policy. The survey firms would appreciate, in particular, actions to streamline licensing requirements and inspection procedures. Especially for small

⁵² The SFs report that, on average, they pay 60,000 yuan annually in "illicit fees." The DC confirmed that the SFs do not equate these fees with bribes. Rather they represent unscheduled, and possibly illegal, levies on firms by local authorities. In only one instance did the IC encounter a specific acknowledgment that sometimes bribes were paid to obtain local officials' approval for the desired actions of firms. Of course, the person acknowledging the existence of corrupt practice denied taking part in it.

⁵³ Reference cited in footnote 6 (see Exhibit 9, page 35). The other two impediments in the top five were: availability of human resources (2), and market access (5).

firms, dealing with factory visits, which often seem simply to be excuses to extract fees, occupy an entirely disproportionate amount of their managers' time. At all levels of government, there is need for better guidance on how policies, laws, and regulations are to be interpreted and implemented, as well as better coordination of the activities of individual agencies of governments to ensure that their rulings are consistent.

Traditionally, the CGCC has acted as a conduit through which the Government and the Party inform enterprises outside the state system, and grant them a voice in national deliberative bodies. There is increasing scope for the CGCC to also play a valuable role in advising governments on the opinions of its members about the ways in which bureaucratic requirements and the actions of bureaucrats exert a negative influence on their business activities. As well, it can advocate changes to laws regulations and policies that would improve the climate for private enterprise in the PRC.

Deficiencies in the Organization of Markets

Almost universally, the SFs expressed discomfort with the highly competitive nature of the markets in the PRC. This is not a cause for concern. To the contrary, the cause for concern is that local officials might intervene to limit competition for established ventures that pay taxes and otherwise support the costs of local governments. The widespread tendency for local authorities to protect local markets is well established; and the PRC's WTO membership could prove valuable to domestic firms, as well as foreign ones, in removing entry barriers to markets throughout the country (see footnote 48). Whether or not that is the case, the SFs identify "local protectionism" as a continuing problem and more should be done to simplify the conditions for market entry and exit. In some places, licenses to operate in markets can be withheld due to bureaucratic whim.

Although the SFs seem comparatively relaxed about the enforcement of contracts and the security of their property rights, the attitudes of the bankers that spoke to the IC suggests that more needs to be done to improve laws governing these areas. The survey did uncover a major concern about "unfair competition," especially with respect to "fake products." There is a need to distinguish legitimate competition from situations in which producers are defrauded by those who sell products under proprietary labels that are not their own. Without restricting the consumer's freedom to choose, there is a clear argument for better enforcement of standards, and for harsher penalties for firms that knowingly infringe the copyrights, patents, brands or other market assets of their competitors. Those penalties might be extended also to officials who turn a blind eye to the violations, especially when to do so favors locally based producers.

Besides the goods markets, the PRC needs to improve the way in which its factor markets work. There are well-recognized impediments to the development of an efficient labor market in the PRC, though the Government has taken cautious measures to improve the situation without adding to the incentives that already exist for a massive rural to urban influx. Evidence from the five-city survey suggests that recruitment outside of the location of an enterprise is becoming more common. That tendency would be accelerated by measures that would increase the portability of pension or social security benefits; clarify the ownership rights to houses and apartments, and make houses easier to sell; and provide more universal coverage of such benefits as health insurance and unemployment insurance. The reforms needed to contribute to a functioning housing market are part of a broader agenda of reform that would establish more security for land use rights, which would enable the holders to sell their assets at need or to pledge them as collateral for loans.

Recommended Measures

On the part of governments, the actions needed are mainly those discussed in the three preceding paragraphs. In almost all cases the remedies are known and under implementation; at issue is to what extent reforms can be implemented more rapidly. Greater vigilance is needed to penalize those who violate the property rights of others. The widespread efforts to move against violators of foreign intellectual property rights should serve as a useful model for action to protect domestic producers from similar damage.

In tackling these problems, the CGCC can again be an important voice for the interests of its members. Several LCs already intercede selectively with local officials to underline complaints by its members. A more systematic dialogue could be encouraged, with regular meetings allowing officers of the CGCC to alert local officials to instances of market disorganization, as well as to broader membership concerns. Where disputes arise at the level of individual firms, especially where the adversaries are all members of the CGCC, there is scope for the CGCC to extend a service it already provides in some cases to arbitrate those disputes. This service appeals as a cost-effective alternative to formal legal action.

Implementing Recommended Measures

Almost all of the measures that would improve the climate for private enterprise are already included in the broad reform objectives of the Government. In particular, governments at all levels are concerned about improving the access of small firms to formal sources of finance, and improving the security of contracts and property rights through improvements in laws and the way the legal system functions. These are essential prerequisites for small private firms to achieve optimal economic size, especially as they increasingly face competition from international firms, as well as from firms located elsewhere in the PRC. Nevertheless, greater urgency could be given to measures in many areas that would ease rapidly the constraints on private enterprise.

Table 3.2 Action Plan for Relaxing the Constraints on the PRC's Private Sector

Priorities	Short Term (within a year)	Medium Term (1 to 3 years)	Long Term (beyond 3 years)
1. Improving Access to Finance			
<ul style="list-style-type: none"> • Make interest rates more flexible 	<ul style="list-style-type: none"> * Expand lending rate band to 100% for SMEs 	<ul style="list-style-type: none"> * Free lending rates for loans to SMEs 	<ul style="list-style-type: none"> * Completely liberalize lending and deposit rates
<ul style="list-style-type: none"> • Supervise credit guarantee companies (CGCs) 	<ul style="list-style-type: none"> * Establish a regulatory agency for CGCs * Monitor CGCs' performance * Investigate scope for collateral guarantees 	<ul style="list-style-type: none"> * Merge or close failed CGCs * Introduce reguarantee facility * With banks and CGCs, initiate pilot program for collateral guarantees and collateral information systems 	<ul style="list-style-type: none"> * Phase out credit guarantees * Depending on results of pilot program, establish collateral guarantees and collateral registration at CGCs nationwide
<ul style="list-style-type: none"> • Clarify property rights to expedite the recovery of collateral 	<ul style="list-style-type: none"> * With banks, CGCs, and legal authorities, develop expedited system for recovery of collateral in events of default * Clarify rights to use land, including where relevant ownership rights, and develop functioning land use markets so that real property can serve more effectively as collateral for loans 	<ul style="list-style-type: none"> * Introduce in a pilot program (selected provinces, one bank, court or arbitration system) to handle collateral recovery quickly 	<ul style="list-style-type: none"> * If successful, extend program to all banks and countrywide
<ul style="list-style-type: none"> • Improve accounting and audit practices 	<ul style="list-style-type: none"> * Through SETC, Tax Departments, and SAIC, reiterate the need for appropriate standards for bookkeeping * Convene a panel to affirm standards for SMEs 	<ul style="list-style-type: none"> * Enforce penalties for inadequate financial reporting 	
<ul style="list-style-type: none"> • Continue general banking sector reforms 	<ul style="list-style-type: none"> * Continue to improve banks' portfolios by assignment of nonperforming loans to asset management companies, by freeing banks to make all loan decisions on the basis of sound commercial practices, by improving bank supervision and regulation, and by recapitalizing the state commercial banks and establishing realistic provisioning policies (and practices) * Introduce competition (both foreign and domestic) in accordance with WTO provisions * Improve the quality of audit and disclosure by enterprises and banks * Implement the revised commercial law, especially as it relates to enforcement of contracts * Encourage the PBC to investigate ways to introduce a credit information system to apprise banks and enterprises of the credit standing and loan servicing records of prospective clients 		
<ul style="list-style-type: none"> • Continue to develop capital markets 	<ul style="list-style-type: none"> * Continue to improve the quality of regulation and supervision of capital markets, including in particular higher standards for disclosure * Complete integration of A and B markets * Promote development of active trading of government securities to establish a yield curve * Encourage corporations with satisfactory performance and financial reporting standards to issue corporate bonds * Develop a municipal bond market * Introduce several over-the-counter markets and markets specializing in high-tech companies 		

Priorities	Short Term (within a year)	Medium Term (1 to 3 years)	Long Term (beyond 3 years)
2. Enhancing Management and Technical Skills			
<ul style="list-style-type: none"> • Facilitate the provision of training 	<ul style="list-style-type: none"> * Appoint a professional body/bodies to accredit training programs from commercial suppliers 	<ul style="list-style-type: none"> * Certify courses offered by licensed training institutions * Encourage CGCC, IAs, and similar organizations to establish rosters of reliable trainers for clients and to seek feedback on the quality of training programs from participants 	
<ul style="list-style-type: none"> • Improve labor mobility 	<ul style="list-style-type: none"> * Develop plans to increase the mobility of senior managers and technical personnel, in particular, by enabling them to dispose of housing and take pension and other benefits to new positions * Continue measures to permit greater mobility of labor (especially rural-urban migration) nationwide 	<ul style="list-style-type: none"> * Develop pilots that allow all workers to increase the portability of pensions, housing, health insurance, etc. 	<ul style="list-style-type: none"> * Mainstream portable benefits countrywide
<ul style="list-style-type: none"> • Empower managers to make independent personnel decisions 	<ul style="list-style-type: none"> * Promulgate the principle that all hiring by private firms are independent of governments and the Party 	<ul style="list-style-type: none"> * Extend principles to all SMEs and collectives * Allow salaries/benefit decisions to be made by managers/boards of firms 	<ul style="list-style-type: none"> * Free all firms, including large SOEs, to appoint personnel on the basis of merit * Delink all enterprise remuneration from official salaries and official influence
3. Improving Quality and Quantity of Information			
<ul style="list-style-type: none"> • Coordinate responsibilities of different agencies to collect and distribute information 	<ul style="list-style-type: none"> * Clearly designate various agencies' responsibilities to collect and disseminate information 	<ul style="list-style-type: none"> * Reduce inconsistencies/ambiguities in the information provided by different agencies 	
<ul style="list-style-type: none"> • Improve the dissemination of information on policies and regulations; internal and external markets; access to technology; availability of training services, finance, personnel, etc; and so on 	<ul style="list-style-type: none"> * Effectively use the Internet as a medium for dissemination * Upon registration, SAIC to provide all new firms with a pamphlet documenting the classes of information they should use and where to find that information 	<ul style="list-style-type: none"> * All relevant agencies (SAIC, SETC, IAs, CGCC, CCPIT, Tax Departments, SSB) to establish and publicize web sites that contain comprehensive information of value to private firms * For CGCC, in particular, recruit library and data management skills, and establish a training program for staffs of CGCC and the LCs in collecting and disseminating information to the membership 	

Priorities	Short Term (within a year)	Medium Term (one to three years)	Long Term (beyond three years)
4. Implementing Policies/Laws/Regulations More Effectively			
<ul style="list-style-type: none"> ● Remove special privileges and level the playing field for all 	<ul style="list-style-type: none"> * Extend the benefits promised to foreign firms under the PRC's WTO accession protocol to all domestic private enterprises * Continue the process of extending equal treatment to all firms irrespective of ownership or origin 		
<ul style="list-style-type: none"> ● Ensure consistent interpretation of regulations 	<ul style="list-style-type: none"> * Using the model of the current training program preparing government officials at all levels for the requirements of the WTO, extend that training to improve those officials' knowledge of domestic policies, regulations, and the like, and how they apply to domestic private firms * Build and maintain a comprehensive database on all policies, laws, and regulations that affect private firms, and disseminate the information as in 3 above 		
<ul style="list-style-type: none"> ● Simplify administrative procedures to make government services more easily accessible and reduce the scope for bureaucratic discretion 	<ul style="list-style-type: none"> * Review licensing requirements for enterprises with the view to eliminating unnecessary ones * Establish timetables for routine inspections (health, safety, environment, etc.) of enterprises and announce them publicly * Eliminate all ad hoc fees and levies on enterprises and replace them by legitimate, transparent tax schedules 	<ul style="list-style-type: none"> * Establish a single point at which new firms can satisfy all their registration requirements (a domestic "one-stop shop") 	<ul style="list-style-type: none"> * Monitor officials' performance and dismiss officials who abuse their office
<ul style="list-style-type: none"> ● Elicit comments on policies/laws/regulations 	<ul style="list-style-type: none"> * Encourage the CGCC and IAs to establish regular exchanges with local officials on behalf of their memberships to provide feedback on how their clients are affected by the implementation of existing statutes, and to recommend changes that would facilitate the activities of private enterprises 		
5. Improving Market Organization			
<ul style="list-style-type: none"> ● Secure property rights (especially intellectual property rights) of private firms 	<ul style="list-style-type: none"> * Review penalties for infringement of proprietary assets of firms and recommend changes to make protection of domestic firms consistent with that required for the property of foreign firms 	<ul style="list-style-type: none"> * Enforce the laws protecting the proprietary assets of individual firms and penalize those who infringe them 	
<ul style="list-style-type: none"> ● Define and safeguard quality and standards 	<ul style="list-style-type: none"> * Governments and private bodies to develop a framework for establishing and conforming to quality and standards 	<ul style="list-style-type: none"> * Implement the framework and improve the enforcement of standards 	

Priorities	Short Term (within a year)	Medium Term (1 to 3 years)	Long Term (beyond 3 years)
<ul style="list-style-type: none"> • Minimize local protectionism 	<ul style="list-style-type: none"> * As emphasized by Prime Minister Zhu Rongji in his speech to the NPC in March 2002, take steps to ensure free access of local firms to all parts of the domestic PRC market * As needed, promulgate new laws to prohibit disruption of inter-provincial commerce, and introduce penalties for local officials who impede the legitimate activities of non-local firms 	<ul style="list-style-type: none"> * Enforce laws that prohibit the protection of local markets, and monitor local legislative initiatives to ensure that they do not act as a restraint on inter-provincial commerce 	

In Table 3.2 a proposed agenda of actions is shown for each of the five broad areas that the survey identifies as being of most concern to entrepreneurs, and for the time periods over which those actions feasibly could be implemented. Probably nothing is more important than clearly establishing rights to property and then ensuring that the legal system is able to enforce contracts in a timely manner. Both are needed if firms are to borrow against assets, be they land and buildings, marketable equipment and other goods, or receivables. Governments need to pay particular attention to the issue of how creditors and guarantors can recover collateral in the event of default, even if this means establishing special courts or arbitration arrangements that can act decisively and quickly to settle claims in days or weeks rather than months or years. Even then, banks will need much greater discretion over the fees and interest rates they can charge for loans if small private borrowers are to become attractive commercial clients. The dramatic growth in consumer lending in recent years demonstrates clearly the enormous commercial potential for banks in lending to small businesses if conditions are right.

Summary

The survey conducted for this study finds an improved climate for private enterprise in the PRC since the earlier IFC study was completed, but confirms that the major impediments to the growth of private firms identified by the IFC study continue to constrain those firms. The areas that most need attention are: improving the access of private firms to finance, skilled personnel, and information; and improving policies and regulations, and the consistency and transparency with which they are implemented. Governments at all levels have initiated many actions to improve the situation, although some of them seem ill-designed for the purpose (e.g., guarantees for bank lending to SMEs), and progress in other cases seems unduly slow. An area that needs urgent attention is the discretion residing with local officials to interpret policies inconsistently, as well as to pester entrepreneurs for non-transparent payments. Better training of officials and more widely disseminated information about policies could help, as would more reliably enforced penalties for officials who abuse their office. The CGCC and similar organizations can help to improve matters by representing members' interests more effectively with governments, and by providing better information in many areas.

Section 4: The Role of the China General Chamber of Commerce

The preceding discussion raises the important question for this study: how best can the CGCC and its LCs ease the constraints on private enterprise and contribute to faster growth of the PRC's private economy? Elements of the answer would include decisions on how a refocused CGCC would better (i) represent its members' interests in discussing with governments members' concerns about the design and implementation of policies, laws, regulations, and rules; (ii) facilitate the interaction of individual firms with official agencies, including, for example, in acquiring licenses or registering with the tax authorities; (iii) inform its members about conditions in domestic and foreign markets, the policies that apply to them, important upcoming events, etc.; and (iv) coordinate social and mutual support activities for members. This section reviews the current organization, structure and functions of the CGCC, and considers what changes might allow it to serve its members better.

Mission and Overview

The All-China Federation of Industry and Commerce (ACFIC), now also known as the China General Chamber of Commerce, was established in 1953 as a (quasi) nongovernment organization (NGO) to represent the interests of industrial and commercial business in the PRC. The ACFIC is a member of the Chinese People's Political Consultative Conference (CPPCC). The CGCC has become the "new face" of the ACFIC, which in 1993 received the approval of the State Council to adopt another name (China General Chamber of Commerce) with the objective of better serving the rapidly emerging nonstate enterprises. The original designation, ACFIC, reflects in its nature the "unification of all political fronts;" the intent of the CGCC is to shift the emphasis more toward economic and nonstate activities. In law, the ACFIC was defined as the representative in national deliberative bodies of economic entities under nonstate ownership, but there is no clear legal role for the CGCC, although it is allowed to run businesses and operate as a NGO.

On 30 September 2001, the CGCC system had a membership of about 1.57 million, comprising enterprises, institutions, and individuals, but members are predominantly SMEs and individually owned ventures (*getihu*). It has an extensive network of local chambers of commerce (called local chapters, LCs) throughout the country. Under its mandate, the CGCC is authorized to provide a variety of services to its members and to the community at large, including delivery of training, organization of trade shows, arranging for technological exchanges, and assistance in developing poor and ethnic minority regions. It is also supposed to promote foreign economic cooperation and trade, and to foster relations between Chinese and foreign companies. As a bridge between governments and the industrial and commercial sector, the CGCC is supposed to safeguard its members' legitimate rights and interests, participate in political consultations, and help in decision-making on economic and social issues.

Structure of the CGCC and Local Chapters, and Links to Other Bodies

The CGCC system has some 3,059 local chapters at the county level and above, of which 358 local chapters are located in major cities throughout the PRC covering 95% of the nation's administrative regions. Below the county level, there are some 18,481 chapters at the township and community level, 461 of which were founded during 2001. Chapters at the grass-root level (township and community) are fee-based. The Chairman, other officers, and staff are appointed and paid by the local governments. Recently, however, a few chapters have decided to experiment and elect entrepreneurs as chairs of local chapters (for example, in Zhejiang, Sichuan and Shaanxi provinces). But these are not free elections by the membership, as political considerations still play a major role in determining who can serve in the office. By contrast with similar associations, the CGCC and its LCs have political status, and can nominate representatives of nonstate ownership to political bodies. This privilege is valued; some private enterprises join LCs, simply because they can be nominated to the CPPCC and the National People's Congress (NPC). Nevertheless, during the IC's fieldwork, some LCs conveyed the sense that they feel both that they have insufficient authority to serve members as they would wish to do, and that the voice of the CGCC and its LCs has limited influence with governments. (Brief information on the structure of five local chambers visited by the IC is in Box 4.1.)

Box 4.1 Characteristics of Local Chambers of Commerce

The international consultant visited several local chapters of the CGCC as part of its field work and thereby gain an appreciation of the extent to which the LCs differ in size and in the scope of their activities. Dimensions of four of the city level chambers are described here, along with one of Beijing's sub-chapters.

Beijing Provincial General Chamber of Commerce: The Beijing Provincial Chamber has 10 departments, 88 employees, and 10,000 members, of which 6,000 are nonstate enterprise (5% of the total enterprise population). It coordinates and provides guidance to 69 branch LCs in Beijing's 18 administrative regions. The area nominates 50 members to the NPC and 288 members to the CPPCC. The *Fengtai City General Chamber of Commerce*, within the Beijing District, draws its membership from 8,000 private enterprises with 120,000 employees in agro-industries (flowers, vegetables), furniture, medicines, service industries, etc. The Fengtai Chamber started in 1993; it has a staff of 11 with a budget of 0.4 million yuan. It has 473 enterprise and 100 individual members, and has eight village branch chambers with 4–5 staff each. The Chamber also owns and manages two businesses—a retail outlet and an elementary school. The Chamber effects liaison between private enterprises and governments, disseminates information on Government policies, provides advice and training, and assists in the start-up of new enterprises. Members value the Chamber's assistance. The Fengtai Chamber is quite active, and would like to offer more services to its members, especially training and information services. It volunteered to serve as a pilot chamber to initiate reform, as part of a broader reform agenda for the CGCC system.

Nanhai General Chamber of Commerce (NGCC): The Nanhai area is a pioneer in developing a private economy; now, almost 90% of its economic activity is generated by 70,000 private enterprises. The main industrial sectors include leather products, tools, aluminum goods, and ceramics. The Nanhai Chamber has 1,380 members, a staff of nine, and a budget of about 1.2 million yuan. The CGCC provides guidance to local chapters, but has no formal financial or administrative link or control. The Chamber provides mainly liaison between private enterprises and the government, disseminates government policies and provides limited training. Many companies join the NGCC because they see it is a government entity that can be their mouthpiece. Some companies view membership as an obligation and expect little in return. The Chamber would welcome more power and authority, but had few specific ideas on either changing its role or expanding its influence.

Shenyang General Chamber of Commerce: The Shenyang Chamber has a staff of 40, a budget of one million yuan, and 10,000 members. The budget also has to finance the benefits of its retirees and former senior officials of the Shenyang Federation of Industry and Commerce. Like the ACFIC, the Shenyang Chamber was also established in the mid-1950s to effect liaison with owners of private firms (so called "capitalists"). Until the early 1990s, its functions were solely of the so-called "unification" nature. In 1994, with the approval of the local government, the Chamber was set up as a chamber of commerce, with five divisions: association, economic and research, external liaison, membership, and the enterprise rights protection center. The external liaison division maintains an international friendship and exchange association with 20 chambers from various countries. The association division provides guidance to a dozen industry and service associations in Shenyang. The Chamber states that its ability to provide services to members has been constrained by its limited budget.

Xi'an General Chamber of Commerce: The Xi'an Chamber's membership comprises 7,212 out of some 23,000 non-state enterprises in the area. It has a staff of 39, and a budget of over 0.7 million yuan. The chair of the local chapter is also an executive member of the CGCC Board. The Chamber feels that it has insufficient authority to provide all the services that the membership needs. It would welcome a law to establish the authority of the CGCC and its local chapters to speak for non-state ownership; its voice currently is not strong enough to have much influence on governments. The Chamber provides the following services: liaison between private enterprises and the government, dissemination of government policies, organization of technology exchanges, promotion of the interests, products and services of private enterprises, assistance to governments in implementing such policies as requiring firms to introduce programs to provide pensions, medical insurance and social security insurance to employees, and support to former officials of the industrial and commercial chamber (more than 700). The Chamber provides only limited training services as it feels that large enterprises can afford to meet their own training needs through outsourcing, while small enterprises' interest in training is low.

The CGCC system comprises a wide network of chambers throughout the PRC at the national, provincial, city and village level. The relationships of the chambers at various levels are informal and quite loose. There is no financial and/or administrative link between different chamber levels. Each chamber is independent and is supported by its respective local government, which provides its LC with budgetary support. There is also considerable variation in the organizational structure, size and activities of different chambers depending upon the local conditions and the attitudes of local governments. The national CGCC provides guidance to the provincial and local chambers. The provincial chambers also provide guidance to their respective

LCs. Given the nature of administrative arrangements, the national and provincial chambers have no formal authority to issue orders to the LCs.

Relationships Between the CGCC and Other Organizations

The CGCC system has loose, and in some cases less than fully, cooperative links with other organizations that have responsibilities for private enterprises or exist to provide services to them. There are, for example, shared interests between the CGCC system and such other associations as those supervised by the State Administration for Industry and Commerce (SAIC); in some cases, local *getihu* associations and private enterprise associations of the SAIC group are also members of the CGCC. A Vice President of the SAIC is a Vice-Chairman of the CGCC. In many instances, there is duplication of activities between CGCC and SAIC supported associations, with the two systems competing in supplying certain services to members. Despite these overlaps, the IC has observed that, in general, there seems to be a lack of coordination and cooperation with private industry associations at the working level, even though some LCs have established working relations with local SAIC offices. The CGCC also has more or less formal interaction with the MOFTEC, the SETC, and the China Council for the Promotion of International Trade (CCPIT). Once again, coordination seems less than it might be, especially in exchanging information and disseminating it effectively to private firms. The CGCC has developed relations with some foreign chambers, and has developed formal exchange programs with chambers in Germany, Norway, and Japan, which provide training, seminars, and advice to the CGCC and some LCs. The CGCC itself provides similar services to the Chamber of Commerce in Nepal. Nevertheless, the CGCC seems to be neglecting opportunities to benefit from the experience of foreign chambers, and there seems to be value in seeking more extensive cooperative arrangements with large foreign chambers operating in the PRC and elsewhere.⁵⁴

Organization, Staffing, and Budget

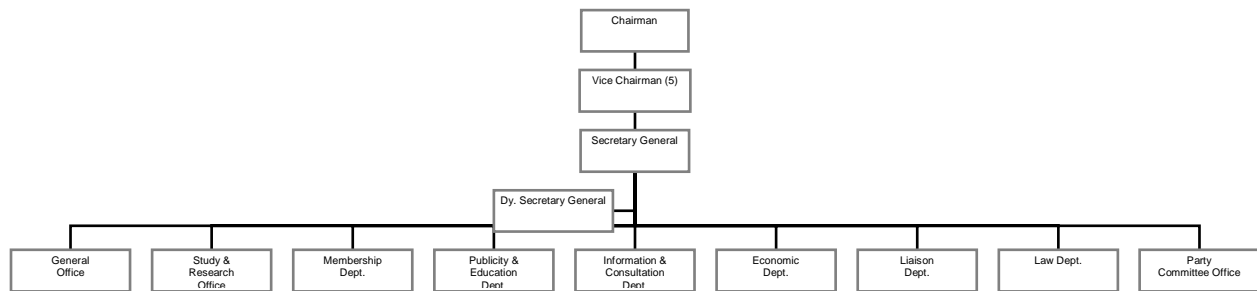
The CGCC is organized into nine departments and employs 166 staff members (Figure 4.1), with some 14 unfilled positions. The departments (with staffing numbers in parentheses) are: General Office (61), Study and Research Office (14), Liaison (14), Membership (17), Publicity and Education (15), Information and Consultation (16), Economic (15), Legal (6), and the Communist Party Committee Office (6). In addition, the CGCC operates three centers as divisions under departments, namely a Training Center, Information Center and Human Resource Exchange Center. The CGCC is top-heavy, with almost half its personnel occupying management positions, including seven director generals, 12 deputy director general, 27 director, and 35 deputy director level positions. The staff are both well educated and experienced: 95% of staff members have higher level (college) education and an average experience at the CGCC of 5 years. A secretary general supported by one deputy secretary general heads the CGCC. Currently, a Vice-Chairman of the CPPCC (which is a deputy prime minister level position) is the non-executive Chairman of the CGCC. In the past, a Vice-President of the PRC as well as Vice-Chairmen of the NPC or CPPCC have occupied the position of CGCC Chairman. The CGCC also has 21 non-executive Vice-Chairmen (with Deputy Minister rank), nine of whom are

⁵⁴ One of the objectives of the training program conducted under this study, as well as the study tours for CGCC officials and members, is to raise awareness of the potential benefits from more frequent organized exchanges with foreign chambers.

residents and responsible for a single department. Despite, or perhaps because of this, there is little coordination between CGCC departments.

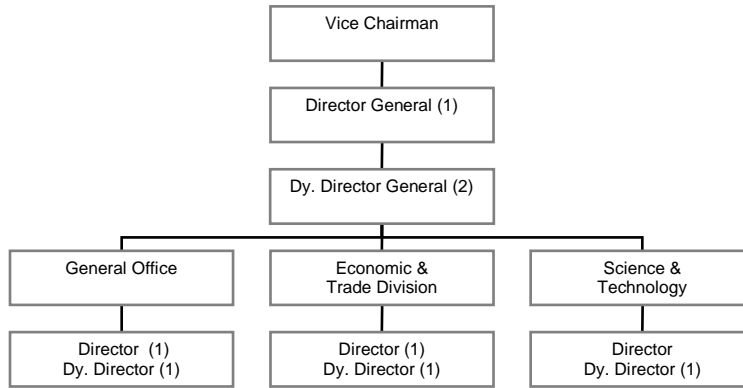
The Economic Department, the main counterpart for this study, is responsible for the CGCC’s economic activities including trade fairs and exhibitions, which are organized mostly in response to *ad hoc* requests from the Government. (See Figure 4.2) A director general, with support from two deputies, heads this Department with oversight from a vice-chairman who is a member of the NPC’s Standing Committee. The Department has 15 staff members, divided among three divisions, each of which boasts both a director and a deputy director. The Divisions (and staffing levels) are: General Office (4), Economic and Trade (4), and Science and Technology Improvements (4).

Figure 4.1 Organization Chart of the CGCC



The Training Center at CGCC has a staff of eight, all at the management level. All training is out-sourced. The Center prepares annual training plans under the guidance of the Education and Training Committee made up of one CGCC Vice-Chairman and the Directors of 47 LCs. Recently, the Center introduced some vocational certificate courses using members’ facilities (not in-house), for example, for employees of beauty salons and hotels (waiters, maids, providers of room service, etc.). The LCs organize their own training programs independently of the CGCC. The most important activity of the Training Center is to train the staff of the CGCC and the LCs, some 60-80 persons annually, in several seminars on such subjects as history, changes in policies and regulations, management skills, dealing with banks, and the like. Training for members focuses on government/party policies, national ethics, economic and financial issues, provisions of the WTO, the history of the ACFIC, and so on. The training courses are open to managers at the provincial level and the members of the Executive Committee of the CGCC. The training is contracted out to training providers (experts) and costs are charged back to the enterprises.

Figure 4.2 Organization Chart of CGCC's Economic Department



The CGCC also operates an Information Center (set up in 1993) that runs a web site (www.acfic.org.cn) containing information on many aspects of the economy, technology, trade fairs, and so on. It is developing another web site (www.chinachamber.com.cn) to provide information on some 600,000 domestic and foreign enterprises and their products. The Center has three divisions and 20 employees, and is self-financed from fee income. It earned 600,000 yuan in 2000. It is free to hire and fire staff based on the demand for its services; in 2000, its staffing was 30, a one-time increase to develop web-based services. The Center helps arrange logistics for members' travel, trade fairs, exhibitions, and other activities. Registration in the database is free, and data on enterprises are entered by LCs. The Center also supplies information to such external bodies as the Japan Friendship Council in Beijing. Services to the CGCC are provided free of charge in return for using CGCC's "brand name" and office space.

The CGCC's revenues comprise an annual government appropriation and the fees collected from organizing events for members. Information on annual budget levels was unavailable from the CGCC, but based on an average cost per employee of up to 30,000 yuan, CGCC's staffing costs could be as much as 5 million yuan. Adding nonstaff costs would push the CGCC's annual expenses to as high as 7–10 million yuan. In addition, the Government appropriates separately expenses for trade fairs and special projects. No detailed information was available as well for the LCs' budgets, except for some limited data provided by the local chambers involved in the IC's fieldwork and reported in Box 4. Personnel data are incomplete but the whole CGCC system with some 21,500 chambers probably employs in excess of 100,000 people. The number of employees differ widely by chamber, with those in big cities employing scores of people, those serving towns employing three to five people, and those in villages or districts, only one or two people. In the aggregate, the vast CGCC system could be costing the public budget more than a billion yuan annually.

Membership

The CGCC's membership includes enterprises, organizations/associations, and individual professionals, managers, and producers. The enterprise members include both Chinese-owned and joint ventures, and more than a thousand foreign-owned firms, one of which is member of the national chamber; these comprise privately owned, state-owned, and collectively owned

enterprises, as well as individually owned ventures. The membership is primarily determined at the local level, and all members of local chapters are regarded as members of the CGCC. Firms with assets exceeding 100 million yuan and inter-provincial business activity (thus, mostly large enterprises) are eligible to become direct CGCC members. There are no well-defined criteria for direct membership, but individual memberships can be extended to professionals who are famous in their respective fields. Of a total of 411,415 enterprise members, only 164 are direct members of the national CGCC, including 35 private firms, 31 foreign-funded firms (including investors from Hong Kong, China; Macau; and Taipei, China), 16 SOEs, 12 collectives, 63 shareholding corporations, five shareholding cooperatives, and 2 TVEs. As of 30 September 2001, the total membership of the CGCC system was 1,566,665, including the 411,415 enterprise members (of which some 233,499 were private firms, representing about 13% of the national total of almost 1.8 million), 13,485 organizational members (of which 14 are members of the national CGCC), and 963,728 individual members, of which 98,978 are non-state investors/managers and 772,376 *getihu* (or 3% of national total). Of all individual members, 282 (including 150 non-state investors/managers) are direct members of the national chamber.

The enterprise members are drawn from virtually all sub-sectors of the economy including trading, retailing, manufacturing, agriculture, mining, food processing, pharmaceuticals and medicines, construction, and restaurants. Firms under various forms of non-state ownership comprise 83% of the membership. The growth in membership has been quite slow despite fast growth in the number of private enterprises in the PRC during the past decade. During 1995-2001, the total membership of CGCC grew by almost 70% or an average annual rate of around 9%, but the active membership may be somewhat overstated in official figures as not all members are required to pay annual membership dues. The LCs decide their membership fees, which can be nominal. There are no accepted national criteria for establishing fees, although they could reflect enterprise size and location. By all accounts, collecting membership fees is difficult as membership is voluntary.

Services Provided by the Chambers

In addition to its role as a bridge from the Party and the Government to industrial and commercial agents external to the formal Communist Party system, the ACFIC/CGCC is charged with the performance of numerous functions that make its position unique. Specifically, it is empowered to: (i) nominate members to the CPPCC and the NPC, and propose bills to the NPC to promote the interests of its members; (ii) effect liaison with government officials on policies and regulations affecting non-public business development; (iii) organize such economic events as trade fairs, exhibitions, technology exchanges, and other networking events; (iv) promote foreign economic and technological cooperation and trade, and support linkages between Chinese and foreign companies; and (v) disseminate information on government policies, markets, new technology, and many other things. Because of its participation in national legislative bodies, senior officials of the CGCC view it as a law-making body rather than as a lobby for its membership.

The CGCC recommends 60 delegates annually to the NPC, and 65 to the CPPCC (every 5 years when they change terms) from its whole membership, carefully maintaining provincial/regional and village/town/city balance. It also recommends members for prestigious awards. The CGCC played a role in the establishment of the Minsheng Bank (the first nonstate-owned bank in the PRC) as an advisor to the Government. Although it has no ownership interest in the bank, the Chairman of CGCC is on the Minsheng Bank's Board. The CGCC (through

LCs) conducts an annual economic survey of large enterprises, which reports on enterprise structure, operations, employment, and sales. The CGCC also promotes the Government's Poverty Relief Program. It hosts promotional events for returning students and private enterprises. Chambers are also involved in advising governments on the credit guarantee schemes. The LCs commission out-sourced services that include training, trade fairs, and conferences. The Government essentially directs the CGCC in what services it should provide, granting little freedom or incentive to experiment with services that respond to members' demands. But the range of services provided by LCs varies considerably based on the regional situation, membership needs and local government guidance. The LC in Nanhai is more active and entrepreneurial in offering service to members on a cost-recovery basis; in general, LCs in the South seem greatly influenced by the example of the Hong Kong Chamber of Commerce, which operates much more like the business focused chambers of wealthy countries than does the CGCC.

Future Role of the CGCC: Potential Scenarios

Although the scope of services available in principle from the CGCC is quite comprehensive, the reality is that the CGCC's focus remains on the liaison between the government and the business community and its traditional political function, with only a secondary concern for providing direct services to its members. But the economic landscape in the PRC is changing rapidly, with an ever-expanding role being played by the private sector. The Government's interest in promoting growth of the private sector has increased along with the rising importance of private activity in the PRC economy. Add to that the Government's concern to nurture the small- and medium-sized enterprises that are expected to be a major source of job creation and income generation in the PRC, and one can easily conclude that the officers of the CGCC would be wise to reassess its role. With economic transformation expected to receive a further boost as the PRC adapts to the WTO, the CGCC needs to give serious thought to how it should transform itself to meet the challenges of the PRC's new economic reality.

Depending on how it chooses to meet these challenges, the CGCC needs a strategy for how it will equip itself and its chapters with the tools needed to deliver high quality services to their members and other clients. The scope of services that CGCC could choose to provide might be limited only by its imagination, and by what the membership values and is prepared to pay for. The central office could serve as an even more effective bridge between the government and private business, and LCs could be given even greater freedom to experiment with activities best suited to the demands of their constituencies. To that end, the CGCC is engaged in what appears to be some more or less uncoordinated initiatives including the current study, the election of officers of LCs, and the establishment of five committees to advise on activities in: economics and technology, education and training, political and policy consultation, external liaison, and legal consulting services. Though praiseworthy in themselves, these innovations fall short of a comprehensive strategy for tomorrow's CGCC.

The relevant question is not whether but how the CGCC should reinvent itself. The speed at which the PRC economy is changing convinces the project team that stodgy options for the CGCC are unlikely to succeed: the CGCC system must evolve to survive. As a way to focus its thinking, the senior management of the CGCC might wish to analyze three options for its future, with a view to developing a forward-looking strategy that could be presented to the Government as part of a request for an alternative mandate. Those options are:

- Business-as-usual with a narrow focus and no significant changes to current functions;
- Full conversion to a membership-oriented organization with no government support; and
- Abolition of the current CGCC system, accompanied by transfer of its public functions to other official bodies, and of its membership services to private industry associations.

Given the budgetary costs of the CGCC system, the view of the IC is that the days of the first option are numbered, and that either the second or third option would be an improvement compared with the *status quo*. Of course, during a transition period, governments at all levels might still wish to finance certain activities of the CGCC, and to use the CGCC system as a way to communicate with the nonstate business community.

Summary

Which strategy the CGCC adopts will depend, of course, on several factors, including the demands of private enterprise, the activities of other organizations, recent and prospective economic changes, changes in the role of public organizations, etc. In our view, the way the PRC's economic scene is changing means the CGCC will be unable to continue in a business-as-usual mode for long, especially given its continuing dependence on scarce government resources. At the same time, we judge that the Government is unlikely to be willing to shut down the CGCC system completely in the near future (as it has done in the case of some government departments). That gives the CGCC a respite in which to begin to implement a transformation that will attune it better to the needs of the PRC private economy. Of course, that conversion will take time, and abrupt attempts to convert the CGCC to a membership-funded organization independent of official financial support could be undesirably disruptive. A scenario that is both appealing and feasible would see CGCC's narrow functions continue to be financed by governments (with budgetary support declining over time), while new membership services would be introduced more or less gradually, depending on the capacity of individual LCs and the willingness of their memberships to pay.

Section 5: Assistance to the China General Chamber of Commerce

Several types of information could facilitate the CGCC's efforts to devise a working strategy. This section contributes information on the objectives and activities of modern chambers of commerce in more advanced economies throughout the world. Obviously, not all of those activities will necessarily be appropriate for the CGCC in the PRC. Hence, the CGCC needs to be selective in defining its role in promoting the growth of private enterprise, and also of SMEs. In this context, the feedback received from the Tsinghua University survey provides valuable information about the potential demand for the CGCC's services from its membership. In addition, lessons learned from the study tours about operating and managing chambers of commerce in other countries should be a major source of supplementary input. Once its leadership reaches a consensus on the future role of the CGCC and devises a strategy to attain its objectives, the next step should be to evaluate the system's current capacity to implement the strategy, and to develop an action plan to shore up that capacity where necessary.

In terms of the immediate constraints on private business, the CGCC's comparative advantages seem to lie in more comprehensive dissemination of information, selective provision

of upgraded services, and more effective intercession with all levels of government. Despite efforts to assist members gain access to finance, and experiments of the kind that were described in Box 2, there seems to be little call for the CGCC and LCs to engage in credit guarantee schemes or other initiatives to channel funds to enterprises. Clearly, however, in outlining a revised strategy and developing business plans, the CGCC and LCs can benefit from more knowledge of how foreign chambers collect, manage, and distribute information, as well as how they respond to their members' demands for services.

A revised strategy should specify general objectives for the whole CGCC system, leaving it to individual business plans to go into the nuts and bolts of particular activities. Inevitably though, CGCC's transformation will require adjustment to its existing organizational structure; a significant upgrading of its managerial and staff skills in such areas as business advisory services, database management, negotiation, etc.; considerably improved infrastructure (especially, information technology (IT) and physical resources); better procedures for expanding and retaining membership; and a major enhancement to its financial management. The upgrading of the skills of CGCC's staff to enable it to improve services to members might involve an expansion of the current team (that implies recruitment, but there should be an offsetting reduction of staffing in some low priority areas), especially in the main regional industrial centers where first class services are needed most. The objective should be to equip the CGCC with a substantially enhanced capacity to provide valued services to its members and to participate in the delivery of some publicly funded and/or donor assisted programs to assist members (and indeed the entire PRC private sector) to enhance their competitiveness.

Best Practices of Foreign Chambers of Commerce

In general, the broad family of chambers (including Chambers of Commerce, Trade, Industry, Crafts and Exporters) representing business fall into two main types: first, those established by statute and having a formal quasi-governmental function (Type 1) and, second, those that are voluntary membership organizations governed entirely by their members (Type 2). The first category predominates in continental Europe, while the second reflects more the Anglo-American tradition. An advantage of chambers of Type 1 is that they can be well resourced from compulsory membership fees, which gives them a sound, permanent financial footing. In addition, they can administer such governmental or quasi-governmental requirements as licensing or certifying businesses. Their drawbacks are the tendency to become bureaucratic and captured by the local political system in ways that cause them to fail either to provide valued service to members or to represent the general body of entrepreneurial interests. The main strength of Type 2 chambers is their ability to tap the genuine interests and energies of their members. By volunteering to join, members indicate their strong interest in supporting the activities of their chamber, and governance by members can ensure that their chamber represents their interests and provides services they both need and will pay for. The drawbacks are that these chambers are often poorly resourced and they can be "hijacked" by factional interests to the detriment of their ability to represent the general membership, which can cause them to be ineffective. The reality is that in both traditions there are some chambers that are effective and respected and others that are ineffective and irrelevant.

Typically, both types of chambers perform four main functions. They are: (i) to represent members' interests in political and policy discussions; (ii) to perform regulatory and other official or quasi-official functions relating to a particular area of business or trade; (iii) to supply services to their members (e.g., training, professional business advice, and information); and

(iv) to coordinate social and mutual support activities for business groups and individuals. The balance between these functions will vary with chamber type and location, and will reflect also the particular priorities found in different chapters of a national body.

Representation in Policy Forums: The Advocacy Function

In Type 1 chambers, where membership often is compulsory for all enterprises (in some circumstances there are choices of which chamber to join but membership in one from an approved list is mandatory), there are often formal processes for consultation (which can include business councils, and membership of special committees dealing with regulations and related policy matters) side-by-side with other less formal, but no less important, lobbying tasks. Where a chamber serves as the administrative body for registration of business and certification of origin for goods, for example, its official responsibilities lends it authority in its interventions for the membership. The combination of official responsibility and universal membership allows Type 1 chambers to be perceived to be in touch with the real interests of their members, and so able to represent them with governments, even when the reality is less clear cut.

In Type 2 chambers, where membership is voluntary, formal consultation processes do occur, but the norm is more likely to be informal lobbying and ad hoc representation. Being voluntary can mean that officials take them more seriously; their memberships clearly feel strongly enough to form a lobby, which shows their views must be genuine. In other circumstances, they might be dismissed out of hand as representing only narrow or vested interests. In no country, however, has this consideration prevented the proliferation of business associations that represent very specific interests—for example, bodies focused on a single policy issue (e.g. import tariffs); representatives of a single region; bodies speaking for a single industry, trade, or exporting group—from emerging as active policy players, rather than entrusting their interests to a single chamber with a broad representational remit.

Regulatory and Quasi-Official Functions: The Facilitation Function

The compulsory membership bodies (Type 1 chambers) are the main actors in this field. Often they are used to administer business licenses and certificates of various types—for example, they might certify that businesses have met all their statutory registration requirements and are known to have paid all relevant taxes. They also might be involved in liaison with central and local governments as well as their regulatory bodies on behalf of the membership, and could facilitate members' dealings with governments at all levels in complying with regulatory requirements and clarifying tax and other enforcement matters. Chambers also assist their memberships through the provision of arbitration services, and in organizing better business bureaus; services that frequently substitute for those that public agencies supply in other circumstances. Usually, each service that a chamber provides has an associated fee, which provides additional income for the chamber, or, at least, covers the cost of the service. Where chambers perform these functions well, they efficiently provide a business service that frees clients from having to contend with the vagaries of bureaucracy.

Member Services: The Service Function

This is the area of greatest variation in both coverage and quality of performance by all chambers. Virtually all provide at least a business-oriented information service, which covers

initiatives of and programs from public agencies working with business, essentially a signposting service that covers laws, rules and regulations. In relation to public programs, this can also extend to a gateway service: initial advice on eligibility for programs, and on how to apply for business licenses, environmental clearances, export permits and related customs clearances, etc., sometimes including direct help in making formal applications. Chambers also often act as a clearinghouse for business-to-business requests from nonmembers interested to buy goods and services or make commercial alliances with agents or partners in their region. Advising members on potential sources of finance is another area where chambers could be helpful and, to the extent that chambers do help firms to apply for bank loans, they might assist in preparing business plans, filling out loan applications, and meeting other requirements of lenders such as registering collateral, securing land titles or mortgages, and so on.

Additional information services include compiling registers of members to show their business competence and interests, essentially the basis of a chamber's promotional service. Even-handed treatment of members makes it difficult to extend this service to making recommendations about particular members. But that does not preclude hosting promotional events, including local buyer-seller meets; or organizing marketing missions to other localities to promote members' services and products; or hosting investors or other incoming groups looking to do business in the area. Indeed, in performing these functions chambers are often at their most visible. Their information services could include advice on the availability of equipment and technology, and their prices; on sources of training from domestic and foreign sources; on product markets and prices; on economic and other developments in the private and public sectors; on intellectual property protection systems; tax and other regulations; ISO certifications; impact of WTO requirements; and so on. In most cases, the provision of information also requires monitoring of the media for reports on developments in the private sector, and often involves the chamber directly in the collection and analysis of statistics and the conduct of periodic surveys.

The third category of services in which many chambers commonly involve themselves is training. This can be a very far-reaching activity, and because of the potential scope of training activities, more often than not, they are organized with the involvement of local training providers from both academia and the private sector. Training services are more prevalent where chambers have a significant membership of small firms, as larger firms are usually equipped to fend for themselves. The virtually unlimited options for training range from the basics of "doing business;" through advanced technical topics, especially where there is a particular craft or sectoral emphasis to the chamber's membership; to such specialist management areas as finance, taxation, marketing, human resources, management information systems, patent and license rights, standards, exports and foreign trade legislation, productivity and total quality assurance, and so on. Frequently, the chambers will need to institute training programs for their own staffs, in order to facilitate the provision of consulting and training services to clients, especially SMEs. Ideally, training services for SMEs respond to problems and issues that the SMEs themselves have identified, as member firms are best placed to determine what they need to improve their capacities and performance.

Another important area where chambers typically have a useful function is in providing information on the supply of consultant services, typically by preparing a roster of consultants who are able to supply technical and business services. Most SMEs are infrequent, and often very reluctant, buyers of consultancy services of any kind. Some of the reasons for this attitude lie in the actual or perceived cost, in the specialized nature of infrequently needed services, and

in the paucity of information on the quality of service providers. In offering this service, a chamber seeks both to improve the availability of information to its members and to help upgrade the quality of technical consultants.

Chambers can also be involved in the hybrid area between information and training typified by topical workshops and seminars, which often are led by “best practice” companies among the chambers’ memberships, and leavened by high status external contributors. In some instances, these workshops also perform a policy and lobbying function, as a sufficiently high profile event can raise an issue’s visibility on the political agenda. Chambers can also assist in organizing or operating business incubators and technology parks. Although it may be less relevant for the CGCC in the PRC, chambers in other countries are also involved in administering “matching grants” programs, which extend grants to those SMEs willing to acquire better technology to boost their competitiveness and so facilitate penetration of international markets.

Social and Mutual Support: The Networking Function

One class of activities of successful chambers that is crucial but often forgotten is the provision of a forum for social interchange. Running a business—especially a small business—can often be a lonely affair, and the chance to network with peers (and public officials) in a social setting can be invaluable. Raising the status of businesses in social and political life also helps with the broader local climate or culture, and serves to encourage more and higher quality participation in commercial activity. Events can range from something as simple as a “private club” where members are known to congregate, to glittering public social events where people of note will clamor to be present. An active, restricted program of social events held more frequently can complement such “one-off” events. Another associated area is events that celebrate local achievements: for example, such awards as “Young Businessman of the Year,” also can serve to heighten social standing and create a positive climate for entrepreneurship.

Once the effort has been made to establish an extensive network of businesses then chambers often become potential partners for the delivery of such additional third party services as buyer-seller contacts or links to potential investors, and they can play a value-added targeting role for business-oriented economic development projects. The marginal cost of adding extra services is lower than is setting up an independent delivery system; and targeting services as the need becomes apparent can lead to faster and deeper penetration among the beneficiaries.

Redefining the CGCC’s Mission and Strategy

The case for a change in the role of CGCC is compelling. The IC’s view is that the change scenario most likely to succeed is one where some of the current functions supported by governments will continue (but decline over time) and new membership services will be introduced gradually (and increase over time). The strategy would be to establish the CGCC as a modern organization delivering valued services to its membership, and as an influential voice with the government and business community for reforms—of policies, institutions, laws and regulations—that improve the PRC’s business climate. To succeed in practice, change would have to be designed for implementation in a phased manner, taking account of members’ demands as well as the CGCC’s institutional and resource capacity. To carry out its future mission, the CGCC will have to transition from being a one-way bridge between the government and the business community to a two-lane expressway that carries government’s message to the

business community and, even more importantly, carries back to the government the concerns and aspirations of that community. Development of a vigorous two-way dialogue between the private sector and the government will serve the membership better and also improve the formulation and execution of public policy.

Under its new strategy, the national chamber could become a loosely centralized federation with essentially autonomous local chapters serving the grass-root level members. The changes to be introduced at the national level will differ from those at the LC level; however, at both levels, the emphasis should be on efficiency and real accountability to a chamber's members rather than to the Government. Although the advocacy function will benefit the entire business community, the improved service function should serve predominantly private SMEs, especially startups. The strategy should outline how reform will be implemented nationally and locally. This may lead to the abolition of certain functions and downsizing of the current organization, including closure of some LCs. To bolster its credibility with the actual and prospective membership community, the CGCC will need gradually to reduce its emphasis on its political role and focus more on its services to members. As the CGCC's quasi-official role declines, the members of the CGCC and LCs should elect their boards of directors. In turn, the boards should appoint the chambers' managers and determine their compensation. Such a strategy could also involve the CGCC in enhancing liaison and coordinating more effectively with other national and international organizations. As the CGCC's members increasingly involve themselves in international trade and investment, the CGCC eventually might need to establish an international presence by establishing branch offices in countries that have extensive commercial links with the PRC.

As well, reforms might require changes in the way members are selected. The focus probably should be on private enterprises, with clear guidelines for membership eligibility and annual fees. Over time, the existing membership roster will need to be purged so that only active dues-paying members remain on the list. This is likely to result in an initial reduction in membership; thereafter, membership growth will be determined by the value that members obtain from joining the CGCC system. Once the new role and membership criteria have been established, the CGCC will need to undertake a nationwide promotion campaign to publicize its new image and to raise its credibility with the business community. The campaign will have to emphasize new activities, and might need to be waged over a sustained period by the CGCC and its LCs. A professional public relations organization could help greatly in designing and implementing the promotion.

Various governments provide most of CGCC's current budget. However, the higher costs likely to accompany a substantial expansion of CGCC activities (as would be expected if it begins to lead the private sector in improving productivity, boosting exports, and developing a better business climate for SMEs in the PRC) will be unaffordable if using public funds alone. To finance its expanded mandate and to make it accountable to its members, CGCC should investigate ways to generate more resources from private sources, with the obvious and most promising candidates being through membership fees and grants, as well as fees for services. In this regard, the experience already gained from the fee-based services provided by the Information Center and the Training Center should help considerably.

Financing for CGCC's operating expenses could include, therefore, membership fees, direct and indirect government support, fees for services, and domestic and foreign grants. The costs of CGCC's projects could be met entirely by the project sponsors or shared in some manner, for example, on a 50-50 basis with the participating firms contributing their half. The

shared-costs model would ensure the attention of the beneficiary firms' managements to the project; they are more likely to be concerned with the performance of any project that is funded at least partially from their own pockets. That might help, too, in recruiting members if they can be assured that they are genuinely likely to benefit. Of course, the introduction of cost recovery mechanisms might need to be gradual, and could depend on the content and objectives of the services provided, as well as the capacity of members to pay. Under no circumstances should plans to expand services to members be based on expectations of increases in the governments' support for the CGCC system; participating members should finance all new activities.

Study Tour: Purpose and Lessons

The main objective of the study tours was to familiarize CGCC and its LCs with the operations of chambers in selected countries (United States; France; Germany; United Kingdom; and Hong Kong, China) under different economic conditions, in order to benefit from their experience in serving their members. The focus of the tours was on operating modern chambers, developing partnerships and exchange relations with chambers, identifying organizational and staff skill requirements, participating in selected activities organized by chambers, and gaining familiarity with service delivery. The delegations comprised personnel from the CGCC national headquarters and the LCs, including managers and staff. The delegations visited national and local chambers, their clients and members, and financial institutions. After the tours, the delegations prepared reports identifying the lessons from their visits, in order to share their experiences with their colleagues in the CGCC system. These lessons should become an important input in redefining the role of the CGCC, determining its skills and training needs, and choosing the mix of services and delivery mechanisms of most benefit to members.

Training and Recruitment Strategy

In general, a training strategy is based on organizational objectives, and comprises job descriptions in line with those objectives, and analyses of training needs (to identify the gap between the existing skills base and future skills needs), and how to provide training. After CGCC reaches consensus on its new role and organizational objectives, it will need to redefine job descriptions in line with these objectives. This process involves considering the following:

- What new functions (or activities) are required from the organization? The organizational structure itself might need to change, with the abolition of unnecessary positions, as well as consolidation or elimination of some units.
- What new institutional arrangements are needed to support the new functions?
- What changes in personnel are needed to perform the new functions?
- What are the responsibilities of each job, especially the new ones?
- To what extent can training of existing personnel substitute for recruitment?

How these questions are answered will depend largely on how ambitious CGCC is in defining its new goals. A training program is the action plan for a training strategy; a good one comprises organizational objectives, training goals, training methods, and identification of the trainees and the trainers. In the PRC, there have been cases where, despite good design, training programs failed because either the participants were unfit for the training topics or the trainers were ill-equipped to present them.

New job descriptions will point to the need for a comprehensive training program for the entire organisation based on the skills needed by individual staff members to attain the new corporate objectives. For example, if CGCC decides to assist its members with business development, it will need expertise in helping members prepare business proposals, apply for business licenses, and seek financial resources. If the objective is to provide more comprehensive and better quality business information, it needs more expertise in media and industry monitoring, as well as database maintenance and management. The training program should say what goals are to be achieved by training and proceed to identify what types of courses are needed and their frequency, duration, content, and location. Some courses may need to be offered regularly, others occasionally. Much of the training might focus on “training of trainers;” the trainers would then supply, in turn, the training needs of the staff of the LCs or, in selected cases, the needs of employees of member firms.

Training can either be on-the-job or off-the-job, the choice depending on circumstances. On-the-job training has the advantage of allowing the employees to perform their regular jobs at the same time. It can include such techniques as orientation seminars, job instruction training classes, apprenticeships, internships and assistantships, job rotation, and mentoring. On-the-job training often can be conducted in the CGCC’s or member firms’ own facilities, and, in most cases, it can be added to the responsibilities of an employee’s supervisor.⁵⁵ Off-the-job training might comprise formal diploma or even degree courses in universities or similar tertiary institutions, but it could also be based on more informal and short duration activities, for example, lectures, special studies, case studies, conferences and seminars, and so on. Irrespective of location, CGCC and its LCs are likely to find that out-sourcing most training activities to experts is the most cost-effective way to keep knowledge up-to-date. In this regard, CGCC could consider making formal long-term arrangements to hire some colleges in the PRC and foreign chambers of commerce to perform off-the-job training.

Recruitment should be based on the need for specific skills, in turn largely depending on actual demands of members for services, and not simply to replace retirees. Well-designed job specifications are an essential prerequisite for recruitment decisions. The job specification details the education, skills, experience, and other personal qualities needed to perform the job satisfactorily, and sets standards against which a candidate for the position can be measured. Because skills can be developed through training, the cost of acquiring skills through new employees should be weighed against the cost of training. In some cases, however, the services of independent contractors, (for example, for IT, training, accounting and legal services), can be procured at lower cost than developing the capacity in-house.

Pilot Program to Introduce Changes

Any institutional reform is challenging, time consuming and costly. Especially in the PRC, change is best introduced gradually and with commitment from the top. Also, the introduction of new services by CGCC and the LCs should be gradual and in response to the memberships’ demands. What appeals as a useful pilot for the PRC is to initiate reforms in a few LCs that have begun to adopt international standards. The pilot would be introduced more widely (and adapted to local conditions) based on the experience of the pilot LCs. In selecting LCs to participate in the pilot, the emphasis should be on their willingness to innovate, and on the attitudes of their

⁵⁵ Obviously, CGCC’s own Training Department is equipped to provide needed facilities and already supplies training in some of the suggested areas.

members and local governments. Well-executed pilot programs would contribute importantly to the overall success of the reforms. Beginning with the pilots, local chambers should be free to determine the services they will provide and the activities they sponsor (as some now do) without instructions from CGCC central. Depending on membership demands in particular chapters, the CGCC and its LCs could introduce some of the menu of services discussed earlier and highlighted in Box 5.2.

Box 5.1 The Training Program for the CGCC

For this project, a training program was designed and implemented from 11-14 March 2002 for an average of 15 participants per day from various departments of CGCC and representatives of LCs. The training program had three parts: the role and service to members of chambers of commerce in other countries; best practices in business, financial and information services that can be provided by a chamber of commerce to its members; and evaluation of the training needs in CGCC and its LCs. The training program aimed to familiarize the participants with the practices of chambers of commerce in other countries; identify which existing services of CGCC and LCs can be improved; project future functions and services of CGCC and its LCs; evaluate the training needs of their staff; and review a draft training manual. As part of their training, participants in the study tours were to prepare a questionnaire to enable them to acquire the information needed for their reports.

The training director introduced the two types of chambers of commerce (described in section 4) and compared them with the CGCC. Representatives from the British Chamber of Commerce in the PRC, Chamber de Commerce et d'Industrie de Paris, and Association of German Chambers of Industry and Commerce presented their associations' roles and services. The British Chamber of Commerce is a self-governed organization with a voluntary membership and fees (Type 2); the other two chambers are organizations with a compulsory membership and fees that perform quasi-governmental functions. The presentations illustrated the commonalities among the chambers, and also their differences. Following the presentations, the program participants compared the foreign chambers' practices with their own and identified areas for improvement.

The training director also presented materials on best practice in business, financial and information services, including standard formats that are commonly used in preparing a business plan and applying for a loan. The participants were exposed to the documentation required for bank loan applications in the PRC, and learned about the functions of a credit guarantee system.

The participants were shown how to locate information on the Internet. (More hands-on Internet training was conducted for the Economic Department of CGCC in advance of the training program.) By searching for information from useful web sites, for example, those of the SETC, United States Small Business Administration, British Chamber of Commerce in the United Kingdom, and CGCC's own web site, the participants recognized deficiencies in their current information services to members, as well as the need for training to improve their skills in finding and disseminating information.

To identify the training needs of trainers, the director prepared an outline of a training manual geared toward the needs of small businesses; this was distributed to and discussed by participants in the program. The training manual covered strategic planning, business planning, financial management, marketing, human resource management, and foreign trade. The participants saw potential uses for the manual, especially in pointing to important topics for members from which informational pamphlets could be produced and distributed; the same materials could be disseminated through their web sites. The training program materials were left with CGCC to serve as input for a similar program that CGCC might develop for its staff.

Summary

The profound changes in the PRC economy and the improved climate for private business create opportunities for CGCC significantly to transform its role and functions. Indeed, in the absence of some fairly major changes, CGCC risks becoming an increasingly marginalized organization. There is considerable potential, however, for CGCC to reorient itself from its traditional role of linking private enterprise to the state system, to an expanded role emphasizing service to members. Any expansion of the activities of CGCC and its LCs should be in response to the demands of members as indicated by their willingness to pay for the services the CGCC system provides. Over time, CGCC should expect that the budgetary support provided by governments will be withdrawn; certainly the governments' support cannot be expected to expand in a way that creates a basis for a sustained expansion of activity. The Tsinghua University survey of

CGCC members indicates where an expansion of CGCC's activities might be valued most: better information, better professional advice, and better representation with governments at all levels. To deliver better services in these areas, CGCC and its LCs will need to raise the skills of their employees, which means both enhanced training and recruitment.

Box 5.2. Menu of Services

The menu of services that might potentially be supplied by CGCC and its LCs is virtually limitless and, as the text emphasizes, individual local chapters should have considerable autonomy to supply those services for which their memberships are willing to pay. Within the broad classifications of functions of chambers (advocacy, facilitation, professional service provision, networking, etc.) the areas in which CGCC and its LCs might provide services include:

- liaison with national and local governments and regulatory agencies;
- representation on statutory bodies, business boards, committees, and other national and international forums;
- liaison with international bodies and foreign firms, including by maintaining a presence for the CGCC abroad;
- arbitration services for disputes between members, and with non-members by prior agreement of the parties;
- performance monitoring of third party providers of goods and services, and other activities of better business bureaus;
- assistance in establishing "business incubators" and technology parks;
- research on national business issues with the objective of influencing policy formulation and implementation;
- compilation of business surveys and hosting policy forums on important business policy matters;
- dissemination of information on policies, laws, regulations, domestic and international trade, markets, products, and services;
- organization of benefit plans for members, including pension plans; health, life, and disability insurance, etc.;
- assistance to small businesses to secure inputs needed for their growth;
- help to members in exploring new business and investment opportunities, and in meeting visiting businessmen and officials investigating opportunities for trade;
- organization of formal trade and investment forums, trade fairs, and other exchanges promoting business opportunities in the PRC;
- organization of training conferences and seminars in such areas as trade, investment, economy, tax, standards, and marketing;
- assistance on WTO-related issues, and ISO standards and certification;
- advice on patent and brand protection, and dealing with infringement;
- promotion of members' products through the CGCC website (for example, by posting company profiles, logos, and brands);
- publication of a monthly magazine on latest business news and CGCC activities, including updates on important events organized by CGCC; and
- organization of social events, including those that recognize the achievements of members.

Bibliography

- American Chamber of Commerce. 2001. *2001 White Paper: American Business in China*.
- Asian Development Bank. 2001. *Country Economic Review, People's Republic of China*. Manila.
- Berger, Allen, and G. Udell. 1998. "The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle," *Journal of Banking and Finance* 22 (August):613-73.
- Bratkowski, Andrzej, Irena Grosfeld, and Jacek Rostowski. 1999. "Investment and Finance in De Novo Private Firms: Empirical Results from the Czech Republic, Hungary and Poland," *Working Paper 236*, William Davidson Institute, University of Michigan, Ann Arbor.
- Broadman, Harry G. 1996. *Policy Options for Reform of Chinese State-Owned Enterprises, Proceedings of a Symposium in Beijing, June 1995*, World Bank Discussion Paper No. 335, Washington, DC., World Bank.
- China, Ministry of Foreign Trade and Economic Cooperation. 2002. import and export statistics, <http://www.moftec.gov.cn>.
- China, State Economic and Trade Commission. 2000. *Policy Measures for Encouraging and Promoting Development of Small and Medium Enterprises*.
- International Finance Corporation. 2000. *China's Emerging Private Enterprises: Prospects for the New Century*.
- Jiang, Zemin. 2001. *Speech at the Meeting Celebrating the 80th Anniversary of the Founding of the Communist Party of China*, Central Committee of the Communist Party of China.
- Jin, Hehui, and Yingyi Qian. 1998. "Public versus Private Ownership of Firms: Evidence from Rural China," *Quarterly Journal of Economics* 113 (August):773-809.
- Lardy, Nicholas [1998] *China's Unfinished Revolution*, Washington, DC.: Brookings Institution Press.
- Lardy, Nicholas. 1999. "China's WTO Membership," Policy Brief #47, Washington, DC.: Brookings Institution.
- Li, Hongbin, and Scott Rozelle. 2000. "Saving or Stripping Rural Industry: An Analysis of Privatization and Efficiency in China," *Journal of Agricultural Economics*, 23(3):241-53.
- Llorens, Juan Luis. 1997. "Loan Guarantee Systems for SMEs in Europe," *Financier* 4 (February/May).

- Lou, Jiwei. 1997. *Macroeconomic Reform in China, Laying the Foundation for a Socialist Market Economy*, World Bank Discussion Paper No. 374, Washington, DC., World Bank.
- Martin, Will, Betina Dimaranan, Thomas W. Hertel, and Elena Ianchovichina. 2000. "Trade Policy, Structural Change and China's Trade Growth," Working Paper No. 64, Center for Research on Economic Development and Policy Reform, Stanford University.
- McMillan, John, and Christopher Woodruff. 2001. "Entrepreneurs in Economic Reform," Working Paper No. 102, Center for Research on Economic Development and Policy Reform, Stanford University.
- Meggison, William L., Robert C. Nash, and Matthias van Randenborgh. 1994. "The Financial and Operating Performance of Newly Privatized Firms: An International Empirical Analysis," *The Journal of Finance* (June).
- National Bureau of Statistics. various issues. *China Statistical Yearbook*.
- People's Bank of China. 2001. information on interest rates, <http://www.pbc.gov.cn>.
- People's Daily. 2002a. "China Drafts Law to Boost SMEs" (February 19).
- People's Daily. 2002b. "China to Hold Symposium on Listing of SMEs" (March 5).
- Priest, George L. 2001. "Rethinking the New Deal and the Liberal State—The Role of the Government as an Insurer." (mimeo)
- World Bank. 1996. *The Chinese Economy: Fighting Inflation, Deepening Reforms*, Washington, DC.
- World Bank. 1997. *China 2020: Development Challenges in the New Century*, Washington, DC.
- World Bank. 2001. "China, Macroeconomic Update," Washington, DC. (mimeo)
- World Trade Organization. 2001. "Protocol on the Accession of the People's Republic of China" and Annexes.
- Xu, Jieqin. 2002. "Support for SME Financing in Transitional China." (mimeo)
- Young, Susan. 1995. *Private Business and Economic Reform in China*, New York: M. E. Sharpe.