Case Studies of Local Private Enterprises in Zhejiang Province, China

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要 旨
改革・開放政策が実施された1970年代後半以来、中国経済は30年近くで高成長を続けています。中国経済の三つの柱と言われている国営企業、三資企業、民営企業は持続的な経済発展に大きく貢献してきた。今回の調査は、民営企業が最も早くから発展し、民営企業発祥の地と言われる浙江省対象地域を対象、中国で最初に自由化され、いまや完全競争がほぼ実現されるほどに発展した製造業に重点を置いています。現地調査では、企業の創業者を直接訪問し、企業の設立過程、所有構造の変化、政策が企業に与えた影響、製品市場や資金調達市場での地位及び行動パターンに焦点を当てて聴き取りを行った。

調査結果は5つにまとめられる。第一に、企業の所有構造は、民営企業があらゆる社会資源を活用した結果である。民営資本主導の多様化した所有構造は、単純な家族企業や独資民営企業よりも発展性において優れている。第二に、民営企業の発展は、需要依存型の第一段階から技術依存型の第二段階に転換している。外国からの先進技術の導入・吸収等は、第二段階における競争力の鍵となっている。第三に、民営企業は外国からの資金・技術を必要としているが、国営企業はそれに対応して、より優れた企業統治と管理システムを必要としている。ただし、浙江省では民営企業の競争力が高いため、外資企業の参加がその他の地域に比べて難しいことが観察された。第四に、20年以上の発展を経て、民営企業にとって企業間信用が重要な外部資金の調達手段となっている。また、政府の厳しいコントロール下にある中国の金融システムにおいては「所有構造差別」が存在し、中小企業が資金調達に窮するという不均衡な需要・供給関係が見られる。第五に、政府、特に地方政府は、民営企業の発展を積極的に推進してきたが、資金調達面の環境改善に関して地方政府の力は限られている。概して、民営企業発展のボトルネックは、資金調達と技術革新の制約にある。

I. INTRODUCTION

Since China initiated reforms and implemented its opening-up policy in the late 1970s, its economy has witnessed rapid growth. To a considerable extent, such growth is attributed to the emergence and expeditious development of private enterprises. Thus far, the private sector has accounted for one-third of the national economy, with state-owned enterprises (SOEs), foreign-invested enterprises (FIEs), and private enterprises constituting the three pillars of the Chinese economy. A majority of private firms are small and medium-sized enterprises (SMEs). They lay the gargantuan groundwork that is needed for the growth of the Chinese economy and provide a reliable safeguard for

* This research project was launched in January 2008 by International Finance Research Group of JBIC Institute, led by Toshiro Nishizawa. The report itself is one of the first outputs of this project, co-authored by Professor Xiaoxuan Liu, Deputy Director of Department of Microeconomics, Institute of Economics, Chinese Academy of Social Sciences (CASS) and Qun Liu, Economist, JBIC Institute. The CASS team consists of three experts in this particular research field: Professor Xiaoxuan Liu (Team Leader), Professor Lei Shang, and Assistant Professor Shiyong Zhao.
the employment of millions of ordinary people.

To understand the "China Miracle," we should first understand Chinese private enterprises. Why have private enterprises in China been growing so rapidly? What is the impetus for their growth? What are the behaviors of these enterprises? What are the new features that have emerged in recent years? What are the constraints for their further development? The answers to these questions are of critical importance to the sustained development of the Chinese economy in the future.

In this paper, we attempt to closely observe the developmental path of Chinese private enterprises by investigating several case studies, particularly, by interviewing entrepreneurs—the founders of enterprises. By doing so, we expect to identify the pulse and chief reason for the development of private enterprises, and assess the effect of private enterprises on the entire Chinese economy.

Zhejiang province is the cradleland of Chinese private enterprises and also the region where private enterprises have witnessed the highest growth. This is why we chose private enterprises in Zhejiang for our case studies. We believe the reasons for the emergence and sustained development of private enterprises in Zhejiang can be used as reference points for other regions in China; similarly, the problems faced by Zhejiang private enterprises can also be applicable to the overall Chinese private sector.

While designing the surveys, we set a framework that mainly aims at two markets—product and financial markets—and examined the behavior of private enterprises from the twin viewpoints of the evolution of firms' ownership structure and the effect of external environmental changes on private enterprises during the transitional period. Next, while conducting the case studies, we emphasized on field interviews in order to obtain first-hand information; on the basis of the material obtained, we provided an empirical description and analysis to compile the report. Lastly, we arrived at conclusions by theoretical abstraction.

Since the manufacturing industry is the fastest-growing sector in China as well as the first sector to be opened for market competition, we chose firms in the manufacturing sector. There is nearly perfect market competition in this sector. Further, private manufacturing enterprises have evolved rapidly, which is reflective of China’s reform and transition.

As for the scale of the firms, we chose one large-sized firm, which has been listed on the stock market; four small and medium-sized firms; and two newly established firms. The choice of firms is indicative of the fact that we pay attention to firms that have different sizes and are going through different developmental phases. Moreover, since the financing problems of firms forms one of our areas of focus, we also visited a shareholding commercial bank with the aim to obtain information on bank behavior in the context of bank-firm relationships. Owing to budget constraints, we only chose firms in Ningbo, including two county-level cities that come under the jurisdiction of Ningbo.

On January 6, 2008, with the aim of investigating firms, a team from the Chinese Academy of Social Sciences (CASS) left for Ningbo. From January 7 to 16, we investigated seven manufacturing firms and one shareholding commercial bank in Ningbo, fulfilling the scheduled task in the process.

During the investigation, we collected substantial first-hand material. By recording, clearing, processing, and classifying the material, we built an unique database and used it to compile the final report. We processed and classified the material according to a theoretical framework, and after several rounds of discussions, we consolidated our final report.

The report is organized as follows. First, we examine the sampled firms’ history from the
time of their establishment until now, and the formation of their ownership structure during their transitional periods. The emergence of private firms is closely related to their founders' motivations for starting a business. The nature of ownership of private firms determines their basic behaviors and development objectives. During China's transition, market liberalization and policy promotion were carried out in different phases, and founders of private enterprises were faced with different external environments. Private enterprises founded in different periods may have adopted ownership arrangements that were different from each other. By reviewing the history of such enterprises, we can understand more about why Chinese private enterprises were able to develop and what emerged from such progress.

Second, we focus on firms' production operations, technological progress, transactions, and development strategies. During the time of material shortage in the early 1980s, investment opportunities generated by market demand resulted in the emergence of private enterprises. Almost all private enterprises founded in the early years of reforms and liberalization depended heavily on the market. The most conspicuous behavior of private firms in that era is explained by the fact that firms could survive and grow fast as long as they met the existing market demand. However, with increasing market liberalization, competition becomes increasingly fierce, thereby altering firms' behavior. The survival and growth of firms, then, depend not only on price competition but also on product quality, brand, and intellectual property rights (IPRs). In other words, the dependence of competitiveness on intangible assets like technical innovation or technical progress continually increases. Some firms also need to seek foreign partners to establish joint ventures in order to industrialize new technologies and create new market demand for their products. Given this, only those firms that manage to survive high-level competition can garner larger market shares and achieve good market performance in the future.

Third, as aforementioned, we study firms' financing problems. During the early stages of China's transition, the product market was most liberalized, but the financial market was still regulated by the state. With the passage of time, financing has emerged as a bottleneck that has restricted the development of most private enterprises. Under this constraint, how can private firms survive and develop? What are the features driving their financing behavior? What kind of financing avenues do they use? Are trade credit loans widespread, and do banks have to suffer many loan defaults? Why do so many private firms seek foreign partners in addition to technological considerations?

We also examine bank behavior, for example, the ways in which banks zero in on firms to grant loans. How do banks set their position in the financing market? How can they maximize profit and minimize risks? Furthermore, in bank-firm relationships, how does bank behavior affect enterprises? By studying these relationships, we expect to (1) ascertain whether the financial market can arrive at an equilibrium in its interaction with the product market and (2) find some key weaknesses of the financing system in China. Under the current financing situation, what effect does a private firm's financing pattern exert on China's economic growth? All these are issues worthy of study in the context of the Chinese economy.

Finally, we theoretically summarize the behaviors of private Chinese firms from the perspectives of firm-market, firm-bank, and firm-government relationships, and bring to light the major difficulties that are faced or will be faced by private firms in their quest for development. We then draw the main conclusions, offer possible policy implications, and conclude the report.
II. Developmental Course and Ownership Structure of Enterprises

During the early transitional period of China, especially at the stage of the shift from a centrally controlled and planned economy to a market economy, the government played the role of the first mover. In those seminal years, without the deregulation and incentivized policies of the government, private enterprises would not have been established at all.

1. Initial development and start-up phase: government-sponsored case of Cixi

According to the introduction of sampled firms, the significant development of the Cixi economy is attributable to the far-sighted policies of the Cixi county government in the late 1980s and early 1990s. Around that time, the county government asserted the need for Cixi to have township enterprises and self-employed individuals, and this assertion was made prior to Deng Xiaoping’s comment on his tour to South China. It was then commonly thought that “70% of township enterprises and 100% of self-employed individuals were guilty of tax evasion and avoidance”; accordingly, for some time, people were apprehensive and policies were stringently implemented.

The local government organized a meeting that was attended by county-wide enterprises, factory directors, and managers. At the meeting, the president of the local court, the director of the prosecutorial office, and the director of the police bureau were present. On this occasion, the assistance of all leading officials of the functional departments was sought, and the mayor declared before all attendees, “You can do anything for the development of your enterprise, and if the court takes someone into custody, you can come here and appeal to the president of the court.” At that time, the president of the court, the director of the prosecutorial office, and the director of the police bureau took the floor and voiced their stance publicly. The mayor also remarked to the entrepreneurs, “When you conduct business negotiations with foreigners, I may directly accompany you to the banquet if my presence as a mayor is helpful for your business.” It is generally accepted by Cixi people that the actual development of the Cixi economy cannot be separated from the mayor’s daring declaration. In the history of development of the Cixi economy, the mayor is seen as a monumental figure by entrepreneurs and the masses. The mayor has worked in Cixi for at least 10 years, shaping its development in this period. In the past, Cixi was lacking in infrastructure in the form of highways, railways, or waterways; however, the situation changed once the Cixi economy went on an overdrive, while other local economies continued to be mere witnesses.

Given the case of Cixi, it is reasonable to state that private enterprises can be started and developed in regions where the planned economy is weak and that they can only flourish under the support of local governments. Therefore, the initial external driving force for the growth of private enterprises comes from the local governments outside the planned system, because the local government what is required for the growth of social wealth.

Among the seven manufacturing enterprises surveyed, six are pure private enterprises and
one is a listed company with a state-holding diversified ownership structure that is different from that of a private enterprise. As given below, we categorize the studied firms into four types, according to the basic characteristics of these enterprises, and then study them in detail.

2. Type 1: Private or family enterprise

Driven by the efforts toward reforms and liberalization and by the "encouraging-some-people-to-get-rich-first" policy, numerous village activists were dissatisfied with the situation in former living states. In order to shake off the status of farmers and escape the inferior social status, establishing businesses and manufacturing enterprises appeared to be the most viable option.

**H Mould Company:**

This enterprise was established in April 1988 as a family workshop by four members of a family. The enterprise has developed from a family workshop to an enterprise with a production value of over RMB 80 million.

The president of X Group remarked the following: We started the business in 1982, but since individuals were not allowed to establish an enterprise prior to 1983, the enterprise was initially a red-hat collective enterprise. No investments were made by the village, but all of us contributed. We signed a contract with the village and agreed to hand in a certain sum of money each year.

I never had the privilege of a full meal in my childhood, even though my family was not the poorest in the village. Living a better life was the only motive for my entrepreneurship, and I could do anything if that helped me to escape being a farmer. This was the so-called motive force. The enterprise was registered as a limited company and had five capital contributors at the time of its formal registration, including my parents-in-law and my wife. Today, the enterprise has developed into a group with a registered capital of over RMB 100 million.

President of C Electrical Appliance Company stated the following: I stayed in Shanghai for seven years, started my industrial component business from scratch, and familiarized myself with many machinery products. The most profitable one was an auto product, with an annual net profit of RMB 0.2 million. I came back to my hometown in August 2005, and organized a private limited company jointly with my wife and my parents-in-law, the registered capital of which was RMB 1.50 million.

Pure private or family enterprises mainly (1) rely on financing from their own family members during the startup period, (2) start operations as individual workshops handling components and parts, (3) borrow money from relatives and friends, (4) achieve gradual accumulations and rolling developments, and (5) ultimately achieve a large development scale. For example, X and H are, in essence, the type of family enterprises that were established through contributions from family members and borrowings from relatives and friends. Although the investment sources for C Electronic Appliance Company could not be separated from the support of family members, the company’s funds were also bolstered by the capital accumulated by the founder while he did business during his early years in Shanghai.

*  The interviewee is the office manager of H Company.
These enterprises represent the inception of the startup history of Chinese private or family enterprises, the entire process of which—from investment source to registration, production, and operations—is built on the mutual efforts of individual founders and their family members.

3. Type 2: Transformed township collective enterprise

These are private enterprises that originally started as collective enterprises, for example, Y and J. Both enterprises were set up in the early 1980s or even earlier, and were built as township or village-run enterprises.

Y Company:*2 Established in 1979, the company was initially a village-run collective enterprise, the mission of which was to realize upliftment that would eliminate poverty and backwardness. At that time, the villagers put together over 20 sewing machines, used a poultry farm as the plant, gathered RMB 2,000 as the startup fund, invited a retired tailor from Shanghai to the village to serve as the technical director, and set up the enterprise. In 2000, Y was changed into a private enterprise, and today, the president and chairman holds 52% of the shares, while the village collectively holds the remaining 48%.

The president of J Group Company remarked the following: It was a township enterprise established in 1985. At that time, there were numerous collective enterprises, many of which went bankrupt later. Only about a dozen developed and have survived to this day. After 20 years of development, any enterprise can become a large enterprise if it manages to survive.

Our enterprise is one of the largest 20 enterprises in Cixi. J was transformed into a limited company in 1996 upon the call of the government. The position of the president and chairman of J was concurrently assumed by the former president; he and his son bought the factory by making payments in installments for a span of 3 years, and at the time of the transformation, they paid RMB 10.60 million to the township government’s assets management company as the cost for removing the “red-hat,” i.e., the red-hat of a collective enterprise.

With the support of the township government, the start-up financing of township collective enterprises appears to be more secure than that of pure private enterprises.

The initial start-up capital of J Company was mainly sourced from employee equity financing, private borrowings, and land-mortgaged loans. The enterprise was established by a total fund of RMB 0.8 million and grew to a large-scale township-run enterprise at that time. The founders of J came from the former community mould factory, on the basis of which the predecessor of J was created, and had experience and background in managing business operations. As a result, they could gain the required equity financing support of some employees from the former community mould factory. In addition, another important mode of financing at that time was social financing. This involved, for example, collecting funds from people of surrounding communities by putting up stands on the street, publicizing the enterprise’s projects and their prospective returns and scope, and leveraging on the reputation and experience of the enterprise or individuals. This kind of equity financing needed to pass the examination and

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*2 The interviewee is the office manager of Y Company.
approval of the township government, and in those days, a number of township enterprises conducted equity financing and started business in this fashion.

However, as a village-run enterprise, Y Company could only rely on the funds and materials contributed by villagers, upon its establishment. A village-run enterprise operates on a much smaller scale than does a township-run enterprise, wherein the village collective mainly mobilizes and integrates various resources.

Similar to Type 1 enterprises, i.e., pure private enterprises, Type 2 enterprises are private enterprises; however, the latter utilize support from the local community government (township- or village-level leaders) in the organization and coordination during the startup period. Therefore, Type 2 enterprises can procure facilities by utilizing resources. As a result, the early ownership structure of these enterprises inevitably resulted in collective brands, and later, most township enterprises were crowded out in the competition. Only a small number of enterprises under the control of entrepreneurs continued to develop, and these enterprises were ultimately transformed in the late 1990s, becoming private enterprises after paying a portion of the redemption fund.

4. Type 3: State-holding listed company founded by private entrepreneurs

B Company:*3 Established in 1992, this enterprise essentially had the structure of a township enterprise in which several recently graduated students owned 49% of the firm by “contributing their labors” and the local government held the remaining 51% by “contributing money.” At that time, the Daqiao township government borrowed a fund of RMB 5 million (which was paid off later) for starting this venture. After witnessing development for some years, the enterprise turned into a limited company in 1997, wherein the entrepreneurial team (four founders who set up an institute that conducted research on communication technologies) owned 80% of the company, and the local government, the remaining 20%. At the same time, it became the largest electronic information enterprise, with a sales revenue of over RMB 100 million and a profit of over RMB 10 million in Ningbo. Further, the company emerged as a leader in the industry. In 1997 or 1998, the local Electronic Information Industrial Group reorganized B Company, and turned it first into a state-holding company, and subsequently into a listed company.

After negotiations between both parties, the process of assets reorganization and shares restructuring was finalized. The local Electronic Industrial Group had two of its subordinate factories (dealing in electric condensers) acquired by B, thereby becoming the biggest shareholder of B. The local Electronics Industrial Group held 45% of B's shares, and the entrepreneurial team gave up the status of the controlling shareholder and only served as the second largest shareholder. Ningbo B Co. Ltd. was formally established in 1999 with a total of 5 shareholders: the local Electronics Group was the largest shareholder and held 45% of its shares; B's entrepreneurial team held 44%; and the other three minority shareholders sharing the remaining 11% among...

*3 The interviewee is the deputy general manager, secretary of the board of directors of B Company.
them. Thus, all the state-owned shares totaled up to 51%.

Through this reorganization, B satisfied three objectives. First, cellphone production operations had to pass through an examination and then secure the required approval; however, the problem of obtaining a license could not be solved by only relying on B itself. In the process of procuring the license for cellphone production, the largest shareholder, the local Electronics Industrial Group, played the most important role, thus fulfilling an important objective. Second, the problem of funds could be solved. In 1999, B had only an appraised net asset between RMB 60 and 70 million, which was not enough for operating the cellphone business. Meanwhile, after the listing quota was obtained, the company could secure loans before its stock issuance, and thus, the problem of funds was solved. The third objective pertained to technology, and it was fulfilled by seeking for foreign cooperative partners (a French company).

After being listed in the year 2000, B entered a new developmental phase. With the active support of the government and aid from the capital market, it witnessed rapid development. B exported 6.11 million cellphones in 2005, becoming the first homemade cellphone manufacturer to cross an accumulated export volume of RMB 10 million. For three consecutive years from 2003 to 2005, it achieved the highest ranking among homemade cellphone manufacturers in terms of export volume. B also remained the homemade cellphone manufacturer with the highest sales volume for six consecutive years. By the end of 2005, B cellphones had achieved an accumulated global sales volume of RMB 50 million, thereby becoming the first homemade brand cellphone maker to reach the level of RMB 50 million.

As a non-governmental high-tech enterprise, B Company underwent a rather complicated reorganization process during its startup and developmental period. In order to achieve the high-tech objectives of the founders, it needed to do more than merely rely on ideas for new technologies or blueprints. Further, to fructify ideas into actual products, there were many barriers to be overcome. The achievement of the aforesaid goals required (1) investment funds that were considerably greater than those generally required by private enterprises, (2) a manufacturing permit or license from the government, (3) services of a group of technicians in research and development, and (4) the quota of a listed company. All these requirements made it imperative for them to solicit governmental support and vested power with even the grassroots township government. In this case, B formed an incentive ownership arrangement for its founders, that is, an ownership structure in which the founders’ technology shares accounted for 49% and the Daqiao Township government’s loan shares accounted for 51%. Thus, the embryonic form of B was formed under the support of the Daqiao township government.

Thereafter, the ownership structure of B Company witnessed several changes, and the entrepreneurial team held up to 80% of its shares at one point. However, in order to achieve its objective of engaging in the cellphone business, B had to cooperate with the local government. After negotiations between both parties, B gave up the controlling rights as the largest shareholder to the government and thus obtained the listing quota and the cellphone license. As a result, B ultimately grew to become a state-holding listed company. Al-
though the real managerial right was still in the hands of the original entrepreneurial team, the management was indubitably subject to many tangible or intangible constraints. Thus, the ownership structure of B was shaped in the manner elucidated above, and B expanded to hold the position of the largest cellphone manufacturer in China for a certain time.

The model outlined above is a typical development model for non-governmental high-tech enterprises that function under the constraints of the existing system framework. Overcoming these constraints entails integrating human capital elements, such as the technological inventions of individual founders, with capital and other indispensable external elements into a reasonable ownership arrangement framework by devising acceptable schemes for each party, and thus forming a unique ownership structure. In this structure, each element fittingly essays the role assigned to it and consequently achieves the development objectives of the enterprise.

5. Type 4: Private joint venture

**F Company:** This company was established in 2001 and went into operation in 2003. An Italian company holds 51% of its shares, and this joint venture company has a Chinese president whose individual proprietorship accounts for 49% of the total shares. The joint venture abides by a basic tenet of technological sharing and continues to study and assimilate technology. It manufactures low-cost products that are exported to Europe and America. Its Italian technology helps it assume a leading position in its sector, with the enterprise utilizing its ready-to-use technology. The products of F Company also legally copy the Italian brand. The forte of the Japanese is industrialization, and they are not as competent at making technological inventions. The Italians are more experienced and perceptive in the technological aspect.

The enterprise initially had a registered capital of USD 0.7 million, and if the technology shares of 25.5% were excluded, the company was actually worth only a little over USD 0.5 million, equal to RMB 5 million. In those days, since land prices were very cheap, valued at a mere RMB 50,000 per mu, the enterprise bought 10 mu of land at the cost of RMB 500,000. It also spent RMB 3 million in building a factory, excluding machinery equipment. Thus, the enterprise was built in this fashion through the use of small amounts of money. It also borrowed loans from bank by mortgaging land.

F Company is a typical combination of private entrepreneurs and foreign capital. The private entrepreneurs discovered the market opportunity, sought the relevant advanced Italian technology, and then assembled a team. They implemented Italian technology and established a production base to industrialize the technology. The equity arrangement was beneficial for both parties because the Italians desired to obtain the returns of industrialization by exporting intellectual property rights, while the Chinese founders wanted to manufacture highly competitive products by comprehending and assimilating advanced Italian technology.

In terms of human capital, although the Italian party enjoys the advantage of better tech-
technology and brand, it requires the cooperation of the Chinese party to build a complete operational framework that includes production, management, R&D, procurement, and sales in China. Meanwhile, similar products are manufactured at low costs in China by the use of Italian technology and sold to the international market. As a result, the benefits brought by both parties complement each other and result in the current ownership structure that is largely balanced.

6. Equity and start-up financing sources

By comparing the start-up financing sources of the different enterprises mentioned above, we can find that start-up financing is mainly sourced from private assets and that these enterprises have developed their scale by partnerships or gradual accumulations and rolling developments from small individual workshops and individual merchants. Such start-up financing channels are often highly safe and involve minimal risk. However, these rolling developments are also very slow, which is not conducive to rapid development.

There are also a few large township enterprises that are provided a secure financial platform for their development, by community financing, which is important as the seed of non-governance financing. Unfortunately, however, this financing mode fails to realize standardization and legalization or ensure complete development. As a result, the entrepreneurial efforts of people at the grassroots level have not received the support of effective financing channels until today.

The financing sources and modes listed in table 1 build the unique ownership structures of the studied enterprises during their startup period. In other words, on starting a business, the founder has to depend entirely on the savings of his/her own and his/her family, or on the borrowings from relatives and friends and other equity financing modes. This increases the possibility for the formation of a pure private or family enterprise. In a scenario where the capital market is entirely under governmental control, if an enterprise desires to raise external funds, especially borrow money from banks, or raise funds by an IPO, it has to obtain the support of the government, and often has to solicit equity participation of the government. Thus, it is likely to transform into a township collective enterprise or a joint stock enterprise with a diversified ownership structure.

As a result, a pure private or family enterprise can only rely on its self-development and the gradual accumulation of its profit, if it desires to expand in scale. In this case, the pace of

<table>
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<th>Firm Name</th>
<th>Financing Mode</th>
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<td>1 X</td>
<td>Borrowings from relatives and friends</td>
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<td>2 J</td>
<td>Employee equity financing and community equity financing</td>
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<td>3 H</td>
<td>Borrowings from relatives and friends</td>
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<td>4 C</td>
<td>Borrowings from relatives and friends</td>
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<tr>
<td>5 B</td>
<td>(1) Borrowings from relatives and friends; (2) attracting external funds through shares; and (3) raising funds as a listed company</td>
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<td>6 Y</td>
<td>Pooling and equity financing from each family in the village</td>
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<tr>
<td>7 F</td>
<td>(1) Borrowings from relatives and friends; (2) making private placement debt securities; (3) borrowings from various non-banking financial institutions; and (4) attracting external funds through shares.</td>
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development depends on how much capital it accumulates. In contrast, the development may be much faster and the expansion in scale may be greater during the early startup period for enterprises that are able to secure governmental support and external capital. Therefore, it is difficult for pure private enterprises to compete on level terms against enterprises that enjoy governmental support. In fact, in this case, the ownership structure of an enterprise is dependent on the degree to which the enterprise utilizes social resources and capabilities. B Company is a typical case wherein various social resources are integrated through a diversified ownership structure, and thereby rapid development and expansion were achieved.

III. Competitive Behaviors in the Market and Performance of Enterprises

1. Different types of competitive behaviors in the market and the performance of enterprises

The enterprises studied in this paper are generally faced with competitive markets. On the whole, the market competitive behaviors of these enterprises can be divided into the following three categories:

(a) The market-dependent type: Good at discovering domestic and foreign market opportunities

All the sampled enterprises exhibit market-dependent behavior, and their products mainly include household electronic appliances and apparel. Enterprises belonging to this type strive to discover market opportunities from their early startup period in order to survive, and in the process of continuously exploring and expanding market demands, they gradually accumulate wealth by investing voluminous effort. In the process, they not only accumulate capital but also witness continuous development and expansion. Such enterprises often represent the general private enterprises that are first established and developed in townships and villages.

Most founders of such enterprises were born of parents who were farmers with low educational levels. They secured a competitive edge for their enterprises by largely relying on their clear-sighted market perceptions and rapidly seizing various market opportunities. However, they lacked the ability to become leaders in technology and were deficient in terms of various innovative capabilities such as technological innovation, marketing innovation, and organizational innovation; as a result, competing firms manufacturing similar products are generally faced with disadvantageous starting points, outdated technologies, and shrinking profit margins. After having faced competition for over ten years, most of such homogenous enterprises struggle to survive, while the remaining enterprises exhibit outstanding performances brought about by competitive advantages. In view of the large dependency on market demand of such homogenous enterprises, in the case of economic fluctuation and demand shrinkage, they will find it difficult to withstand the impacts.

X Electronic Appliance: From the time of the implementation of reforms and the opening-up policy, Cixi has built a group

*5 The interviewee is the president of X Company.
of house-to-house individual workshop-type enterprises. The process of formation of such a group has been started and developed gradually from simple components and parts. There are no social resources or state investments, and the enterprise is developed mainly by the Cixi people’s efforts at discovering new market opportunities for themselves. During the early startup period, the enterprise solicited for subcontract work, but slowly, it became a cooperative producer for their previous outsourcer. In this fashion, the enterprise gradually developed and expanded and reached the current sales revenue of RMB 500 to 600 million.

C Electronic Appliance:*⁶ This enterprise had always been engaged in manufacturing low-end products with low profits. By 2005, many regional enterprises with similar products had gone bankrupt. At that time, the enterprise realized that although there were many electric hair cutters that work on alternating current in the market, there were no rechargeable electric hair cutters, except imported products. The enterprise started to focus on this industry and took all its loans for rechargeable products. The enterprise’s current production value of RMB 20 million is a colossal jump from RMB 3 million. In light of this, it can be inferred that through product segmentation, the market narrows and demand blooms. This helps an enterprise to generate relatively higher profits. The core technology of this enterprise is mainly design, and its main components and parts may be produced by OEMs or through outsourcing. However, the enterprise needs to absorb more foreign information and manufacture products that are novel and practical. It can then cater to the high-end market.

J Group:*⁷ As the first company to produce “plastic parts” in Cixi, this enterprise has mainly been engaged in processing for large enterprises. It made its primitive accumulations by manufacturing plastic parts, and subsequently started a new business. In terms of its current product orientation, the enterprise maintains a competitive status at low or medium grades. Its products sell well and are even in short supply at times. Of its products, 40% are sold in villages and 60% are sold abroad. Since it is an enterprise that has both its ends abroad, i.e., part of the material providers and the ultimate consumers in the overseas markets, it is subject to fluctuations in the exchange rate to a lesser degree than those enterprises with only one end (the material providers or the ultimate consumers) abroad. The products are manufactured at low or medium grades and exported to over 60 countries, mainly in South America, Middle East, Southeast Asia, and east Europe, and many countries in these regions do not have their own manufacturing industries.

For dealers, the enterprise generally delivers goods on the basis of credit sales, which are generally not in excess of RMB 1 million. This credit is cleared only after a certain time interval. The sales were initially made on a cash-before-delivery basis in the absence of relevant knowledge about the counterpart. The enterprise used to suffer bad debts worth millions of RMB that it could not recover, although it won a

*⁶ The interviewee is the general manager of C Company.
*⁷ The interviewee is the president of J Company.
lawsuit in this regard. Such a case is rare in these days.

**Y Company:** From the 1990s onward, this enterprise has been evolving from a domestic-orientated enterprise to an export-orientated one, and today, its products are sold in overseas markets. At the outset, they were sold to Japan. Gradually, the product base expanded to encompass the European, American, Middle Eastern, and Southeast Asian markets. The enterprise mainly functioned as an OEM and as a source for processed products for other enterprises. At the end of the 1990s, 90% of its products were exported to over 30 countries, with an annual sales revenue of RMB 800 million and a profit of nearly RMB 100 million, including tax. During this period, the enterprise successively established three Sino-foreign joint ventures as the majority shareholder. The first company was a joint venture with Hong Kong investors, while the second and the third companies were joint ventures with Japanese investors. After 2000, the enterprise began to refocus on the domestic market; it did not accept many foreign orders so as to avoid a loss. The current export and domestic sales are approximately equal.

Although each of enterprises cited above is unique, they are common in that they can successfully discover new market demands and continuously expand their market share, which is taken as the foundation for their success. J Group focuses on low- and medium-grade products that are sold in villages and exported to developing countries. As the profit margin is very small, the enterprise survives mainly on small profits with high turnovers. Its situation is in contrast with that of C Company. The latter discovered a market demand gap by segmenting small household electronic appliance products, seized this opportunity to engage in production and development, and achieved success in the process. At first, C’s market was oriented to counter high-end competition; consequently, it focused on exports. Gradually, it shifted its attention to domestic sales, which can be regarded as an effective developmental path. As for X Group, it is against the odds that the enterprise has survived the threat of competition of other homogenous enterprises, developed into an enterprise with a reasonable scale and brand presence, and occupied a large market share in similar domestic products. At present, the enterprise mainly wins by its scale and brand, whereby it relies on an established marketing network.

The returns on assets (ROAs) of these three enterprises have stayed above 6% in the last two years, remaining stable in the face of fluctuations. The profit margin appears to be limited owing to intense competition. In addition, the apparel manufacturer is currently faced with changes in exchange rates, antidumping policy, export rebate cuts, and immense pressure from the international market. In recent years, these factors have continuously driven down its profit margin to only 1% and led to a rather worrying development prospect.

**(b) The new product follow-up type: competing against transnational corporations and domestic low-level producers**

Enterprises of this type are characterized by high-level technologies, large scale, and multi-

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*8 The interviewee is the office manager of Y Company.*
tier management levels at the time of inception. Such firms are established as a result of the efforts of a group of typically young intellectual entrepreneurs. Simultaneously, they also share some typical characteristics with state-owned listed companies.

**B Company:** The cellphone market made rapid inroads in 2003 and 2004, and most foreign brands gained quick profits. However, domestic cellphone manufacturers that came under the purview of the former Ministry of Information Industry did not fare as well. They needed R&D investments, large fixed equipment investments, strict quality assessment, and sound post-sale service systems. These investments, if made, increased the costs of these enterprises and placed them at a disadvantageous position vis-à-vis smuggled cellphone makers. After 2005, with the greater availability of cellphone technology, many assembly plants that made cellphones at extremely low costs were set up in Guangdong. In these two years, the modularized development of the cellphone market has evolved expeditiously, as an accompaniment to the rapid strides made by the Chinese cellphone market. The simplest way for an enterprise to manufacture a specific kind of cellphones is to buy modules from Taiwan MediaTek Company and then assemble them.

Even though B was successful in the past, it is currently going through a difficult phase now and will have to cope with greater uncertainty in the future. In 2007, its losses for the first three quarters exceeded RMB 500 million. Why did the enterprise fare so badly? The reason is that the enterprise lacked foresight and only followed the path charted by other enterprises in order to organize its business development. Further, the inferior professional standard of the enterprise placed it in an unfavorable position with regard to development.

The cellphone market mirrors a market faced with high competition, with each major transnational corporation in the sector having to cope with stiff competition. Several tycoons take turns to lead at different phases, without much difference to the state of the company. Japanese cellphone producers were crowded out at the very start of the market boom, as a result of incorrect strategic choices. Nokia and Motorola occupied half of the Chinese cellphone market by relying on their traditional brand image; however, the Korean Samsung, with a better understanding of the situation in China, has surpassed the former two to emerge as the cellphone maker with the best prospects.

The colossal size of the cellphone market notwithstanding, it is a low-end market. There is widespread copying of cellphone designs because of the scope for easy assembling of individual modules. The results of such low-end competition will crowd out enterprises similar to B Company. Currently, B is placed in an enviable position wherein it is susceptible to both high-end competition from Samsung and low-end competition from cellphone makers manufacturing easily assembled products.

On account of its delayed attempts and limited technological capabilities and investments, B could only adopt the mode of follow-up development and learn from other enterprises. It

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*The interviewee is the deputy general manager and secretary of the board of directors of B Company.*
could not maintain a leading position in the technological aspect, only exhibiting commendable performance during the high-growth period of the cellphone market, at which time B occupied the largest market share among domestic cellphone enterprises. However, once the market became saturated, its performance would decline sharply. The profit rate of B dropped from 5.7% in 2004 to −10% in 2005, and it had to suffer heavy losses. Although the year 2006 saw favorable returns, the profit rate was only a marginal 0.7%.

What then is the solution to the problem faced by enterprises such as B? Should such an enterprise diversify or acquire outsiders? Given these questions, B is faced with a few difficult choices and litmus tests.

(c) The new technology-dependent type: Introducing and developing advanced technologies

F Electric Machine: * At the very start, the enterprise relied on not only Italian technology but also the foreign market. Gradually, the enterprise assimilated Italian technology and utilized it for the promising Chinese market. The development of many plants in China begins with the copying of foreign products. Since as a start-up, F Electric Machine desired to compensate for its deficiencies in a short span of time, it was compelled to copy foreign products and technologies. Gradually, it made the transition to independent R&D. It desired to adopt Italian technology, owing to which it was interested in a joint venture. Italian technology maintains a leading position in this sector. The forte of the Japanese is industrialization, and they are not as competent at making technological inventions.

The main products manufactured by this enterprise include standard and integrated electric machines. In the case of many of these products, F does not have domestic competitors and is the only domestic enterprise that can carry out mass production. Although the enterprise operates on a small scale, it enjoys promising prospects. The market for its products needs to be further developed. Currently, all the main customers of F are large world-famous companies, for which it is not worried about the market and is not looking at tapping it fully. The technological content in the products of F is so high that the enterprise has virtually set the benchmark in the industry. The enterprise has few domestic competitors and the market is colossal.

Enterprises of this type that rely on technological innovations hold the most promise, and regardless of where a technology is sourced from, a new technology can help make forays into new markets, even through reasonably strong industrialization channels. As a result, such enterprises as F Company do not rely on current market demand; instead, they continuously create new market demand and tap into a boundless demand market.

H Mould: * This is considered a high-tech enterprise in both Zhejiang and Ningbo, with the highest production value and profit in the industry. The enterprise currently engages in mass production and makes large investments. It has large and well-known domestic enterprises as its domestic customers, in addition to many

*10 The interviewee is the general manager of F Company.
*11 The interviewee is the office manager of H Company.
foreign customers. H Mould occupies 30% of the market share in Guangdong, and its main product is a high-precision, high-speed mould with a high technological content, which is used in high-speed punching machines. Further, there are few enterprises that manufacture products that are similar to this mould. H is the leader in the domestic industry and also enjoys certain popularity worldwide. The enterprise manufactures products according to customers’ orders and focuses on the domestic market, which accounts for 95% of the gross sales revenue. Today, its main product can completely substitute for imported goods and is technology-intensive and high value-added. Therefore, H has a high profit margin, which may go up to 20 or 30%. However, the technological content in the product is still considerably less than that in competing international products. H follows a low-price strategy, and the price of its main product is only one-third of that of similar Japanese products.

H Mould is characterized by the manufacture of technology-intensive products and mainly depends on highly specialized and segmented product demand. Its products have a high technological content and can fulfill the need for import substitution. Given this, a high technological threshold increases the market power of the enterprise, leaving it with few competitive domestic producers in the fray. By introducing advanced imported NC machine tools and relying on a group of well-trained high-tech professionals, the enterprise has been able to process high-precision moulds – technology-intensive products that have lent it a strong competitive edge in the market.

By relying on innovation, both enterprises, F and H, have built a strong competitive edge. As a result, both enterprises have high ROAs, approximately 6 to 20%, with the 2007 average above 10%. In recent years, the total assets of F Electric Machine Technology Co. Ltd. have annually grown at a two-digit rate – from RMB 15.78 million in 2003 to RMB 55.56 million in 2007, i.e., a growth of 252.02% in four years. It is the fastest-growing enterprise among the sampled enterprises.

The swift growth of H Mould’s assets occurred in 2005 and 2007. This was accompanied by a significant decrease in the assets-liabilities ratio, indicating that its investment source was not only liabilities but also its own profits and accumulations.

2. Investigating how the competitiveness of private enterprises is built from a technological viewpoint

Technical know-how

The strong competitive edge of private enterprises is not only attributable to their robust ownership structures, effective management mechanisms, strong enterprising spirit and market perception, but also to the facts that these private entrepreneurs have distinctive technical insights and are able to outperform competitors in terms of technology and product quality.

Since most founders of grassroots private enterprises are not very well-educated, it is often difficult for them to create high-level intellectual property. However, they have an advantage in that they are especially good at “learning by doing.” Further, they have a certain natural understanding of their own technologies, owing to which they have a better command of these technologies than the common man has. This helps them produce high-quality products.

The founders of H Mould were former technicians who had a special preference for mould technologies. The president of J Group was a
technical worker in the former township enterprise, who was determined to study technology intensively. For his efforts, he was honored as the national pacesetter in the new Long March. However, being uninterested in gaining official promotion, he declined the opportunity to serve as the secretary of the Youth League Committee of the community and turned to business wholeheartedly.

On account of the reasons cited above, the technological capabilities of private enterprises cannot be considered as salable patent rights or other intellectual property rights, but as certain technical "know-hows" that are not salable but central to a certain person. This kind of technological capabilities can often only be taught in person or through verbal instructions and shown by means of practical operations; therefore, they can seldom be copied or stolen. By relying on such capabilities, which are mastered through practical mass production processes, private enterprises have built unique intangible assets, which have become an important source for their success in the market.

Equipped only with such unique technological capabilities, even in a market with similar products, private enterprises often manufacture products of a higher quality than that of others. By conducting intensive research, exploring and developing the production process, and possessing higher technological capabilities than other enterprises, these private enterprises establish higher technical benchmarks, or even set the technological standards in the industry, and build a significant competitive edge.

**Utilizing the benefits of technology spill-over by employing technical talent**

In all the sampled enterprises, it can be seen that there are technical talents employed from state-owned enterprises, state-owned research institutes, and foreign countries. These various types of talents bring in new technologies and process flows to grassroots private enterprises and thus effectively accelerate the rapid development of private enterprises.

It has become common for private enterprises to engage the services of technicians or engineers from SOEs for full- or part-time jobs at high salaries. These private enterprises effectively take advantage of the human resources of SOEs and fully utilize the capabilities of these talents, who have been unable to realize their potential with their former employers. With this type of flow of human capital, grassroots-level private enterprises that are lacking in technology outperform SOEs that have a large gathering of talent but have been incapable of using it to counter competition.

**H Company:**

This enterprise engaged the services of an expert from Jiangsu who was entitled to Government Special Allowance (GSA). He is the director of a research institute and is employed with H on a long-term basis wherein he works for a period of time each year. In addition, Engineer Xu joined the enterprise after retiring from Shanxi Caihong Group, and Engineer Yang came from South China Weapon Group. These personnel have abundant experience and possess the skills to solve the practical problems of the enterprise. The enterprise pays huge annual salaries of several hundreds of thousands of RMB yuan to senior engineers such as Xu and Yang.

With the gradual internationalization of the local markets, private enterprises need to make better use of international talent, in order to upgrade their own competence. J Group pro-

*12 The interviewee is the office manager of H Company.
cured the services of Korean technicians through a Korean intermediary and thus effectively upgraded its own technological level. One enterprise dealing with machine tools employed a retired Japanese engineer at a high salary, in an attempt to narrow the original technological gap with regard to its competitors.

As a result, the search for talent has been increasingly transcending national boundaries, especially for those private enterprises that can be highly benefited by the capabilities of highly technical talent. Qualified personnel with human capital traits are often attracted to enterprises where their value can be best realized, and the optimum allocation of these human resources results in higher productivity and a general developmental trend of economic globalization and trade liberalization.

**Overcoming technological bottlenecks by means of joint ventures**

It is common to procure advanced technologies and industrialize new technologies by means of formal joint ventures and collaboration, as exemplified by various joint ventures in China’s automobile sector. The joint venture between F Company and the Italian company, as mentioned earlier, is a typical example. The Italian company’s technology shares account for 25% of the joint venture. Through this joint venture, F may exploit the Italian firm’s brand value, and the latter will designate technicians to impart knowledge about the technology.

B Company also resolved the issue of technological development by establishing a joint venture. After it garnered funds for development by making an IPO, it entered into a joint venture with a foreign cooperative partner (a French company) to break through technological bottlenecks faced by the cellphone industry.

In response to the question of why B failed to enter into a technological alliance with a Japanese firm, the deputy general manager of B Company remarked that Japanese cellphone manufacturing was actually unsuccessful even though it had been successful earlier. Japan’s technologies are unique, for which it does not face any problem in the domestic market. However, it might encounter a problem in the foreign market if the latter does not adopt its system. Although Japanese electronic components are very sophisticated, Japanese enterprises are not willing to bring updated technologies and products to China; instead, they use ordinary, third-class technologies for the Chinese market. In terms of developing cellphone technologies and replacing outdated technologies with new ones, Samsung has performed well and has managed to bridge the gap in the Chinese cellphone market.

**Importing advanced equipment and technical training from overseas**

Importing advanced equipment from overseas is the most common way for an enterprise to improve its competitiveness.

The office manager of H Mould said that 80% of its machine tools were numerically controlled. Since homemade NC machine tools are not as good as imported ones, imported machine tools account for 20% of its equipment. Currently, these tools are not purely imported; many of them are produced by Sino-foreign joint ventures or by completely foreign-funded enterprises in China. H Mould desires to be the pace-maker in the industry, for which it plans to import high-grade NC machine tools from America, Switzerland, and Japan.
Private enterprises import equipment not only for the purpose of generating revenue but also for acquiring new equipment, learning to handle new machines, and absorbing new technologies. In addition, H also takes full advantage of operational training opportunities provided by American machine-tool makers in China by developing a group of its own high-tech workers that are able to skillfully handle high-precision NC machine tools.

3. Relationship between private and foreign enterprises

Most of the enterprises listed above are typical grassroots private enterprises that are established and nurtured on native soil. Initially, they depend on local market demand, and gradually develop into large-scale enterprises. The production and operations of these enterprises expand from their local counties and cities to their provinces and then to other domestic provincial and overseas markets. In the market, SOEs were the main competitors of private enterprises initially; however, the former could not keep up pace with such enterprises for long. Since the appearance of private enterprises in the mid-1980s and the rapid strides made by them in the early 1990s, SOEs have suffered widespread losses and had to exit the market only after a few years. As a result, from the mid-1990s onward, village collective enterprises have been transformed and privatized in several areas, while urban SOEs have also experienced large-scale transformation in the late 1990s, and have been privatized.

It can be seen from the success enjoyed by the sampled private enterprises in Zhejiang that the competitive behavior of private enterprises is the underlying reason for which market competition has removed inefficient SOEs, leading to their gradual exit from the competitive market since the 1990s.

Zhejiang has few foreign enterprises or joint ventures, which are seen even less in the counties and cities in its interiors. Why do foreign enterprises find it difficult to effect big development in Zhejiang, while in other regions such as Jiangsu and Shanghai, foreign enterprises enjoy considerable scope for development? A possible cause can be gleaned from the competitive behaviors of the enterprises mentioned above.

Private enterprises, especially those at the grassroots level, can identify and seize critical market opportunities in the local arena as a result of their acute demand perception. These are the inherent advantages of native-born private enterprises in the local market, which foreign enterprises can only aspire for. As a result, Zhejiang has a group of highly developed private enterprises with distinct competitive edge, and foreign enterprises find it difficult to compete against them.

Conventionally, a foreign enterprise enters a certain country or region with the expectation of gaining a competitive edge in the new market; in the absence of such expectation, it will not enter a new market. Given this, we can express the motive for foreign entry by a simple expression:

\[
\text{Relative competitiveness of FIEs} = \frac{\text{Competitiveness of FIEs}}{\text{Competitiveness of domestic firms}}
\]

Foreign enterprises can easily expect to perform well in a market teeming with inefficient SOEs and collective enterprises. As a result, they will be driven by this factor and will enter the market in hordes, although there are other

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* Yasheng Huang, "Selling China: Foreign Direct Investment During the Reform Era," (Chinese Version), p.80, New Star Publisher, Beijing, 2005
market environmental factors too. However, at least in similar market environments, foreign enterprises do have to consider the relative competitiveness at the time of entry. For example, Jiangsu and Zhejiang are two regions with very similar market environments. In Jiangsu, there are many foreign enterprises entering the market, while Zhejiang has seen only a handful of foreign enterprises enter its market. The reason is that the relative competitiveness of these two regions is different for foreign enterprises. Private enterprises in Zhejiang are very strong and equipped to face intense competition. In comparison, foreign enterprises do not boast the advantage of established mechanisms or the capability to widely penetrate into grassroots market layers. In addition, they lack the adequate flexibility required to respond to the market and thus find it hard to gain a competitive edge over private enterprises.

As for the private enterprises’ demand for foreign capital, among the seven sampled enterprises, two are in negotiations for collaboration with foreign investors. For example, F bought a huge volume of equipment required for the manufacture of high-speed punching machines from England and built a special workshop, in order to use this workshop while doing cooperative work with foreign investors. Further, it is also currently negotiating with a European enterprise, the second-largest in the industry. Another example is C, which is very willing to cooperate with foreign enterprises and keen to take advantage of their capital, technologies, and sales networks. Currently, it is engaged in negotiations with a French company for a joint venture; the biggest advantage of such an association would be that it may solve the problem of fund constraints for C.

Therefore, although foreign enterprises do not enjoy a significant competitive advantage in Zhejiang, local private enterprises are willing to cooperate with foreign enterprises in order to help them compensate for inherent disadvantages. This cooperation is mainly reciprocated by the supply of foreign funds to private enterprises, which may address the problem of fund shortage for private enterprises. Additionally, the fulfillment of the demand of private enterprises for technology and equipment can bring such enterprises closer to the global technological level, and that of the demand for overseas sales networks can help them expand their exports and make stronger entries into foreign markets. Given the immense benefits that both parties can avail of, cooperation and joint ventures are mutually beneficial.

However, the demand for foreign capital may decline somewhat as a result of the new tax law and the land policy that has come into force in 2008. Owing to the new policy, enterprises wishing to enjoy preferential policies by engaging in joint ventures will not seek foreign capital. The primary demand for foreign capital stems from the technological bottleneck, whereby enterprises wish to maximize the advantage of the spillover effect of new technologies. Since China has a large market, foreign capital of any one country cannot achieve a monopoly, consequently it is a long-term development strategy for private Chinese enterprises to seek for the optimal technologies and cooperative terms. With the competition of international capital in the Chinese market, new technologies emerge continually and older technologies are replaced with new ones. Private enterprises have a high capacity to absorb new technologies and industrialize them rapidly and the potential to reach an advanced level in the future. Therefore, any attempt to monopolize new technologies is virtually impossible.
### IV. Enterprises and the Financing Market

#### 1. Short-term financing source and financing modes for enterprises

**Trade credits**

An important financing mode for enterprises is trade credits, which includes various receivables, payables, advance payments, and advance charges. As a financing mode, trade credits is generally adopted by private enterprises in cases when they find it difficult to obtain bank funds. For instance, Y Company and H Mould often adopt this mode of trade financing. In the case of H Mould, 80% of its financing is sourced from customers in the form of advances. When an enterprise occupies a market position that is comparatively advantageous that, in turn, helps it assume a strong position between trading parties, or when the partner has a high need to make the deal, the enterprise may be able to make deferred payments or request its partner to pay in advance.

As shown in table 2, in addition to obtaining bank loans, the sampled enterprises procure short-term financing mainly by means of trade credits (namely, arrears) and inter-enterprise borrowing and lending. Using these financing sources has become a common phenomenon for private enterprises in Zhejiang.

In the past, this kind of inter-enterprise short-term credit lending has widely resulted in unpaid arrears. However, with time, the situation has changed, and such cases are virtually unheard of today. Private enterprises pay increasing attention to bankable reputation and long-term behavior while choosing a trade partner, and debt evaders find it immensely difficult to secure a foothold in the market once they default on their credit.

*C:* The enterprise has lent a substantial sum of credit to its domestic customers; however, currently, there are few cases of debt evasion, and the domestic trade credit environment is significantly better than what it was earlier. In Chinese culture, a lawsuit is regarded as an undesirable option. Debt-ridden enterprises on the verge of bankruptcy and closure are rarely pursued through litigation. However,

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**Table 2 Possible financing sources in addition to bank loans**

<table>
<thead>
<tr>
<th>No.</th>
<th>Firm’s name</th>
<th>Financing sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>X</td>
<td>–</td>
</tr>
<tr>
<td>2</td>
<td>J</td>
<td>T/T in exports, commercial bills</td>
</tr>
<tr>
<td>3</td>
<td>H</td>
<td>80% from advanced payment by customers, 20% from private borrowing</td>
</tr>
<tr>
<td>4</td>
<td>C</td>
<td>–</td>
</tr>
<tr>
<td>5</td>
<td>B</td>
<td>Advanced payment by customers while ordering; arrearage (most important); stock; and bond</td>
</tr>
<tr>
<td>6</td>
<td>Y</td>
<td>Inter-firm borrowing, with an interest rate of 2 – 3%</td>
</tr>
<tr>
<td>7</td>
<td>F</td>
<td>(1) Inter-firm borrowing; (2) advanced payment by customers while ordering; (3) arrearage (numbered in descending order of priority)</td>
</tr>
</tbody>
</table>

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*14 The interviewee is the general manager of C.
if the non-payment is actually a case of debt evasion, then persistent demands for payment are acceptable. In practice, it often transpires that while operating a business, people take loans. However, sometimes, the business fails and they owe their creditors money. At this point, defaulters are not persisted with; instead, they are allowed to garner the required earnings through other businesses, following which they repay the debt. In a nutshell, Chinese people have a regard for credit. In reality, most industries have only a few enterprises, and often, people across these enterprises meet with each other. Therefore, if an enterprise has a bad credit standing, the news easily spreads in the industry, which then undermines the public perception of the firm.

F:* 15 This enterprise generally has to arrange for the working capital, deliver goods, and then collect the money in four months. It generally does not allow a customer to have arrears, except when it knows the customer well and the customer is in a serious financial crunch. As far as the domestic credit environment is concerned, F sees improvement, although the situation is undoubtedly much worse than it is overseas. The enterprise has many small suppliers and small customers.

Y:* 16 This enterprise generally solves debt disputes through negotiation. It seldom goes to court and has not been involved in any lawsuit in over ten years.

J:* 17 This enterprise had arrears in millions of RMB yuan in the past. Although it won a lawsuit, the money was not recovered. The 1980s witnessed many debt lawsuits; however, with improved market networks, people are not easily susceptible to lending to potential defaulters. The enterprises too have carried out stricter identification, thereby exhibiting maturity.

In general, with the development of Zhejiang’s market economy, cases of arrears are increasingly rare; further, business credits are directed at healthy development. In fact, triangle debts can often assume serious proportions in an immature market. Debt evasion as a firm behavior cannot be sustained among enterprises with risk-bearing ability. In a period of economic boom, such phenomena are even rare. It is only during a period of economic recession that the breakdown of fund chains can initiate a Domino chain reaction and result in large-scale arrears.

**Bank loans**

In recent years, bankers’ acceptance bills are being more widely used by banks as a common means for financing enterprises.

When a client applies to a bank for the issue of bankers’ acceptance bills, the client is required to deposit a certain proportion of security or cash deposits in the bank. The maturity period of bankers’ acceptance bills can last up to six months. For instance, among the surveyed enterprises, X Group is required to have deposits in the bank as security deposits for the issue of bankers’ acceptance bills. In such a case, the deposits/loans ratio given by the bank is generally 30 – 50%. For J Company, the deposits/loans ratio given by the bank is about 50%; that

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*15 The interviewee is the general manager of F.
*16 The interviewee is the office manager of Y.
*17 The interviewee is the president of J.
is, the company has adequate deposits in the bank in the form of security deposits. As the drawer of bankers' acceptance bills is actually the accepting bank, the risk of default at the time of maturity of a bill is minimal.

Using the financing means of bankers' acceptance bills may considerably help to solve the problem of lack of floating capital, which is encountered by non-state enterprises in carrying out their business operations. For instance, enterprises that need to make advance payments for the acquisition of such supplies as raw materials may use bankers' acceptance bills to make payments, instead of making cash payments. Upon the maturity of the bankers' acceptance bills, the enterprises may pay the bills via the sales revenues. In such a case, the bank issuing the bankers' acceptance bill actually acts as the credit guarantor that provides direct financing for enterprises in need of funds. Banks issuing bankers' acceptance bills can effectively prevent and mitigate the credit risk and receive certain financial service charges paid by the applicants as long as they have sufficient understanding of the applicants' financial condition and the market situation.

Among the sampled enterprises, X, J, and B use acceptance bills as one of their main financing modes. In the case of B, the use of acceptance bills accounts for 70% of its financing sources.

In addition, X, J, F, and B are granted different credit lines. In other words, the bank authorizes a maximum comprehensive credit line on the basis of an overall evaluation of an enterprise's risk and financial conditions; signs a credit line agreement with the customer; allows the customer to draw a loan, open a letter of credit, or handle the negotiation business at any moment during the given period and within the authorized line; and determines the repayment time as the situation may require. In ensuring that these steps are carried out, the bank meets the principal financing demands of its customer.

However, regardless of the bank financing mode adopted, all enterprises have to procure bank credits or loans by means of traditional mortgage.

As shown in table 4, if housing and land are used as mortgage, bank loans can be usually procured within a proportion of 60 – 70%, while if the mode of acceptance bills is adopted, the enterprise has to deposit the margin money at a high loan-deposit ratio. In addition, accounts receivable may also be taken as mortgage, wherein the proportion is fairly high and may reach 80%. In such cases, this financing option is not available to all enterprises; the choice of enterprises to fund rests with the bank. Given the nature of bank-firm relationships in China, the banks occupy a strong market position and can always minimize the risk so as to be assured of the maximum income.

<table>
<thead>
<tr>
<th>No.</th>
<th>Firm Name</th>
<th>Assets used as mortgage or guarantee</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>X</td>
<td>Firm's deposit, housing and land</td>
</tr>
<tr>
<td>2</td>
<td>J</td>
<td>Firm’s deposit, housing, land, and equipment</td>
</tr>
<tr>
<td>3</td>
<td>H</td>
<td>Firm’s housing and land</td>
</tr>
<tr>
<td>4</td>
<td>C</td>
<td>Firm’s housing and land</td>
</tr>
<tr>
<td>5</td>
<td>B</td>
<td>Firm’s housing, land, and accounts receivable</td>
</tr>
<tr>
<td>6</td>
<td>Y</td>
<td>Firm’s housing and land</td>
</tr>
<tr>
<td>7</td>
<td>F</td>
<td>Firm’s housing, land, and accounts receivable</td>
</tr>
</tbody>
</table>
The investment behaviors and corresponding long-term liabilities of the sampled enterprises are mainly studied by the cash flows generated by the investment activities of the enterprises.

As reflected by the above data in table 5 on the enterprises, most sampled enterprises have been involved in investment activities in recent years. Among them, H and F have made big investments in the last two years, and their investment expenditures have considerably exceeded the investments available to them, appearing as a shortfall on the balance sheet. B and Y also made big investments in previous years, but appear to have made no big investment expenditure in the last two years. In other words, on the basis of most of their investment expenditures, they would have obtained the financial backing of fund sources. The data of X Group indicated that during the studied period, the scale of the enterprise’s activities directed
at investment recovery was always larger than that of activities that were investment expenditures, indicating that X made no new investments.

Thus, it is evident that private enterprises have always encountered difficulty in receiving adequate financing support for making investments, especially long-term investments. Therefore, they have to compensate for the shortage by "making long-term investments through short-term loans," or relying on the cash flows generated from operating activities. There are also other avenues for enterprises: access to the cash intended for operating activities, deferred debt service, or increased liabilities for investment activities. All of these constitute common modes for private enterprises to make reparations for the shortage of investment funds.

With respect to the assets-liabilities ratio of the sampled enterprises, large-scale enterprises have relatively high assets-liabilities ratios – about 60% – while small-scale enterprises have relatively low assets-liabilities ratios – 50% or below. According to a survey on the age of the enterprises, enterprises that have been existent for 10 years or more have relatively high assets-liabilities ratios, whereas newly established enterprises have relatively low assets-liabilities ratios.

In recent years, banks have maintained an interest rate of about 6% for working capital loans and a higher interest rate for fixed assets loans. In 2007, in order to control the rise in price index and investment rate, the financing costs of enterprises have registered a sharp rise. According to our survey, the current financing costs of private enterprises have reached an annual interest rate of 10%, which is a rather heavy cost burden. It remains to be asked then that for different types of financing sources, what are the differences in costs?

As shown in table 7, from among the various financing modes, the sampled enterprises rea-

<table>
<thead>
<tr>
<th>No.</th>
<th>Firm Name</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>X</td>
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<td>50.03</td>
<td>63.26</td>
<td>58.59</td>
<td>64.03</td>
</tr>
<tr>
<td>2</td>
<td>J</td>
<td>42.70</td>
<td>42.76</td>
<td>58.26</td>
<td>59.39</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>H</td>
<td>58.63</td>
<td>63.66</td>
<td>37.96</td>
<td>23.85</td>
<td>36.96</td>
</tr>
<tr>
<td>4</td>
<td>C</td>
<td></td>
<td>4.98</td>
<td></td>
<td></td>
<td>43.65</td>
</tr>
<tr>
<td>5</td>
<td>B</td>
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<td>62.76</td>
<td>67.17</td>
<td>59.10</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Y</td>
<td>59.27</td>
<td>40.54</td>
<td>43.50</td>
<td>49.47</td>
<td>66.79</td>
</tr>
<tr>
<td>7</td>
<td>F</td>
<td>46.91</td>
<td>40.55</td>
<td>49.75</td>
<td>44.01</td>
<td>48.31</td>
</tr>
</tbody>
</table>

Table 6 Changes in the sampled firms’ assets-liabilities ratio (%)
son that the financing by making IPOs or introducing external funds involves the minimum cost. However, availing of this option is not feasible for an absolute majority of SMEs. Regular bank loans constitute a feasible low-cost financing mode. The third avenue is employee equity financing and borrowings from other enterprises, relatives, and friends. Comparatively, the interest rates of bank loans are significantly lower than those of enterprise or private borrowings. This indicates that the fund costs of IPO financing are lower than those of bank financing, while the fund costs of bank financing are lower than those of private financing. These different financing costs are applicable to enterprises with different market positions.

In general, the smaller and newer an enterprise is and the lower position it occupies, the less will be its probability of procuring bank financing and, therefore, the higher will be the burden of financing costs. On the contrary, the stronger market position an enterprise is in and the larger asset scale it has, the more will be its chances of obtaining a low financing cost and, therefore, the lower will be the burden of financing costs.

3. Bank behavior and bank–firm relationship

Among the sampled enterprises, J and Y seem to be able to largely meet their investment needs by taking bank loans. Both these enterprises were transformed from township enterprises. Although their investment projects do not always have good prospects, the enterprises can meet their investment and financing demands by virtue of their large corporate scale and sound bank credit background.

In contrast, C and F appear to show sizeable fund gaps. Both are examples of growth enterprises. C believes that current financing can only meet 40% of the demands for long- and medium-term development and daily production, while F can only meet 25% of its demands for long- and medium-term development. Thus, for both firms, the actual financing level is far lower than the demand. As corroborated by the data on these two enterprises, it can be said that they mainly engage in high-end or high-tech products, focus on the export market, and thus exhibit good performance and developmental prospects. However, both these enterprises find it hard to meet the accompanying financial demands.

As shown above, the resource allocation of banks seems to have significant inconsistencies. They often pay attention to assets acquired in the past, but not to future prospects. Under such an environment, emerging enterprises may find it hard to procure the necessary financing for development, and often have to incur high costs in order to procure limited financing; in contrast, large-scale enterprises with much less potential for future development may easily obtain financing at low costs.

How did such a system of financing resource allocation come into effect? We now examine how a bank makes its resource allocations and loan selections.

An interview at the joint-stock bank’s local branch: 

Under macroeconomic control, small enterprises terminate businesses first. Large enterprises are not afraid since they have at least five banks to procure loans from. If one bank reduces its loans, there are four other banks to provide support, enabling the large enterprises to stay afloat. Small enterprises generally

\*18 The interviewee is the deputy head of the branch of the bank.
have only one bank to receive loans from; therefore, even if the bank reduces the loan amount by half, the enterprises will not survive. As a result, large enterprises have to take relatively small risks with regard to bank financing. For example, banks request Youngor Company to obtain loans from them; this is because although the banks may grant a credit line in tens of billion RMB yuan to Youngor Company, it often only uses tens of million RMB yuan.

Currently, the bank follows a sound risk-control system and often makes post-loan examinations. In Ningbo, all enterprises are private ones that usually do not have to worry about unfavorable operating conditions and are generally able to cope with economic difficulties. For the bank, enterprises with adequate cash flows are the safest to grant loans to, even when they suffer temporary losses. For instance, if an enterprise is going through a difficult phase, the bank may help the enterprise negotiate safely through the period. Given this, the bank pays considerable attention to cash flows.

The bank tries not to deal with new enterprises. Usually, the bank focuses on enterprises that have a total asset of less than RMB 100 million and a sales revenue of less than RMB 100 million. Only one of ten small enterprises will develop into an enterprise with annual sales in excess of RMB 100 million. As a result, we give consideration to an enterprise only if 90% of risks are eliminated. The bank is also interested in dealing with large enterprises such as Beilun Port Authority, Shanghai Oil Refining, and Chemical Processing; unfortunately, these enterprises do not show a similar degree of interest in the bank. They have large projects and need large amounts of fund, and the bank cannot provide a satisfactory credit line to them.

The costs for the approval of loans, irrespective of the loan sum, are almost the same. With respect to human costs, it is not worthwhile to deal with small enterprises since the bank is understaffed; as a result, the bank seldom deals with small enterprises. Small enterprises may seek local credit cooperatives for loans. It is very difficult for such enterprises to survive, and they will only acquire a reputation after surviving a startup period of 3–5 years. Before the passage of this interval of time, loaning them would be fraught with risk. As a result, the bank focuses on the middle path, wherein it cannot support large enterprises and cannot bear the risk for small enterprises.

In the past, the cost of financing by the use of acceptance bills has been low, but with the continuing rise in the interest rate, the cost of financing has increased. In the past, the cost of financing stood at a monthly interest rate of 3%; this has almost doubled to reach 7–8% at present.

The branch has a deposit of about RMB 8 billion, including a deposit of RMB 4 billion generated by bankers’ acceptance bills, which is the outcome of credit expansion. The central bank does not dare to cut deposits, since that would force all joint-stock banks to close down.

The behavioral inclination of banks indicates that to mitigate risk, it is important to determine whether a loan and how big an amount of loan should be granted to an enterprise, given its asset scale. The need to pay attention to the details of loan risks of small and new enterprises is a learning acquired by banks after many years of practice. As a result, we cannot level allegations at banks with regard to their behav-
iors, which are actually their rational choices; further, we cannot question their optimum behavioral mode that is driven by the probability for maximum return and minimum risk.

The asset scale of large enterprises is the most significant indicator for risk mortgage, while small enterprises do not have any such significant indicator. When a bank does not have an incentive or capability to gather adequate, reliable information, it can only determine the feasibility of loans according to the significant external characteristics of enterprises.

However, if the bank is able to acquire transparent information pertaining to an enterprise, then reasonable and reliable decisions can be made on the basis of the collected information. In such a case, the bank does not always have to rely on the enterprise’s assets in order to make its decision; instead, it has to base its judgment on the enterprise’s development potential. In general, community or township financial institutions often find it easy to gather and understand adequate information related to an enterprise within a small local scope. In the same vein, regional and municipal banks are familiar with local enterprises, and large national banks often need to procure adequate information about large enterprises through broader relation networks and human investments. This is because the trading activities of the latter are conducted across the country.

Therefore, the scale or scope of a bank is usually a match for the scale or scope of an enterprise; it is only in this manner that the bank can have complete knowledge about the enterprise, and thus make well-founded decisions on financing. According to a statement by Z Bank, “the bank focuses on the middle part of it, that is, insupportable for large ones, but unbearable for small ones.” This statement clearly conveys the need for a match between the bank and the enterprise; in other words, it is too expensive for a large bank to deal with a small enterprise, while a small bank cannot meet the demands of a large enterprise.

In brief, the zone of influence of a bank is demarcated to a certain extent; this zone is closely associated with the bank’s capital scale that has been built in the past. Since joint-stock banks have short histories and limited service networks, their capital scales are far smaller than those of the four major state-owned banks. Clearly, the former are constrained in the loan business; that is, they cannot provide adequate financing services for super-sized enterprises, and can only do marginal business with such large enterprises.

As a result, joint-stock banks mainly focus their services on large local enterprises, most of which are private enterprises in Zhejiang with sustained periods of development. On the whole, the financing scale of these enterprises matches with the capital scale of these banks, owing to which the banks can largely meet the enterprises’ financing demands. However, for a large number of small, new, and emerging enterprises, the current bank services do not come close to meeting demands, leading to lacunae in financing.

4. Summary

Typically, private enterprises find it hard to procure bank funds for long-term investments, and they make investments mainly by relying on the approach of “making long-term investments by short-term loans,” their own funds, accumulated profit, family self-financing. Further, they solve the problem of short-term financing by mainly relying on real estate, mortgages of other assets, and trade credits. As a result, this financing behavior of private enterprises does not bring financial risks to the macro economy; all risks are taken by private enterprises themselves. In this sense, an important factor for the high growth of Chinese economy hinges on the accumulated profit of private en-
enterprises, which is derived from the substantial social value created by private enterprises.

The behaviors of banks that are directed at the minimization of their own risks will undoubtedly be helpful for minimizing macroeconomic risk as far as private enterprises are concerned; However, they may also lead to excessive conservatism, which is a negative effect. In other words, excessive constraints over the growth potential of private enterprises will inhibit their scope for development. Such bank behaviors are rooted in banks’ strong market positions and in bank-enterprise relationships. The strong positions of banks with regard to SMEs enable the former to easily transfer all risks to the enterprises. This makes bank-enterprise relationships asymmetrical and skewed in favor of the banks, wherein enterprises are faced with too many constraints and risks, while banks are hardly subject to any constraints or risks.

The first cause of such an imbalance is the markedly inadequate bank financing services. In the backdrop of an undersupplied financing market, banks will naturally enjoy strong positions. A typical example of this status quo is the statement made by a bank wherein that it expressed its unwillingness to deal with small enterprises because it was understaffed. In the case of limited availability of banking services, banks naturally give priority to low-risk, low-cost corporate business, and are not inclined to open up to new corporate business, invest efforts to collate corporate information, or make efforts and assume risks to explore new markets.

Given the variables involved, it is natural to view such bank behavior in a light wherein it only “adds the icing to the cake” but does not “do yeoman service.” It is also understandable that we accuse banks of kowtowing to large enterprises, while ignoring small enterprises. The root cause of this lies in the regulated financial system of China and in the governmental monopoly on the financial market. The deregulation of the market economy and the widespread emergence of SMEs propel the Chinese economy and also lay the groundwork at the grassroots level for the development of the Chinese market economy. Although the product market is deregulated, the financial market has been always subject to strict governmental control and monopoly. The deregulation effected in the financial has been marginal as compared to the product market, and thus has led to the undersupply of financial services and a lack of grassroots financial services. Owing to these factors, numerous small and new enterprises have found it difficult to survive and develop. This, in turn, has made it difficult to create a broader middle class in society and opportunities for potential entrepreneurs to utilize human resources and eliminate poverty. Therefore, it is imperative for a large number of private financial institutions to bridge this gap, without which the market economy will be lopsided in favor of a limited section of society.

V. Conclusion and Policy Implications

With respect to the ownership structure, enterprises with a diversified ownership structure under private control seem to have certain advantages over pure private single-investor or family enterprises. The former are able to effectively mobilize various social resources by appropriately allocating property rights; these enterprises essay their respective roles suitably and achieve the optimal effect of allocation. However, from a developmental viewpoint, under private control, such an ownership structure will not produce a very different effect. Grassroots private enterprises have become aware of their own weaknesses and are endeav-
oring to raise the second generation of entrepreneurs, make human capital investments at all costs, and remedy the inherent defects of the first generation of entrepreneurs. As a result, it could be expected that the second generation of entrepreneurs will not only possess new knowledge, technologies, and management philosophies but also have a broader international vision than that of their predecessors. Therefore, the new generation can be expected to utilize social resources in a better manner.

In terms of the operating behavior of private enterprises, traditional private and family enterprises have made rapid strides by relying on market demands in an economy plagued by the shortage of material. In the competitive arena populated by multiple private enterprises, only those enterprises that rely on their own unique technical know-how and are good at establishing sound management standards in long-term production can be successful in the market. However, to unearth newer market opportunities, private enterprises actively import advanced foreign technologies and equipment and make efforts to assimilate and industrialize new technologies. These new technology-driven behaviors belong to a higher level than the demand-driven behaviors of traditional private enterprises. If demand-driven market behaviors of grassroots private enterprises are said to be the behavioral characteristics of private enterprises at the first stage, then the follow-up type of behaviors, that is, assimilating foreign new technologies and industrializing them, will belong to the behavioral characteristics of private enterprises at the second stage. At this development stage, private enterprises have strong demands for foreign or external new technologies. At present, most private Chinese enterprises are at the first or second stage and have not yet reached a higher stage wherein they can lay claim to their own intellectual property rights and possess advanced core technologies at an international level.

With respect to the relationship between private enterprises and foreign capital, most demands of private enterprises for foreign capital pertain to funds and technologies, while SOEs have additional demands for foreign management and systems. As a result, private enterprises have fewer demands for foreign capital than do SOEs. In Zhejiang, private enterprises possess strong market competitiveness, while the competitive advantage of foreign enterprises is not as strong, which considerably reduces their incentives to enter the Zhejiang market. On the one hand, the competitive advantages of foreign enterprises are reflected through new technologies, new products, and superior governance and management. On the other hand, in relation to the international market, foreign enterprises still enjoy the advantages of cheap labor and abundant human capital sources while carrying out production in China. However, with the continual rise in labor costs, only the advantage of new technologies continues to be a sustainable competitive edge of foreign enterprises.

With respect to the business environment for market financing, after over 20 years of development, trade credits have gradually begun to develop in the market. In Zhejiang, there are a few cases of arrears and debt evasion. Trade credits have emerged as an important financing mode for numerous private enterprises, and to a large extent, these enterprises need to meet part of their financing demands by relying on credit relations established between them. However, given the fact that the financing market is not deregulated and the government has excessive control, the bank-enterprise relationship is skewed and asymmetrical. In most cases, this asymmetry is reflected the banks' power to select enterprises, while the enterprises are often passive and seldom have the opportunity to select banks, especially in the case of
private enterprises. As a result, the smaller is the scale of an enterprise, the more difficult it will be for the enterprise to obtain a bank loan and the higher the financing cost it has to bear. In contrast, a large enterprise or a state-owned enterprise will find it easy to procure a bank loan at the lowest financing cost. The banks decide on the credit line largely by the scale of an enterprise and not by the potential for development or profitability of an enterprise. This indubitably results in the unreasonable allocation of financial resources and restricts the opportunities for development for enterprises.

The government plays a decisive role in determining the course of private enterprises during the early startup period when the enterprises urgently need the active support of the government as well as at the development and expansion stage when the enterprises need the approval of the government on financing expansion. As we have seen in the two districts of Ningbo, the able governance of local governments produces a favorable market environment; encourages the establishment, growth, and expansion of multiple enterprises; propels the growth of the local economy; and improves the employment and welfare level of the local people. However, local governments have a limited say in a financial market under centralized control, because although they can allow private enterprises a relaxed market environment in order to ensure fair competition, they cannot change the asymmetric nature of bank-enterprise relationships or guarantee that the growth of private enterprises is not subject to the constraint of financing bottlenecks.

Thus, it could be seen that in Zhejiang, the obstacles to the development of private enterprises are limited external resources, which can be mainly regarded as financing constraints, and the limited capabilities of enterprises, which is indicated by the fact that the enterprises are in urgent need of technological upgrade, and new external technological sources, and resultant industrialization. However, the two major elements required to drive an enterprise toward technological upgrade are qualified human resources and funds. An enterprise will find it difficult to make a forward leap in a short term if these two problems are not overcome. The development of talents is often a time-consuming process, while the problem of fund constraints can be resolved by the deregulation and development of the financing market, which is also a process. As a result, establishing private enterprises as the key driving force for Chinese economic development requires solving these two key problems of constraint. This forms the crux of any strategy for future development that policymakers can formulate.