

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

³³ See Annex 3, TableA3. 5.

³⁴ *Ibid.*

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.