

# Entrepreneurship in Hong Kong: A Model for the World and Questions for Tomorrow

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## Introduction

Joseph Schumpeter defined an *entrepreneur* as a person involved in a method of development using “new combinations.” He suggested that entrepreneurial development could occur in five cases:

- 1) the introduction of a new good...
- 2) the introduction of a new method of production...
- 3) the opening of a new market...
- 4) the conquest of a new source of supply of raw materials or half-manufactured goods...
- 5) the carrying out of the new organization of any industry. (Schumpeter, p. 51)

Entrepreneurs have played an important role in economic development since the beginning of organized trade. They have introduced new ideas, new technologies, and have improved the efficiency of markets. However, the success of entrepreneurs within a given civilization depends heavily upon the obstacles they face. New enterprises, often fragile at birth, require a set of policies and societal attitudes that will allow them to flourish. Often entrepreneurial activity thrives in countries with low tax rates, strong copyright and contract laws, government-encouraged free trade, and low capital costs.

Hong Kong, once a British colony and now a thriving “Special Administrative Region” (SAR) of the People’s Republic of China (PRC), has been a hotbed of entrepreneurial energy for many years. Capitalists flock to the Hong Kong SAR from all parts of the globe in the same way that high-rollers head for Las Vegas. Hong Kong has been perceived as an entrepreneurial land of opportunity for many reasons. It has a

political climate that protects and nurtures business and innovation. This includes well-designed laws, tax schemes, law enforcement, trade policy, government investment, and many other factors described later in this article. Hong Kong has two distinct business models for entrepreneurs, making capital available to almost anyone with a good business plan. First, there is the “family model” in which Hong Kongers seek family investment to create a small- or medium-size business. Small and medium-sized enterprises<sup>1</sup> represent 98 percent of all registered companies. (Feir) The second is the “institutional model” in which venture capitalists or corporations in search of their own niche bring money from external investors to Hong Kong. Finally, there exists a unique business culture in Hong Kong. The perceived level of opportunity is high, even by American standards, as is the willingness of people to take risks.

It is these ingredients that have caused Hong Kong to be described as an “entrepreneurial city in action.” (Jessop and Sum, p. 2297) However, the return of Hong Kong to China in 1997 created much uncertainty in the business community. Many investors, cringing at the thought of a communist totalitarian government takeover, packed their bags and left Hong Kong. However, many insiders would still currently characterize the business climate as unchanged, stable, and thriving. While there have been occasional minor disputes between Hong Kong and Beijing, the People’s Republic of China has by most accounts kept its promise to Great Britain and investors worldwide. That is, the PRC has allowed the rule of law, an independent judicial system, and free trade to continue in the Hong Kong Special Administrative Region (HKSAR) through the doctrine of “One Country, Two Systems.” At the same time, it is evident that there must

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<sup>1</sup> Small- and medium-sized enterprises (SMEs) are defined as manufacturing enterprises with fewer than 100 employees and other enterprises with fewer than 50 employees. (SME Business Centre)

be changes in the immediate future. In the coming months and years, the people of the HKSAR will be handed more political power than they have ever had in the past. Changes in Legislative Council (LegCo) representation will reduce the influence of business leaders and empower the average citizen. If the business climate is to be maintained, it will need to be done consciously by the general population. One cannot help but wonder if the new *democratic Hong Kong* will look the same as it did during its colonial days. Throughout history, the empowerment of a people has brought with it new demands: minimum wage laws, worker protection, subsidized medical coverage, various welfare programs, government subsidized loans, and high tax rates on the relatively rich and on corporate profits. Even though the people of Hong Kong consciously enjoy the benefits of a thriving business climate, the new balance of power may make it difficult to prevent various political factions from demanding and receiving a new basket of goods and services from the Hong Kong government that could potentially dampen the entrepreneurial spirit.

### **Hong Kong's Entrepreneurial Models**

One of the key ingredients of successful entrepreneurial enterprises is, of course, availability of capital. Without monetary support for a “new combination,” an entrepreneur can never get his idea off the ground. Mark Blaug writes that “financial intermediaries are reluctant to lend to an entrepreneur precisely because the entrepreneur’s assessment of a situation necessarily differs from everybody else’s assessment.” (Blaug, p. 85) Entrepreneurs in Hong Kong have traditionally overcome this obstacle with ease. As mentioned previously, within the economy there are two primary

entrepreneurial business models that have allowed a large number of people with different backgrounds to access appropriate amounts of capital.

The most popular route to business formation in Hong Kong is through the “family model.” The “family model” is defined by the source of investment funds. In these businesses, that produce roughly 63 percent of Hong Kong’s GDP, financing is provided to the entrepreneur by family members and by local banking sources. (Feir) This pool of funds is the direct result of the extremely high savings rate in Hong Kong. (Thomas, 2001) In these situations, an entrepreneur would bring a plan to his family to seek support. It is not uncommon for family members to become heavily involved with the new enterprise in terms of labor and supervision. These enterprises generally take the form of retail stores, restaurants, small-scale manufacturing, and other small businesses. The people of Hong Kong are known for their pragmatism and their belief in the existence of opportunity. Their investment in family enterprises is inherently cultural.

The “institutional” entrepreneurship model is defined by the need to involve foreign investment funds in Hong Kong enterprises. These enterprises are often large, expensive, and involved with large-scale manufacturing, business services, importing, exporting, or technology. Funds are sought through capital markets, from large multinational corporations, and from venture capitalists. However, it must be noted that this type of financing is only available to a select few. In 2000, Hong Kong was the recipient of US\$64.4 billion in inward direct investment. (Hong Kong Trade Development Council) By comparison, in 1999 Germany received US\$52.23 billion, Ireland US\$19.09 billion, and Thailand US\$6.21 billion.

## Status of the Hong Kong Business Environment

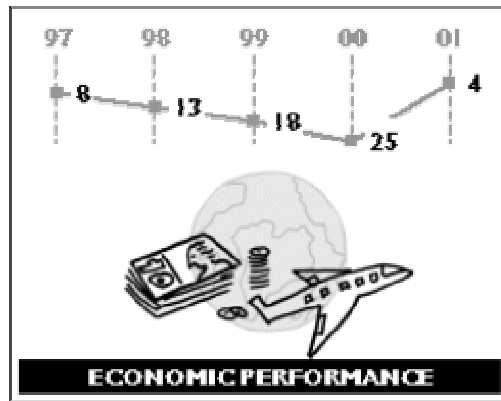
Hong Kong's business environment continues to be its number one asset in attracting investment and promoting entrepreneurial activity. The HKSAR's success in this area is based mainly upon a strong ideological and structural commitment to economic freedom, progress, and the rule of law. The Heritage Foundation and the *Wall Street Journal* have ranked Hong Kong as the world's freest economy for eight consecutive years in their annual "Index of Economic Freedom" (Olivastro), while the Fraser Institute has continually given Hong Kong the globe's highest economic freedom ranking since 1970. (Gwartney and Lawson, p. 172) According to Switzerland's Institute for Management Development, the HKSAR is ranked fourth worldwide for both "economic performance" and "government efficiency," and based upon survey data is the single best place on earth to be an entrepreneur, be taxed as a person, or be taxed as a corporation. (*World Competitiveness Yearbook 2001*, pp. 108-113)<sup>2</sup> Figure 1 shows a dramatic increase in Hong Kong's "economic performance" in the year 2001. This is attributed to its high level of exports (124 percent of GDP) and its trade-to-GDP ratio which is the second highest among all countries. The trade-to-GDP ratio is calculated by adding imports and exports and dividing by the product of GDP times two. Hong Kong has a trade-to-GDP ratio of 130.64 while the international average is 44.97. (*WCY 2001*, pp. 108-13) Figure 2 illustrates Hong Kong's comparatively low tax rates. Hong Kong is second worldwide for the creation of new firms. (*WCY 2001*, pp. 108-13) Hong

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<sup>2</sup> The International Institute for Management Development (IMD) located in Lausanne, Switzerland, publishes annually its *World Competitiveness Yearbook (WCY)*. In the yearbook, the IMD team analyzes 286 variables in 49 economies to determine which governments act to promote business activity. Their methodology includes thorough analysis of hard statistical data and responses to a survey of over 3,500 experts in the business world.

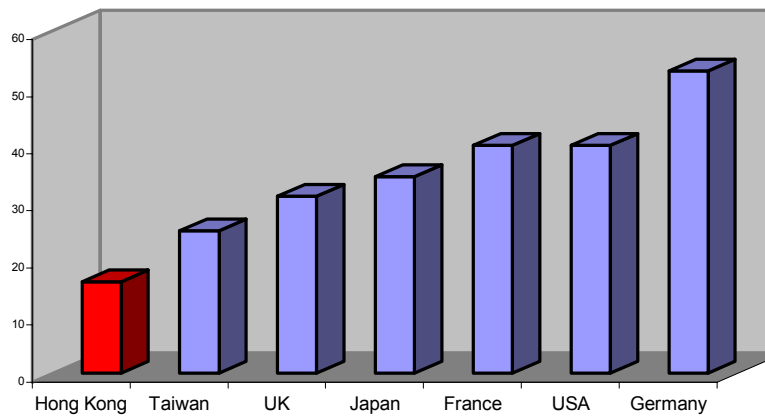
Kong's success in this area stems directly from the business environment that was created under British rule and that is now cherished by many native Hong Kongers.

**Figure 1**  
**Hong Kong's Economic Performance (1997 - 2001) in**  
**Comparison to 49 Major World Economies.**



Source: *WCY 2001*, p. 109

**Figure 2**  
**Average Corporate Tax Rate Percentage on Profit**



Source: Data from *WCY 2001*, p. 408

Hong Kong's constitution, the Basic Law, went into effect on July 1, 1997, promising its residents and the global business world that the rule of law originally

established by the British would continue for at least 50 more years. The existence of the rule of law is based upon the presence of several conditions, but mainly the existence of “pre-existing legal norms,” (Shapiro, p. 1) the equal enforcement of laws, and dispute resolution by independent mediators who are not corrupt. These conditions are incorporated into the Anglo-American common-law tradition that was essentially left in Hong Kong as a gift to provide for its future. The rule of law provides for Hong Kong a stable platform upon which society can function since it results in the enforceability of contracts, efficiency of trade, protection of ideas, and overall fairness within society. Without these attributes, the viability of the Hong Kong business environment would be uncertain, especially in the eyes of foreign investors. Such uncertainty would cause a systemic flight of capital to other markets, perhaps those with higher profit potential. For example, many foreign corporations select Hong Kong as their Asian “hub” despite higher wage rates. It is in Hong Kong that they conduct and organize most of their business for the region, because they know that in Hong Kong their contracts will be enforced, their copyrights will be protected, and their businesses will be free from the inefficiency, uncertainty, and risk resulting from the corruption observed in governments throughout many Asian cities. Hong Kong’s Independent Commission Against Corruption (ICAC) is world-renowned for its success in creating a “level business playing field.” (Liaw)

In addition to maintaining the common law system, the Hong Kong government has taken action (or in some cases, no action) in order to create and preserve an ideal business climate. According to Bob Jessop and Ngai-Ling Sum:

The Hong Kong government, with its commercial and industrial bases of support, continued with the so-called positive non-intervention strategy to

enhance Hong Kong's core commercial competitive advantages. This is reflected in increased emphasis on the provision of the physical, organizational and informational infrastructure for a developing gateway role; a continuing commitment to low and simple taxation, regulation of finance and commerce; and the maintenance of Hong Kong's free port and free trade status. (Jessop and Sum, p. 2297)

The Hong Kong dollar, monetary policy, and financial regulations are also integral to the stable environment and the nurturing of entrepreneurship. The Hong Kong Monetary Authority regulates Hong Kong's financial institutions and policies. The actions of the Authority, which is often described as a *currency board*, are tied to the monetary policy in the United States.<sup>3</sup> The Hong Kong dollar is pegged to the US dollar at the rate of 7.8 to 1.0, and the HK Monetary Authority is required to maintain high levels of US dollar assets to support this peg. (Thomas, 2001) Hong Kong banks hold an enormous volume of assets, measured at 262 percent of GDP compared to 87 percent of GDP in the United States. (*WCY 2001*, p. 460) In addition, Hong Kong banks, for reasons of both law and prudence, maintain an amount of liquid assets to equal to a minimum of 25 percent of qualifying liabilities. (Thomas, 2002, p. 6) In the U.S., the Federal Reserve requires banks to have only a 10 percent reserve requirement on transaction deposits. (Federal Reserve Bank of New York) The idea that the Hong Kong currency can be considered "unbreakable" (Thomas, 2001) from the US dollar greatly reduces the risk that foreign investors take when entering the Hong Kong market. Currency value fluctuations can often have considerable effects on the return on investment. The Hong Kong U.S. financial linkage has allowed Hong Kong to eliminate much of this risk.

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<sup>3</sup> A currency board is a governmental banking apparatus that typically exists in the absence of a central bank. A currency board issues its own currency that is anchored to a foreign currency. In most cases, currency boards have far less discretionary power than central banks. See "Hong Kong's Economic Future: Is a Currency Board the Answer?" by Casey Hanson in this volume.

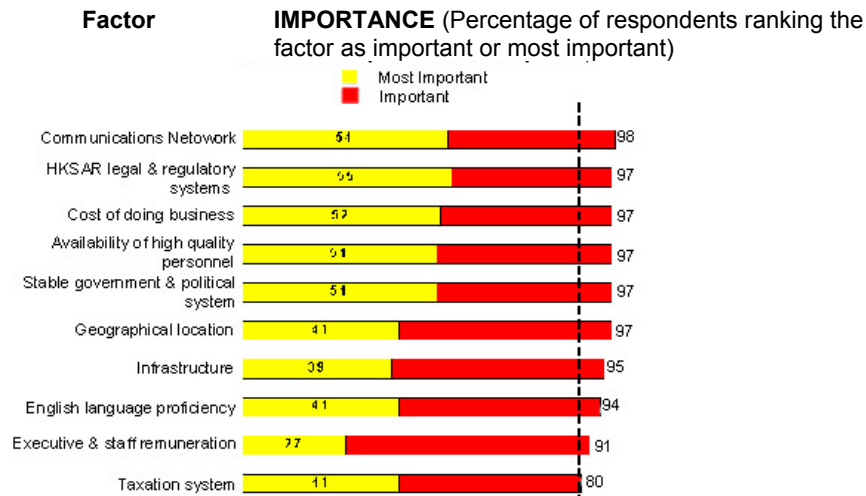
The quality of Hong Kong's human resource pool has also contributed significantly to the quality of its business environment. As a service-centered hub for Asia, many multinational corporations and entrepreneurs seek employees who are well educated, English-speaking, and prepared to work hard. In many ways, the Hong Kong government attempts to be "facilitative" (Yu, p. 906) by developing programs that assist entrepreneurs in starting their new enterprises quickly and at low costs. Current government programs exist in areas such as infrastructure, finance, technology, science, and marketing. The most significant, however, may be the public housing program that supports more than half the population, permitting employees to "work long hours without putting too much pressure on their employers, most of them with little margin to afford salary increases." (Yu, p. 906) By using complementary policies, the Hong Kong government utilizes its resources to continually attract a wide variety of entrepreneurs and investors.

Figure 3 contains the results of a survey by the American Chamber of Commerce in Hong Kong (AmCham) that asked 352 HKSAR executives to rank the importance of various attributes of the Hong Kong economy. The figure depicts which factors are the most important to their companies' "continued investment or presence in Hong Kong." As is clear from the Figure, the "availability of high quality personnel" was ranked as the fourth most important reason. (AmCham)

Hong Kong's other major business environmental advantage is its proximity to China. As stated previously, Hong Kong is like a diamond in the rough: a stable legal and monetary oasis nestled among the unknown and risky economic jungles

Figure 3

### Ten Most Important Factors Affecting Companies' Continued Investment or Presence in Hong Kong



Source: American Chamber of Commerce in Hong Kong, “2001 Business Outlook Survey”

of Asia. The fact that Hong Kong is within a 5-hour plane ride of half of the world’s population (Feir) makes it an even more attractive land of opportunity. With its population of over one billion people and its emergence into the global marketplace, China remains an untapped ocean of potential economic energy. Over the next decade, capitalists will maneuver to be in the right place when the profit floodgates open. But in order to take advantage of the Chinese marketplace, entrepreneurs will require a stable place to conduct business. They will continue to select Hong Kong as this place.

### Hong Kong Business Culture

The Hong Kong business culture plays an important role in promoting entrepreneurship. The following factors help in understanding the mindset of the Hong Kong population. Hong Kongers can be characterized as possessing: (1) strong

aspirations and ambitions for wealth, (2) a strong perception of equal opportunity, (3) Chinese values and work ethic, (4) a willingness to adapt, and (5) societal pragmatism. Hong Kongers are a special group of people. They believe strongly that hard work coupled with a good idea can lead to a successful enterprise. The continued success of others leads to the societal feeling that almost anyone can be an entrepreneur. The availability of capital from local banking sources and family members only adds to this sentiment. According to Yu, Hong Kongers have handled volatile economic conditions

by being alert to business opportunities, making quick decisions, acting promptly, and maintaining a high degree of flexibility and adaptability. They have preferred family businesses and made informal or oral agreements based on trust. They have taken shortcuts to produce some non-capital-intensive and not too sophisticated commodities, with short gestation periods. Their survival has relied largely on adaptive entrepreneurship manifested in the form of small-scale enterprise, subcontracting, product imitation and spatial arbitrage. (Yu, p. 889)

A significant component of the business culture is the work ethic exhibited by the Hong Kong Chinese. In general, Hong Kongers will work harder, longer, and will be more productive in order to get ahead. The average member of the Hong Kong work force works 2,181 hours per year, the fourth highest level in the world. (*WCY 2001*, p. 452) According to Stevan Harrell of the University of Washington, employers are said to enjoy the “stability and industriousness of the labor force.” (Harrell, p. 207) As Harrell states further, “When [Hong Kong] workers [are] given the choice of a shorter day or more work for more money, [they] inevitably choose the longer day and the extra pay.” (p. 207) Barbara Ward, in her study of a small glass manufacturing enterprise, writes that “beliefs about the value of education, the virtue of hard work, and the self-evident goal of economic self betterment, [are] shared by workers and management alike.” (Ward, p. 384) This strong work ethic is important to the entrepreneurial culture for two reasons.

First, the Hong Kong people are attractive to employers. Foreign businesses know they can set up shop in the HKSAR and find the right group of people to work for them.

Second, the Hong Kong people are their own entrepreneurial driving force, creating scores of new small- and medium-sized businesses each year. All this is done, as Harrell states, “for economic betterment of oneself or, more accurately, one’s family.” (p. 207)

While this culture is special, it is not unique. In many ways it is like the American entrepreneurial climate. This is especially evident in the drive for material wealth. The “American dream” for economic freedom and material accumulation has always played an important role in U.S. society. Hong Kong entrepreneurs are said to pursue a similar goal of independent wealth. As Harrell writes, “In the same way that the culture as a whole values hard work in and of itself, the culture as a whole also values the opportunity for material accumulation and, thus, both the work ethic and the economic man tell us something about the motivations behind Chinese industriousness.” (p. 215)

The final key component of the Hong Kong business culture is the strong sense of societal pragmatism. Hong Kong entrepreneurs continue to be successful because they think, plan, and act in a logical fashion. They do what is necessary to run a profitable enterprise, even when this involves abandoning traditional values such as restrictive gender roles for women. Whether it is modifying their marketing practice, hiring new people, or entering a new sector of the economy, these entrepreneurs are willing to act quickly and take risks that may not be customary in other parts of the world. This further adds to the entrepreneurial culture and atmosphere.

## **The Future of Hong Kong Entrepreneurship**

While Hong Kong has been a flourishing environment for entrepreneurship in the past, there are many doubts concerning its future. It is clear that the HKSAR's success is heavily dependent upon the business environment, specifically the tax structure and business-oriented government intervention. Since its beginnings under British rule, Hong Kong has never been a democratic society. Traditionally governed by the colonial system, the Hong Kong people have yet to experience real autonomy. When the first term of the LegCo began in 1998, only one-third of the representatives were actually elected by typical geographical constituencies. This number is scheduled to increase until 2008 when one-half of LegCo representatives will be elected by universal suffrage. The remaining half will be elected by functional constituencies (e.g., manufacturers, organized labor, professional organizations). According to the HKSAR government, "The Basic Law also provides that the ultimate aim is the election of all the members of the Legislative Council by universal suffrage." ("Hong Kong: The Facts")

One question that arises immediately is what type of policies will a newly democratic government undertake. Business interests have always dominated Hong Kong politics. Democratic regimes are known to behave quite differently than those controlled by a small group of men with strong business ties. Throughout history, the empowerment of a population has greatly affected the structures and outcomes produced by their governments. This was clearly evident with the "New Deal" in the U.S. when the working population interests gained control over the federal government, and with countless welfare state policy initiatives in Western Europe. In 1999 the Hong Kong SAR public sector expenditures were only 18 percent of GDP. According to the *World*

*Competitiveness Yearbook 2001*, the world average government expenditure was 39 percent of GDP. (*WCY 2001*, p. 405) Once handed political power for the first time, the people of Hong Kong will be faced with new choices. Should they protect the business environment, or should they increase the role of the public sector in providing services like stronger education, welfare, unemployment protection, and environmental policy? These four areas are mentioned because they are areas in which the HKSAR ranks poorly in comparison to other developed countries. (*WCY 2001*, pp. 108-13) Certainly there will be interest groups asking for these types of programs.

These new empowerment issues must be examined with Hong Kong's unique tax system. At present, more than 52 percent of the HKSAR working population of roughly 3.5 million pay no income tax at all. (Woodward, Masterson, and Dodwell) Hong Kong's 100,000 wealthiest taxpayers produce 62.5 percent of the government's income tax revenue. (Houng-Lee) According to Hong Kong business insiders, this increased "representation without taxation" is dangerous for the business atmosphere. (Woodward, Masterson, and Dodwell) Since the general population of the HKSAR is now empowered, non-taxpaying citizens can demand services from their government that others are forced to pay for. As suffrage is gradually expanded, it will become increasingly difficult for the government to say "no" in a society where government money finances 98 percent of schools, 70 percent of hospitals, and 53 percent of housing. (Woodward, Masterson, and Dodwell)

Nevertheless, many foreign investors remain optimistic. According to the American Chamber of Commerce "2001 Business Outlook Survey," member companies remain very satisfied with many aspects of the Hong Kong business environment.

Survey data show that 78 percent of these companies foresee a "good" or "satisfactory" outlook for the year 2003, and 93 percent have this same outlook for 2004. (AmCham) Nearly half of the member companies are planning expansion over the next three years, while only a small number (10 percent) have business reduction plans during this short economic downturn. The current status of the taxation system remains crucial. From Figure 3 it is clear that 89 percent of companies place the issue among the ten most important factors affecting investment or presence in the region. (AmCham)

The implications of this changing business climate are somewhat unclear. Over the past several decades, Hong Kong has developed into a thriving commercial city. Alterations to the governmental structure have the potential to change nothing or change everything. In reality, it will be up to the Hong Kong people to ensure that their appetite for government services does not crush one of the world's premier business environments.

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