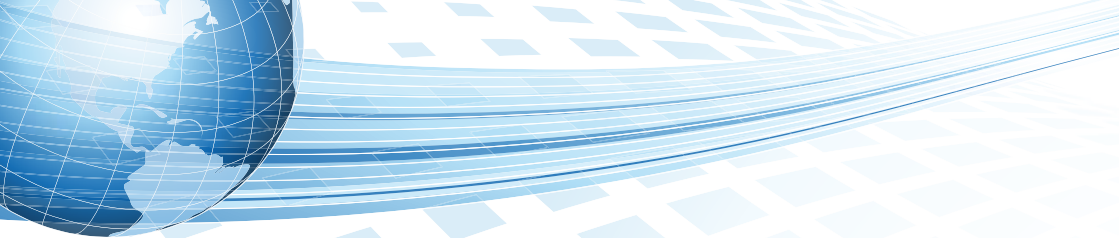


Global Entrepreneurship Monitor Hong Kong 2007

GEM

Hong Kong Team Members

Hugh Thomas
Kevin Au
Louis Leung
Bernard Suen
Sandy Yip
Rosanna Lo



1. INTRODUCTION

This report investigates the current status of entrepreneurship in Hong Kong and compares it with our recent past and with other countries in the world who participate in the Global Entrepreneurship Monitor (GEM). GEM is a not-for-profit research consortium led by Babson College, USA and London Business School, UK, which was started in 1999 to make high quality international research data on entrepreneurial activity readily available to as wide an audience as possible. Today, with over 200 scholars in 42 economies, GEM produces the largest study of entrepreneurial activity in the world (see Appendix 1: The GEM Consortium).

Each team of scholars from each economy conducts its own investigation of domestic entrepreneurship basing its investigation on a single consistent framework. This allows the construction of a unique database. In each year that GEM is conducted, scholars can compare entrepreneurship between economies. And because GEM keeps the methodologies consistent from year to year, GEM builds up a time series panel data set.

The GEM 2007 Executive Report summarizing this worldwide data-gathering and research activity was published on 18 January, 2008 by London School of Business and Babson College. Working with both the harmonized GEM international data set and with economy-specific data, each team in the 42 economies also writes a country summary and more lengthy reports outlining the findings specific to its economy and the policy implications of its research. The Executive Report, country summaries and some fuller country studies can be found on the website www.gemconsortium.org.

The Chinese University of Hong Kong Center for Entrepreneurship joined GEM in 2002 and undertook three previous GEM Hong Kong reports, in *GEM Hong Kong 2002*, *GEM Hong Kong and Shenzhen 2003* and *GEM Hong Kong and Shenzhen 2004*. Using data from those studies and comparable data from 46 countries we also concluded a study in 2006 concerning innovation policy and high growth start-ups. This report is our fifth GEM Hong Kong report and forms a part of the GEM 2007 research project.¹



¹ The four studies undertaken were David Ahlstrom, Kevin Au, Bee-Leng Chua, Cheung-Kwok Law, and Chee-Keong Low, Shige Makino and Hugh Thomas. *Global Entrepreneurship Monitor Hong Kong 2002* (GEM HK 2002);

David Ahlstrom, Kevin Au, Bee-Leng Chua, Siu-Tong Kwok, Cheung-Kwok Law, Chee-Keong Low, Shige Makino, Hugh Thomas, Dong Xiaoyuan, Le Zheng, Pan Xiaofei, Wang Wei, Yang Lixun and Yin Qingxun. *Global Entrepreneurship Monitor Hong Kong & Shenzhen 2003* (GEM HK&SZ 2003);

David Ahlstrom, Kevin Au, Bee-Leng Chua, Siu-Tong Kwok, Chee-Keong Low, Shige Makino and Hugh Thomas. *Global Entrepreneurship Monitor Hong Kong & Shenzhen 2004* (GEM HK&SZ 2004);

Kevin Au, Erik Baark, Bee-Leng Chua and Hugh Thomas. *Innovation Policy and High Growth Startup (2006) Research Report*, The Chinese University of Hong Kong Center for Entrepreneurship.

GEM Hong Kong reports are available on the website of The Chinese University of Hong Kong Center for Entrepreneurship at <http://www.baf.cuhk.edu.hk/research/gem/new/EN/research/gem.asp>

2. CONCEPTUAL MODEL

Entrepreneurship is an attitude that predisposes a person to action. Entrepreneurs ceaselessly search for potential value creation and organize businesses to create value. Entrepreneurship is important both in new and existing enterprises, and is part of value creation both for profit and for increasing social welfare. Because of its importance to economic growth and social development, we believe that entrepreneurship should be studied and promoted.

FIGURE 1: CONCEPTUAL MODEL

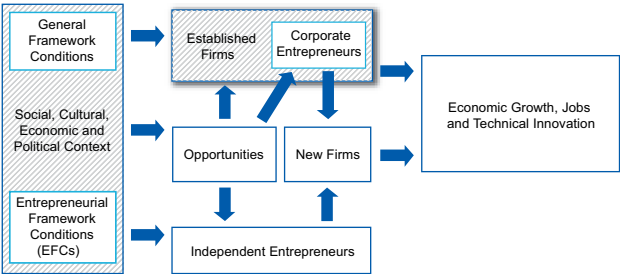


Figure 1 illustrates the importance of entrepreneurship in the economy. Established firms make up the bulk of economic output but their share of old products, processes and services declines over time. Although established firms also deliver new products and services, increase the efficiency of delivering existing services and found new firms, we believe that completely new firms have a larger role in promoting growth.² Because this activity is disbursed and unreported, however, it is hard to measure. GEM measures early-stage entrepreneurial activity – the bottom half of Figure 1 – in cross-national data that enables detailed study of the “Independent Entrepreneurs” of the conceptual framework.

² See *Innovation Policy and High Growth Startup*. (2006) Research Report, Chinese University of Hong Kong Centre for Entrepreneurship.

Rather than relying on firm level data aggregated by government agencies, GEM focuses on the entrepreneur and views his or her start-up activities as comprising different phases; from the very early phase when the entrepreneur is just thinking of starting a business, through birth and development. Although our focus is on start-ups, we research the prevalence of and reasons for enterprise exit – the entrepreneur quitting the firm by sale, liquidation, or other means. And because finance is crucial to a start-up but is largely unavailable from formal financial institutions, we also poll informal investors.

FIGURE 2: THE ENTREPRENEURIAL PROCESS AND GEM OPERATIONAL DEFINITIONS

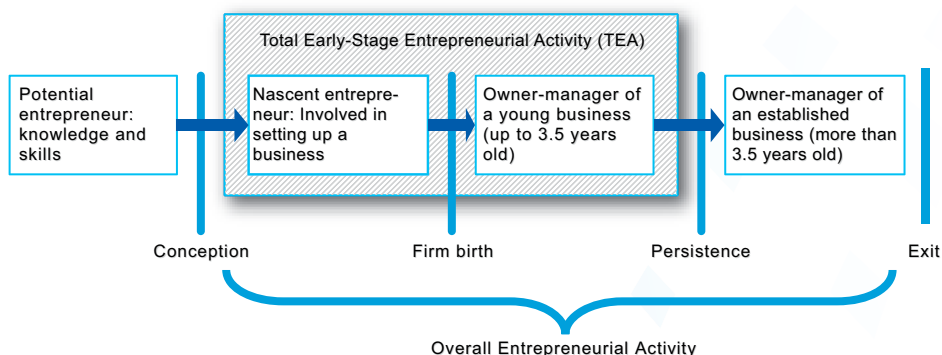



Figure 2 shows how GEM divides entrepreneurship into several phases. Notwithstanding the importance of corporate entrepreneurship³ (the upper channels in Figure 1) GEM defines entrepreneurship as occurring only when the entrepreneur has an ownership interest in a new enterprise. We focus on early-stage entrepreneurship activity – the shaded portion of Figure 2 – after conception and birth. Thinking about the start-up prior to committing resources is not part of our definition. But once the entrepreneurs tries to start a business, for example by writing a plan, looking for or purchasing equipment, putting together a team, registering a company, paying wages, conception has occurred. Birth occurs after conception. GEM defines birth as the new company having paid a salary, either to the entrepreneur or to employees, for at least three consecutive months. So in our definition, a **nascent entrepreneur** is an individual who currently owns and manages a new business that has committed resources but has paid wages, profits or payments in kind for less than three months. A **new business owner** is an individual who currently owns and manages a business that has paid wages, profits or payments in kind for more than three months but not more than 42 months. Together, these individuals are **early-stage entrepreneurs**.

³ For a discussion of corporate entrepreneurship in Hong Kong. See *GEM HK&SZ (2004)* Part I, V, and Appendices IV and V.



GEM chose 3.5 years, or 42 months as the cutoff between **early-stage entrepreneurs** and established businesses because, on one hand, we wanted a period of time sufficiently short to convey the dynamism of start-up activity versus a tradition of established owner-managers. On the other hand, the window of early-stage entrepreneurial activity had to be long enough to provide a meaningful number of early-stage entrepreneurs in a typical sample of 2,000 respondents.⁴

In past studies, we highlighted the **total entrepreneurial activity (TEA)** index. The TEA index is the proportion of Early-State Entrepreneurs as a percentage of the population aged 18 to 64 in an economy. In this study, although we continue to use this measure, we prefer not to call it TEA. The name change reflects the reality that TEA does not actually reflect the totality of entrepreneurship. As mentioned earlier, both social and corporate entrepreneurship are important. Moreover, within the narrower context of Figure 2, a large group of owner-managers of established businesses of more than 3.5 years old are clearly still entrepreneurs, although their companies are less likely to share the dynamism of the more recently born enterprises.

4 The GEM Executive Report expresses the compromise as follows: "the choice of 42 months reflects also operational issues. According to Reynolds, Bosma, Autio, et al. (2005), "The relevant interview question asked only the year when salary and wage payments were initiated and most surveys occurred in the summer months; so the alternatives for choosing a "new firm age" were 1.5 years, 2.5 years, 3.5 years, etc. The shortest time frame that would provide enough cases for stable prevalence rates with a total sample of 2,000 seemed to occur at 3.5 years. Conceptually, any time period under five years seemed satisfactory so this age was considered an appropriate trade-off between conceptual and operational considerations in the early years of the project. There has been no compelling reason to adjust this criteria and a desire for a stable time series has led to its continued use. It should be considered a procedure to capture existing firms less than three or four years old."



3. HONG KONG ENTREPRENEURIAL PREVALENCE RATES COMPARED WITH THE REST OF THE WORLD

Figure 3 summarizes the telephone sample of 146,533 adults worldwide from May through October 2007. Hong Kong has relatively high levels of nascent and new business entrepreneurship which combine to give the SAR a relatively high rate of early-stage entrepreneurial activity. Among adults aged 18 through 64, a full 10.0 percent is involved in early-stage entrepreneurial activity; 5.7 percent of this working-age population is starting enterprises that have not paid wages for more than three months and 4.3 percent is running new businesses as owner managers. For the US, the comparable numbers are 6.5 percent for nascent entrepreneurship and 3.5 percent for new businesses for an early-stage entrepreneurial activity level of 9.6 percent of the population⁵.

Compared with China, however, the SAR looks far less entrepreneurial. China boasts 16.4 percent of the population being involved in early-stage entrepreneurial activity, with 6.9 percent of the population involved in nascent entrepreneurship and 10 percent being new business owner-managers. Note, however, that Hong Kong is a developed economy while China is a developing economy. As the first three graphs in Figure 4 show, there is a parabolic relationships between GDP per capita (purchasing power parity basis)⁶ and early-stage entrepreneurial activity. Lack of employment opportunities in low income countries, the ability of middle income economies to successfully use existing technologies, and the role of innovation to spur the development of leading economies may account for this persistently parabolic shape. Among the high income economies of the world, only Iceland appears more entrepreneurial than Hong Kong. Note, however, that we are making inferences about total population from relatively small samples. The margin for statistical error at the 95 percent level of confidence is about plus or minus one percent. Hence we can be 95 percent confident that Hong Kong's early-stage entrepreneurial prevalence rate lies between 9.0 percent and 11.0 percent. Remembering that other countries' rates must be similarly qualified with confidence intervals, we cannot say with any statistical confidence for example that Hong Kong's rate exceeds the US rate, but we can be confident that it exceeds the UK rate (5.5 percent).

5 Note that early-stage entrepreneurial activity is not the sum of nascent entrepreneurial activity plus new business owners because some respondents have more than one business. If they have both a nascent business and a new business, we only count them once for early-stage entrepreneurial activity.

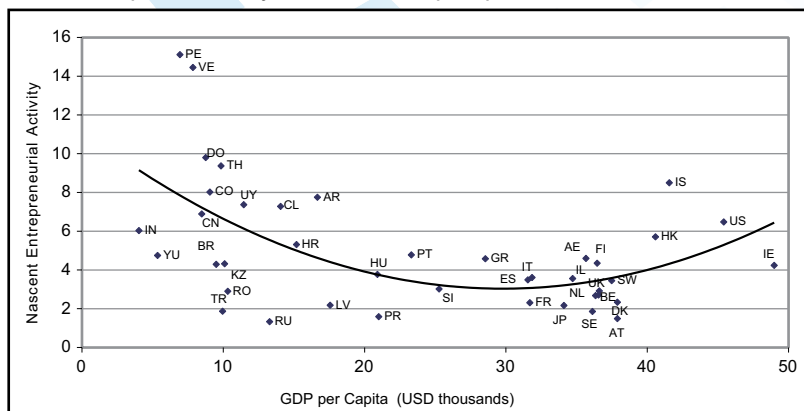
6 Our measure of gross domestic product is on a purchasing power parity (PPP) basis as calculated by the World Bank. This differs from the frequently recorded nominal GDP numbers. Use of PPP adjusted GDP causes, for example, Japan to appear less wealthy than Hong Kong because goods and services in Hong Kong are substantially cheaper than those of Japan.

FIGURE 3: ENTREPRENEURIAL ACTIVITY IN THE GEM COUNTRIES

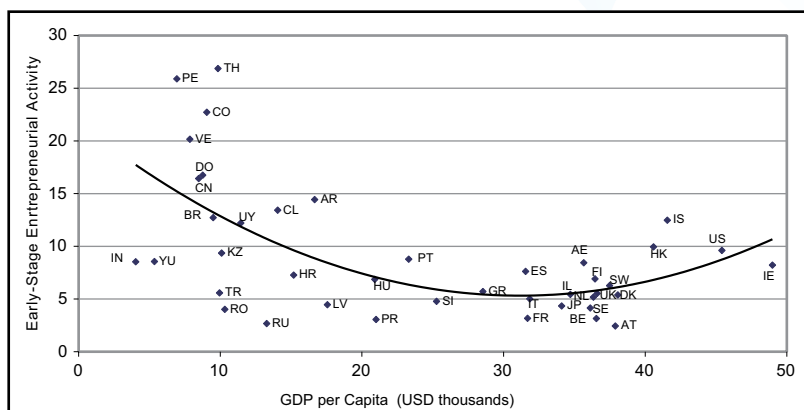
	Nascent Entrepreneurial Activity (percent)	New Business Owner-Managers (percent)	Early-Stage Entrepreneurial Activity (TEA) (percent)	Established Business Owner-Managers (percent)	Overall Entrepreneurial Activity (percent)	Number of Observations	GDP per Capita (USD Thousands PPP Basis) (percent)
High Income Countries							
Austria	1.50	1.00	2.40	6.00	8.40	1,996	39.7
Belgium	2.70	0.40	3.20	1.40	4.60	2,028	36.6
Denmark	2.30	3.10	5.40	6.00	11.10	2,001	39.7
Finland	4.40	2.70	6.90	7.60	14.00	2,005	36.5
France	2.30	0.90	3.20	1.70	4.80	1,567	31.7
Greece	4.60	1.10	5.70	13.30	18.70	2,000	28.5
Hong Kong	5.70	4.30	10.00	5.60	15.00	1,701	40.6
Iceland	8.50	4.50	12.50	8.80	19.80	2,001	41.6
Ireland	4.20	4.20	8.20	9.00	16.8	1,897	49.0
Israel	3.60	2.00	5.40	2.40	7.40	1,885	34.7
Italy	3.60	1.50	5.00	5.60	10.40	2,000	31.8
Japan	2.20	2.20	4.30	8.70	12.60	1,569	34.1
Netherlands	2.70	2.60	5.20	6.40	11.30	2,597	36.3
Norway	3.80	2.60	6.20	4.80	10.60	1,503	45.8
Portugal	4.80	4.10	8.80	7.10	15.40	2,023	23.3
Puerto Rico	1.60	1.70	3.10	2.40	5.20	1,830	21.0
Slovenia	3.00	1.80	4.80	4.60	9.30	3,020	25.3
Spain	3.50	4.30	7.60	6.40	13.40	27,880	31.6
Sweden	1.90	2.40	4.20	4.70	8.80	1,712	36.1
Switzerland	3.50	2.90	6.30	6.60	12.70	2,148	37.5
United Arab Emirates	4.60	4.10	8.40	3.40	11.80	2,097	35.7
United Kingdom	2.90	2.70	5.50	5.10	10.50	39,582	36.6
United States	6.50	3.40	9.60	5.00	14.10	1,583	45.41
Average or Total	3.67	3.15	4.40	5.97	8.68	108,634	35.5
Middle & Low Income Countries – Europe & Asia							
China	6.90	10.00	16.40	8.40	24.60	2,666	8.5
Croatia	5.30	2.00	7.30	4.20	11.10	1,541	15.2
Hungary	3.80	3.10	6.90	4.80	11.70	1,500	20.9
India	6.00	2.60	8.50	5.50	13.90	1,601	4.0
Kazakhstan	4.30	5.30	9.40	5.80	14.80	2,000	10.1
Latvia	2.20	2.30	4.50	3.40	7.70	2,000	17.6
Romania	2.90	1.30	4.00	2.50	6.50	1,739	10.3
Russia	1.30	1.30	2.70	1.70	4.30	1,939	13.3
Serbia	4.80	4.00	8.60	5.30	13.7	1,766	5.4
Thailand	9.40	18.60	26.90	21.40	47.40	1,999	9.8
Turkey	1.90	3.70	5.60	5.50	10.80	2,400	10.0
Average or Total	4.44	4.68	7.05	7.70	10.68	21,151	11.4
Middle & Low Income Countries – Latin America & Caribbean							
Argentina	7.80	7.10	14.40	10.00	24.10	1,719	16.7
Brazil	4.30	8.70	12.70	9.90	22.40	2,000	9.5
Chile	7.30	6.50	13.40	8.70	21.40	3,662	14.1
Colombia	8.00	15.50	22.70	11.60	33.60	2,082	9.0
Dominican Republic	9.80	7.20	16.80	7.60	23.20	2,081	8.8
Peru	15.10	12.20	25.90	15.30	39.00	1,861	6.9
Uruguay	7.40	5.00	12.20	6.60	18.50	1,634	11.4
Venezuela	14.10	7.10	20.20	5.40	24.90	1,709	7.9
Average or Total	9.28	8.97	12.98	13.34	17.64	16,748	10.5
GEM Average/Total	4.94	4.38	9.07	6.58	15.25	146,533	24.4

FIGURE 4: ENTREPRENEURIAL ACTIVITY AS A FUNCTION OF GROSS DOMESTIC PRODUCT PER CAPITA (PURCHASING POWER PARITY BASIS)

a. Nascent Entrepreneurial Activity as a Function of GDP per Capita

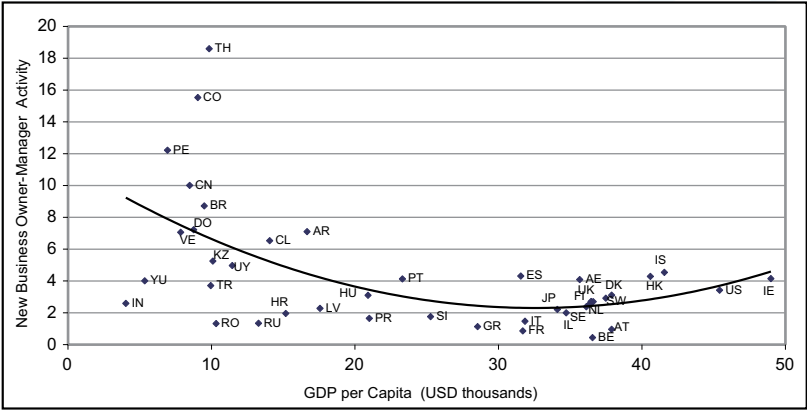


b. Early-Stage Entrepreneurial Activity as a Function of GDP per Capita

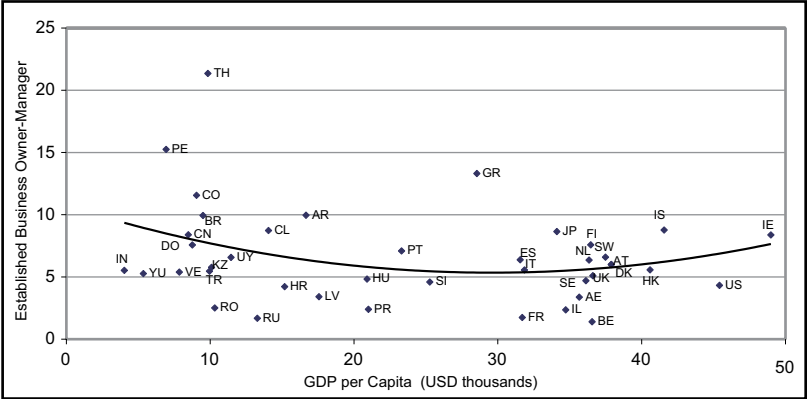


Note: AE=United Arab Emirates; AR=Argentina; AT=Austria; BE=Belgium;
BR=Brazil; CL=Chile; CN=China; CO=Columbia;
DK=Denmark; DO=Dominican Republic; ES=Spain; FI=Finland;
FR=France; GR=Greece; HK=Hong Kong; HR=Croatia;
HU=Hungary; IE=Ireland; IL=Israel; IN=India;
IS=Iceland; IT=Italy; JP=Japan; KZ=Kazakhstan;
LN=Latvia; NL=Netherlands; PE=Peru; PR=Puerto Rico;
PT=Portugal; RO=Romania; RU=Russia; SE=Sweden;
SI=Slovenia; SW=Switzerland; TH=Thailand; TR=Turkey;
UK=United Kingdom; US=United States; UY=Uruguay; VE=Venezuela;
YU=Serbia

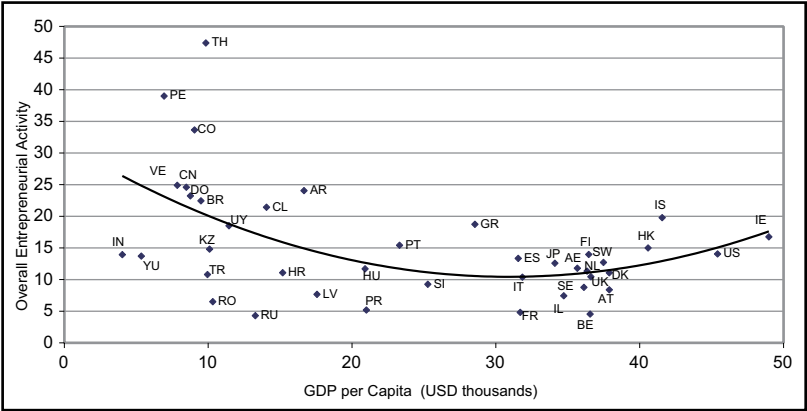
c. New Business Owner-Manager Entrepreneurial Activity as a Function of GDP per Capita



d. Established Business Activity as a Function of GDP per Capita



e. Overall Entrepreneurial Activity as a Function of GDP per Capita



There is considerable difference between early-stage entrepreneurial activity and established entrepreneurial activity, which counts the prevalence among the population of owner-managers of companies that have been paying wages for more than 42 months. As the fourth graph in Figure 4 shows, Greece and Japan, which are characterized by relatively low rates of early-stage entrepreneurship (5.7 percent and 4.3 percent respectively) have particularly high rates of established owner-manager entrepreneurship (13.3 percent and 8.7 percent respectively), while the reverse occurs for Hong Kong and the US, where early-stage entrepreneurial activity exceeds established business owner-manager entrepreneurship. If a respondent is either an early-stage entrepreneur or an established business owner-manager or both, he or she is counted in the measure of overall entrepreneurial activity only once.

Entrepreneurial turnover is important for increasing economic flexibility and innovation. Hence we interpret the high rates of early-stage entrepreneurship of Hong Kong and the US as evidence of a healthy economy. We shall also discuss the high exit rate of Hong Kong in Section 9.





4. HONG KONG ENTREPRENEURIAL PREVALENCE RATES COMPARED WITH THE PAST: CONFIDENCE RESTORED

The percent of Hong Kong's population that has started new businesses between January 1, 2004 and May to June, 2007 (reported above as the early-stage entrepreneurial activity prevalence rate of 10 percent) represents a dramatic rise since the last time we measured the same statistic. In our reports of 2002, 2003 and 2004 we revealed that Hong Kong's TEA (the same statistic that we now call "early-stage entrepreneurial activity") was consistently about 3 percent, placing Hong Kong among the least entrepreneurial countries in the world. When we wrote our earlier studies, we took those measures to be a cause for concern. Figure 5 reproduces those figures from our earlier studies.

Why has the same statistic now more than tripled? This difference is far more than the margin of error implied by the plus or minus one percent confidence interval.


FIGURE 5: HONG KONG'S ENTREPRENEURIAL PREVALENCE RATES: 2007 COMPARED TO 2002-2004

Year	Nascent Activity	New Business	Early-Stage Owner Manager	Established Business
2002	1.7	1.7	3.4	—
2003	1.7	1.6	3.2	3.5
2004	1.5	1.6	3.0	2.7
2007	5.7	4.3	10.0	5.6

First, starting a business is a risky endeavor. Failure causes loss of money, time and alternative opportunity. In the words of one entrepreneur we interviewed for this study, "...entrepreneurs will not start when the times are bad...." Uncertainty about the future economy or political climate, recession and deflation are not conducive to start-ups.

Remember that the measure of early-stage entrepreneurial prevalence is related to starting a business that has paid salaries for less than 42 months.⁷ Counting back 42 months from May to June 2002, when our first telephone sample was conducted, takes one to January 1999. The start-up activity investigated by our previous studies covers the period from January 1999 through May to June 2004. The years following the handover in 1997 were plagued by political and economic uncertainty which included the Asian financial crisis 1997-2000, the bursting of the tech bubble 1999-2001, an escalating series of political demonstrations in Hong Kong, and the SARS pandemic of 2003. Deflation persisted from 1998 through 2003. By late 2003, the economy had bottomed out. By mid-2004, deflation had ended. Political uncertainty was resolved somewhat in 2005 when Donald Tsang was appointed Chief Executive.

⁷ The number 42 months is not strictly accurate. We ask respondents the year they first paid wages. The surveys were done in May and June.



This year's study covers the period from January 1, 2004 to May to June 2007. In the last three years, in addition to strong economic growth, there has been a return of confidence, including greater progress and comfort with the economic integration into the booming mainland Chinese economy. We believe that Hong Kong's return to leading levels of entrepreneurial prevalence rates reflects a renewed confidence in Hong Kong's economic future.

The changes in Hong Kong's population's confidence can be seen in Figure 6. We asked all respondents, whether or not they were entrepreneurs, about their attitudes to starting up businesses. Since we use sampling to ascertain the attitudes of the whole society, we report our findings in terms of a range of percentages, to emphasize that the exact percentage can only be estimated statistically within a confidence interval.

First of all, some attitudes are constant. In all years during which we conducted our research, from 68 to 75 percent of respondents agreed that they often see stories about successful entrepreneurs and from 66 to 71 percent of respondents agreed that those successful in starting a new business have a high level of status and respect in Hong Kong. At the same time, 75 to 82 percent of Hong Kongers believe that most people would prefer that everyone had a similar standard of living. Because the confidence intervals overlap over all periods, we conclude that attitudes of the population have not changed: entrepreneurs are highly visible and well respected. But Hong Kong society also values equality – a trait that is often associated with restricting the entrepreneurial spirit.

With respect to desirability of entrepreneurship as a career, confidence in ability and fear of failure, however, there have been significant changes from the beginning of the decade until 2007. In the early years of the decade, only 52 to 60 percent of people saw entrepreneurship as a desirable career choice. By 2007, that number had increased to 64 to 68 percent. Before, 18 to 26 percent of people thought that they had the knowledge and skill and experience to start a business. By 2007 that number had risen to 30 to 34 percent. Entrepreneurs need to take risks to realize their dreams. In 2003 and 2004, 40 to 45 percent of Hong Kongers harbored fear of failure that would prevent them from starting an enterprise. In 2007, the fear of failure level had dropped to 33 to 37 percent, essentially the same level as it was in 2002.

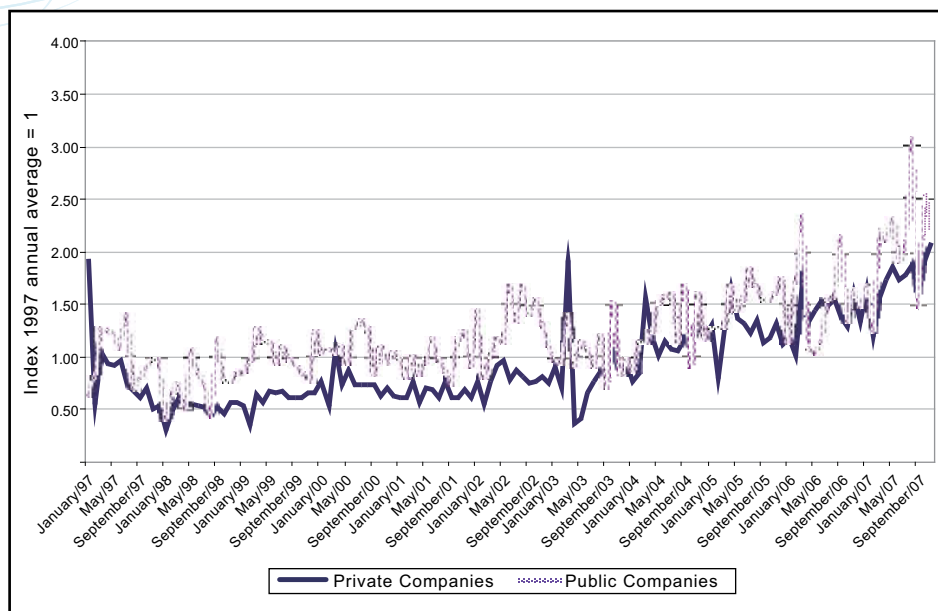
Confidence that good business opportunities exist is crucial to the decision to start a new business. In 2002 only 19 to 23 percent of people believed that there were good opportunities. In May 2003, just as SARS was ending, only 16 to 19 percent of people thought there were good opportunities. By May 2004, there was a substantial recovery in confidence as 24 to 27 percent thought that there were good opportunities. And by May to June 2007, that confidence level had risen to a phenomenal 80 to 83 percent! Clearly confidence, a critical ingredient for an entrepreneur, had returned.

FIGURE 6: HONG KONG'S CHANGE IN ENTREPRENEURIAL CONFIDENCE 2002-2007

Question: Do you agree with the statement:	Percent of Respondents Answering "Yes"			
	2007	2004	2003	2002
In Hong Kong, you will often see stories in the public media about successful new business	70-75%	68-72%	69-74%	–
In Hong Kong, those successful at starting a new business have a high level of status and respect.	66-70%	66-70%	67-71%	–
In Hong Kong, most people would prefer that everyone had a similar standard of living	78-81%	79-82%	75-80%	–
In Hong Kong most people consider starting a new business a desirable career choice	64-68%	52-57%	56-60%	–
You have the knowledge and skill and experience required to start a new business	30-34%	22-26%	20-24%	18-22%
Fear of failure would prevent you from starting a business	33-37%	40-45%	40-45%	32-36%
In the next six months, there will be good opportunities for starting a business	80-83%	24-27%	16-19%	19-23%

Note: The percentage ranges in each of the boxes show range with which we are 95 percent confident that the true population's opinion lies.

FIGURE 7: INCORPORATIONS OF COMPANIES IN HONG KONG 1997-2007



Note: The figure reports monthly statistics of public and private company registrations divided by the average monthly registrations in 1997. In 1997 a total of 48,917 private companies (4,076 per month) and 358 public companies (30 per month) were registered. That rose to an average 8,329 per month for private companies and 62 per month for public companies in first 11 months of 2007.

To corroborate this rapid rise in entrepreneurship, we consulted the Government of Hong Kong Companies Registry and report two trends in Figure 7: public companies and private companies. First, a word of warning. The public corporations represent new listings on the stock exchanges and cannot be equated with start-ups, although they may be correlated with it. And the private incorporations include investment vehicles (for example a real estate investment, in a shell company to reduce tax liabilities) and companies that may be dormant, and so again, cannot be equated with start-ups. Start-ups can occur and exist outside a formally incorporated entity, or they could be started in a formerly dormant corporation. But again, we would expect some positive correlations between early-stage entrepreneurship prevalence and the Companies Registry statistics. From the figure, it is clear that, although registrations are volatile, since 2003 there has been a substantial increase in registrations, a fact that supports our finding of a dramatic rise in entrepreneurship in Hong Kong.

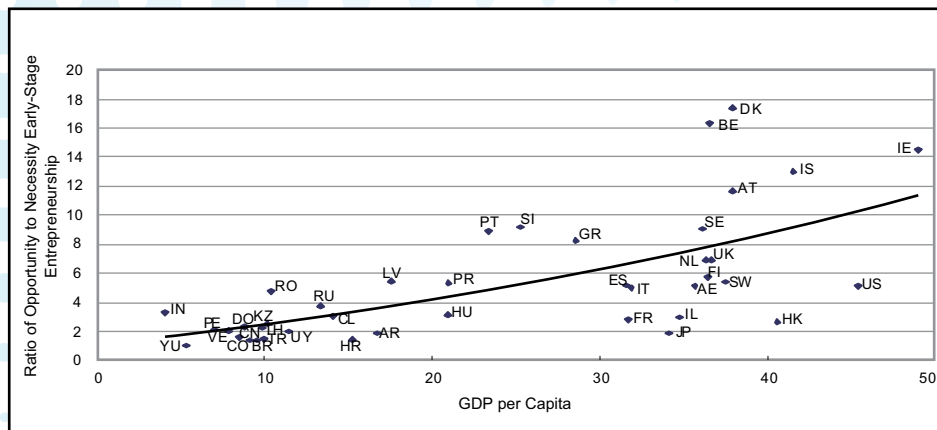
5. WHY START A BUSINESS: OUT OF NECESSITY OR TO TAKE ADVANTAGE OF A BUSINESS OPPORTUNITY?

An entrepreneur can start a business because she is forced by economic circumstances to do so or because she sees an opportunity, the potential to create value, to realize a dream to change her lifestyle. This distinction between necessity and opportunity entrepreneurship, between being pushed into entrepreneurship versus being pulled into entrepreneurship is critical and simple to draw in theory, but in practice motives are mixed and entrepreneurs themselves often inconsistently place themselves in one or the other category.

Our research distinguishes between necessity and opportunity motives by taking two steps. First, we directly ask, "Are you involved in this start-up to take advantage of a business opportunity or because you have no better choices for work?" Then we follow up with the motives, asking "Which one of the following, do you feel, is the most important motive for pursuing this opportunity: to have greater independence and freedom in your working life; to increase your personal income; or just to maintain your personal income?" Only if the respondent identifies herself as being pulled in to take advantage of a business opportunity and the most important motive is to have greater independence and freedom or to increase personal income is the person considered to be an opportunity entrepreneur.⁸

FIGURE 8: OPPORTUNITY AND NECESSITY ENTREPRENEURSHIP

a. Ratio of Opportunity to Necessity Early-Stage Entrepreneurship as a Function of GDP per Capita



Note : See Figure 4 for definitions of country abbreviations.

⁸ Note that this double test represents an innovation from earlier GEM studies which just asked the first question. Hence the necessity – opportunity definition in 2007 study is not directly comparable with previous years’.

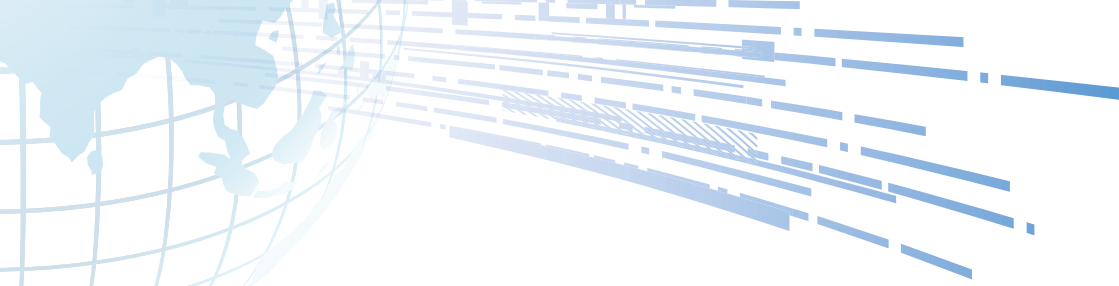


Figure 8b shows the motives for entrepreneurship expressed as a proportion of the population engaged in entrepreneurial activities. To better visualize the different motivations across countries, we show the ratio of opportunity to necessity entrepreneurship as a function of GDP per capita in Figure 8a. The functional relationship is strong – as economies become wealthier, entrepreneurs are more likely to be motivated to search for opportunities rather than simply to be reacting out of necessity in starting businesses – but tremendous variation exists, particularly among the richer economies.

It is interesting to note that countries with very high opportunity to necessity entrepreneurship relative to the trend line, like Denmark and Belgium, with their well established social safety nets, have rather low levels of entrepreneurship, while countries with high levels of entrepreneurship, like the US and Hong Kong, have rather high levels of necessity entrepreneurship relative to the trend line. This may reflect the dampening impact of a comprehensive social safety net on entrepreneurship.

FIGURE 8: OPPORTUNITY AND NECESSITY ENTREPRENEURSHIP

b. Country Percentages

Country	Early-Stage Entrepreneurial Activity In Pursuit of Opportunity (percent)	Early-Stage Entrepreneurial Activity of Necessity (percent)	Opportunity over Necessity
Serbia	4.0	3.9	1.0
Columbia	7.2	5.3	1.4
Brazil	12.6	9.3	1.4
Croatia	4.2	2.9	1.4
Turkey	2.9	2.0	1.5
China	9.8	6.2	1.6
Argentina	8.7	4.7	1.9
Japan	2.8	1.5	1.9
Uruguay	7.7	3.8	2.0
Venezuela	13.3	6.5	2.1
Peru	17.6	8.2	2.1
Thailand	17.9	7.8	2.3
Dominican Republic	11.5	5.0	2.3
Kazakhstan	6.6	2.6	2.5
Hong Kong	6.7	2.6	2.6
France	2.2	0.8	2.8
Israel	3.7	1.3	3.0
Chile	9.8	3.2	3.1
Hungary	5.0	1.6	3.1
India	5.5	1.7	3.3
Russia	1.9	0.5	3.8
Romania	2.7	0.6	4.8
Italy	3.7	0.7	5.0
United States	7.7	1.5	5.1
United Arab Emirates	6.7	1.3	5.1
Spain	5.8	1.1	5.2
Puerto Rico	2.4	0.5	5.4
Switzerland	4.8	0.9	5.4
Latvia	3.7	0.7	5.5
Finland	5.2	0.9	5.8
Netherlands	3.9	0.6	6.9
United Kingdom	4.3	0.6	7.0
Greece	4.5	0.6	8.3
Portugal	7.5	0.8	8.9
Sweden	3.6	0.4	9.1
Slovenia	4.2	0.5	9.2
Austria	1.9	0.2	11.7
Iceland	10.4	0.8	13.0
Ireland	6.5	0.5	14.5
Belgium	2.8	0.2	16.4
Denmark	4.5	0.3	17.4

Note: The rates of opportunity and necessity entrepreneurship in Figure 8b would have added to the Early-Stage Entrepreneurial Activity Incidence as reported in Figure 3 if the respondents had all answered the questions concerning whether they were pursuing opportunity or were forced into entrepreneurship because of necessity. The difference between the sum of the first two columns in Figure 8b and the fourth column of Figure 3 represents those respondents who refused to be categorized as either necessity or opportunity entrepreneurs.

6. FULL-TIME AND PART-TIME ENTREPRENEURS

If an entrepreneur can retain a job at the same time as he launches his new business, some of the risk of the start-up may be reduced. This is particularly true in a high cost of living city like Hong Kong. Holding down a second or third job may be more feasible in locations where transportation and communications are particularly convenient. Part-time entrepreneurship may also reflect on social attitudes: is it acceptable to hold down a second job? Would an employee who is starting up a business on the side be subject to censure for breaching loyalty to his boss, or would his co-workers applaud his efforts to seize the initiative and better himself?

FIGURE 9: FULL-TIME VERSUS PART-TIME ENTREPRENEURSHIP

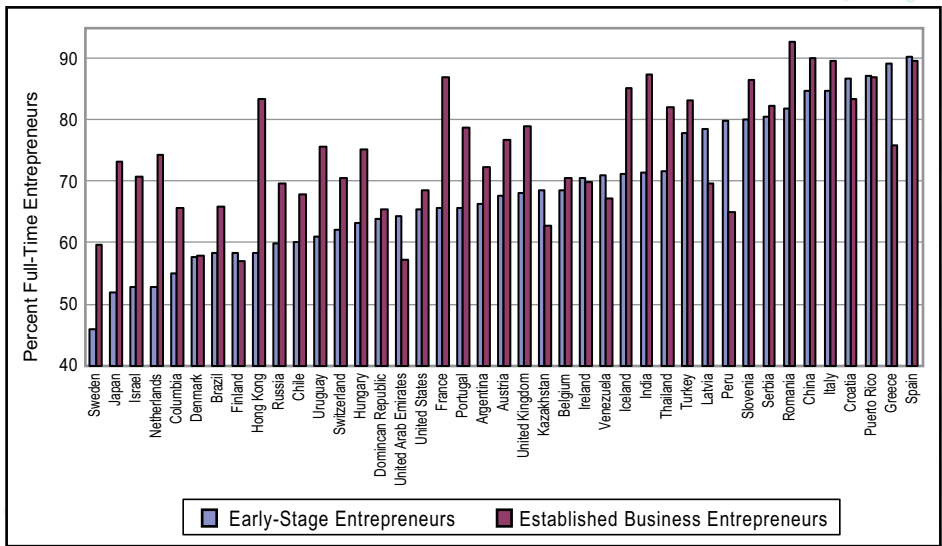


Figure 9 shows the proportion of entrepreneurs that undertake their business on a full-time basis. The graph shows two plots: for each country, the plot on the left corresponds to early-stage entrepreneurship while the plot on the right corresponds to established business entrepreneurship. A relatively small proportion of Hong Kong's entrepreneurs (58 percent) start their businesses on a full-time basis. This is not as low as Sweden (46 percent) but is substantially lower than the US (65 percent) or China (85 percent). But once the business is established, Hong Kong entrepreneurs are far more likely than the average GEM country to be full-time rather than part-time entrepreneurs. A full 83 percent of established entrepreneurs are full-time here compared with 60 percent for Sweden, 69 percent for the US and 90 percent for China.

Interestingly, this shift from early entrepreneurship "hedging" to established entrepreneurship "commitment" has not been constant in Hong Kong when one compares the early years of this decade with the condition today. If one aggregates the data from 2002, 2003 and 2004 studies and compares that with the 2007 data, one finds that "commitment" to established businesses in the earlier period was only 61 percent. This might reflect a combination of lower demand for services during the recession of the earlier years and a greater need, brought on by the uncertain climate, for entrepreneurs to hedge their bets by retaining their jobs, even when they managed established businesses.

7. DEMOGRAPHICS OF ENTREPRENEURS: AGE, GENDER, EDUCATION LEVEL AND INCOME

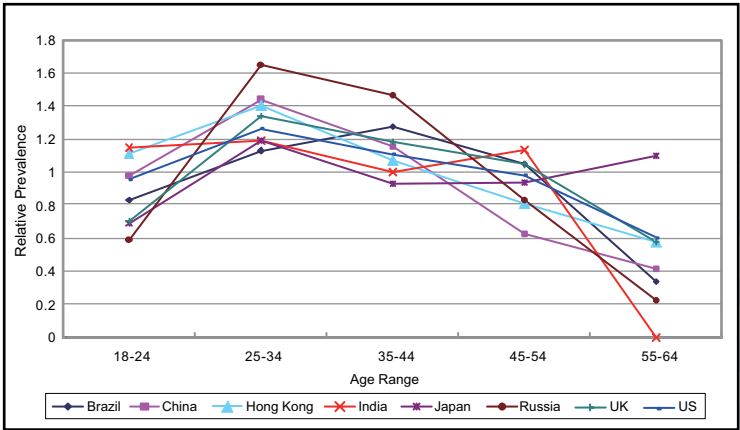
Throughout the world, men are more likely to be entrepreneurs than women. In Hong Kong, men are about 2.5 times more likely to be involved in start-up entrepreneurial activity than women and 2.0 times as likely to be involved in owner-management of established businesses. These percentages are approximately the same as at the start of the decade and are slightly higher than the male bias in most other GEM countries.

One can further divide the entrepreneurial rates by different age groups. We show age prevalence by taking the prevalence rate for each age group and dividing it by the prevalence rate for the total population. For example, in Hong Kong, 14 percent of the population aged 25 to 34 is engaged in early-stage entrepreneurship. Since 10 percent of the whole population of Hong Kong is engaged in early-stage entrepreneurship, the relative prevalence of early-stage entrepreneurship in the 25 to 34 age group is 14 divided by 10 or 1.4. Figure 10 shows the relative prevalence in order to net out two differences between countries – levels of entrepreneurship and age distributions of the population – so that we can focus on the role of age.

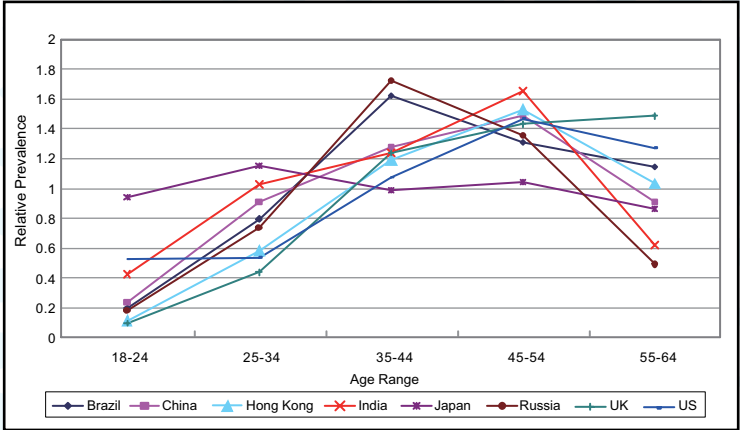
Early-stage entrepreneurship is the province of the young: in all major economies except Brazil, relative prevalence peaks in the 25 to 34 age group. Hong Kong exemplifies this pattern. Within the 55 to 64 year age category, Japan and India stand at opposite sides of the spectrum. In India, in the oldest category, GEM sampling found no early-stage entrepreneurs. Perhaps the recent market oriented reforms have not yet led to elderly start-up entrepreneurship, or perhaps this lack reflects the role of the elderly in Indian society. Whereas in Japan, the 55 to 64 year olds have entrepreneurship prevalence rates of 4.8, above the average population prevalence rates of 4.3 leading to a relative prevalence rate of 1.1, perhaps reflecting the established practice of retirees in Japan setting up small businesses to maintain their incomes. Note that in Japan retirement is a major reason for exit, as discussed below. The relative prevalence of established business shifts for most countries to older age brackets with peaks shifting one or two age ranges older than early-stage entrepreneurship. Again, Hong Kong appears to mirror the trend in other countries with our peak occurring in the 45 to 54 age range.

FIGURE 10: ENTREPRENEURSHIP BY AGE

a. Early-Stage Entrepreneurship Age Distribution



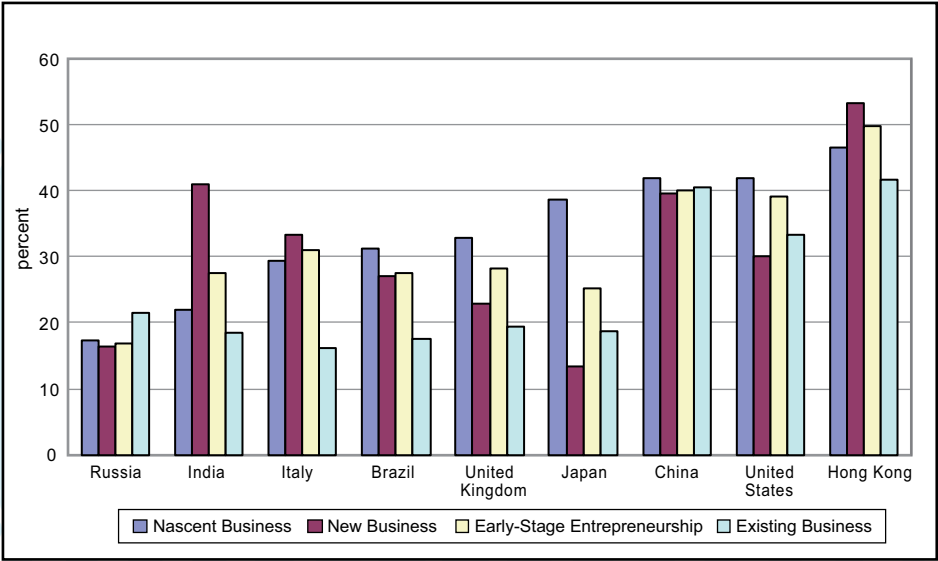
b. Established Business Entrepreneurship Age Distribution



Note: Figure 10 shows the relative prevalence rate of entrepreneurship in each age distribution. The relative rate is calculated by taking the entrepreneurship prevalence rate expressed as a percent of the population in each age distribution divided by the country's total prevalence rate.

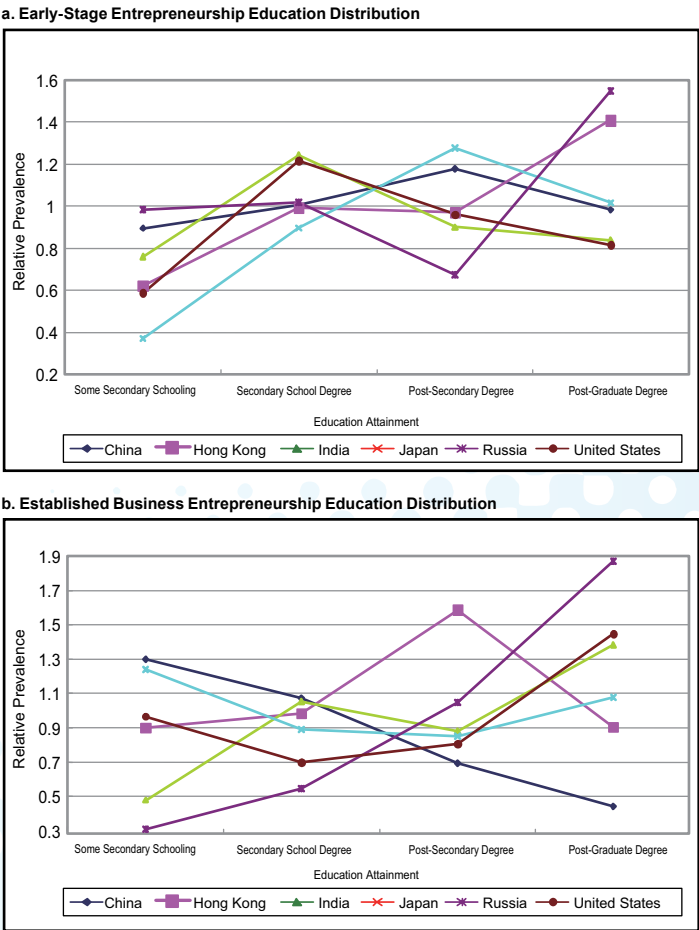
Although early-stage entrepreneurship is the province of the young, experience is extremely valuable to the entrepreneur. If the entrepreneur knows what works in the market, has experience with suppliers and knows how to organize a business, the likelihood of his success increases. In this respect, Hong Kong appears to be at a comparative advantage as shown in Figure 11. This experience level of entrepreneurs should be contrasted with the attitudes of most Hong Kongers who don't think that they have the knowledge and experiences to set up a business (see Figure 6).

FIGURE 11: PERCENT OF ENTREPRENEURS WITH PRIOR EXPERIENCE

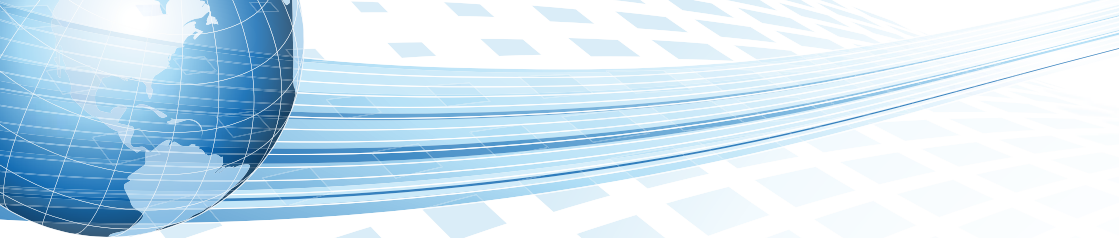


Note: Figure 11 shows the percentage of entrepreneurs within each category who said that they had started – either alone or with others – a business prior to having started the current business. Within the countries highlighted here, Russian entrepreneurs are the least experienced while Hong Kongers are the most: approximately half of all early-stage entrepreneurs in Hong Kong have previous start-up business experience.

FIGURE 12: ENTREPRENEURSHIP BY EDUCATIONAL ATTAINMENT



Note: Figure 12 shows the relative prevalence rate of entrepreneurship in each education attainment group. The relative prevalence rate is calculated by taking the entrepreneurship prevalence rate expressed as a percent of the population in each educational attainment group divided by the country's total prevalence index.



Turning to educational attainment, in Hong Kong, Figure 12 shows that the early-stage entrepreneurship relative prevalence rates are monotonically increasing in educational attainment. Post-graduate degree holders are over-represented among entrepreneurs (they are 1.4 times as likely to be an entrepreneur) while those with only some secondary education are under-represented (they are only 60 percent as likely to be entrepreneurs). We observed this monotonic relationship between educational attainment and early-stage entrepreneurship in our last study in 2004, and noted that it marked a departure from previous years. We can see the effect of that departure when we look at established businesses. Hong Kong holders of post-graduate degrees are only 90 percent as likely to be established business entrepreneurs. This gives further evidence of a change in job orientation of the more recent generation of educated people who see entrepreneurship as a more viable career path than those in earlier periods. The change appears to have occurred from 2003 to 2004.

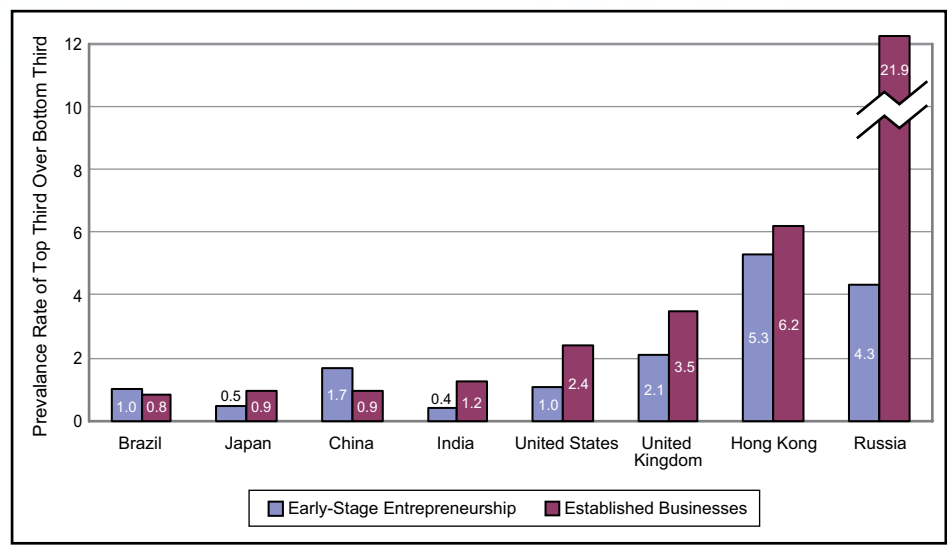
Notwithstanding Hong Kongers' joint belief in entrepreneurship and equality described earlier, entrepreneurship in Hong Kong is not egalitarian. As Figure 13 shows, if one divides our 2000 respondents by income distribution, those in the top third are more than five times as likely to be involved in early-stage entrepreneurship and more than six times as likely to be an owner operator of an established enterprise than those in the lowest third of income distribution. This higher proportion of high income involvement in entrepreneurship has not been significantly altered since 2004. Because early-stage enterprises typically have yet to generate substantial income, clearly starting a new business does not immediately result in wealth. Hence, we can confidently state that in Hong Kong starting a new business is partly caused by being better off. Those with more income, and their families and friends have the money to invest in new enterprises. Moreover, their income may give them better access to information and contacts helpful to creating profitable business models. With respect to established enterprises, it is not as clear which is the cause and which is the effect. Owning and operating an established business may in Hong Kong be a cause of higher income as much as it is the effect of belonging to a higher income bracket.

Among the countries shown in Figure 13, only Russian entrepreneurship is more skewed to the rich than Hong Kong entrepreneurship. There, early-stage entrepreneurship is four times more likely among the richest third than the poorest third, but the rate of ownership of established businesses is more than twenty times higher among the richest third than among the poorest third in Russia.

Both the US and China, in contrast, present more egalitarian pictures. In China, early-stage entrepreneurs tend to be slightly more prevalent among the richer third of society than the poorer third but established entrepreneurs are not. In the US, although established business owners are more likely to be from the wealthier part of society, early-stage entrepreneurs are as likely to come from any third of society.

Japan and India present a somewhat different picture with early entrepreneurship being less prevalent among the richest third of society than among the poorest third.

FIGURE 13: INCOME LEVEL AND ENTREPRENEURSHIP



Note: Russian Established Business relative prevalence rate is 21.9 but the y-axis has been truncated at 12.

8. CHARACTERISTICS OF ENTERPRISES: BUSINESS ACTIVITIES, COMPETITIVENESS, TECHNOLOGY AND GROWTH EXPECTATIONS

The business activities of Hong Kong's current early-stage entrepreneurship reflect the SAR's status as a mature, developed, city economy. Figure 14 shows entrepreneurship today in Hong Kong is 77 percent service-oriented. And within services, consumer services dominate. This represents a substantial difference from established entrepreneurs, who are predominantly transforming oriented – these are the Hong Kong owners of factories and logistics industries. The difference can be attributed to two factors – on the one hand, past entrepreneurship centered on manufacturing and transformation. On the other hand, the turnover rate of consumer services is likely to be far higher than transforming industries. It is easier to close a restaurant or a store than a factory.

FIGURE 14: INDUSTRY DISTRIBUTION OF ENTREPRENEURSHIP

	Early-Stage Entrepreneurship				Existing Enterprises			
	Extractive	Transforming	Business Services	Consumer Services	Extractive	Transforming	Business Services	Consumer Services
Hong Kong	0	23	18	59	0	48	23	30
United States	2	21	35	42	12	24	34	30
Brazil	2	30	14	54	3	31	15	51
Russia	12	32	11	45	3	52	9	36
India	3	22	16	58	2	36	23	40
China	6	46	12	36	12	45	10	32
Japan	0	6	44	50	3	27	25	45
United Kingdom	3	26	31	40	6	35	32	27

Note: Rows may not add up to 100 percent due to rounding errors.

Extractive industries include agriculture, forestry, fishing, mining and construction. Transforming industries include manufacturing, transportation, communications, utilities, wholesale and motor vehicle sales and services. Business services include finance, insurance, real estate and other business services. Consumer services include retail, hotel, restaurant, health, education, social services, and other consumer services.

We asked the entrepreneurs to assess the impact of their enterprises on the market in several ways. Does the product or service have many, few, or no competitors? Does it involve new technologies? Will it serve the export market? And will the enterprise grow quickly?

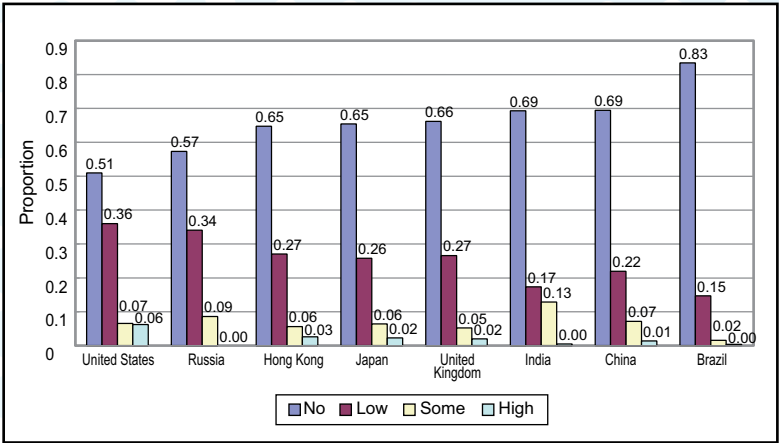
Figure 15 shows that Hong Kong's new and existing entrepreneurs exert modest market impact. We define an enterprise with no market impact as one assessed by the entrepreneur as having many competitors. An enterprise with low market impact is one that has few competitors but no new technology. An enterprise with some market impact has few competitors but uses new technology and an enterprise with high market impact is one with no competitors.

From their responses, we determine that about two thirds of the early-stage entrepreneurs provide no market impact and only three percent provide profound market impact. This percentage level of impact is essentially the same as what is observed in our 2006 study *Innovation Policy and High Growth Startups* which is a summary of data from GEM studies in 2002, 2003 and 2004. Hong Kong entrepreneurial market impact compares unfavorably with the US levels, where only 51 percent have no market impact and 6 percent have profound market impact. Hong Kong's early-stage entrepreneurship market impact is roughly comparable with Japan, the UK, India and China. Figure 15 shows that, among Hong Kong's established businesses, the impact of products and services is even less. Eighty-one percent are offering products and services with many competitors, while no respondent said that he or she had no competitors.

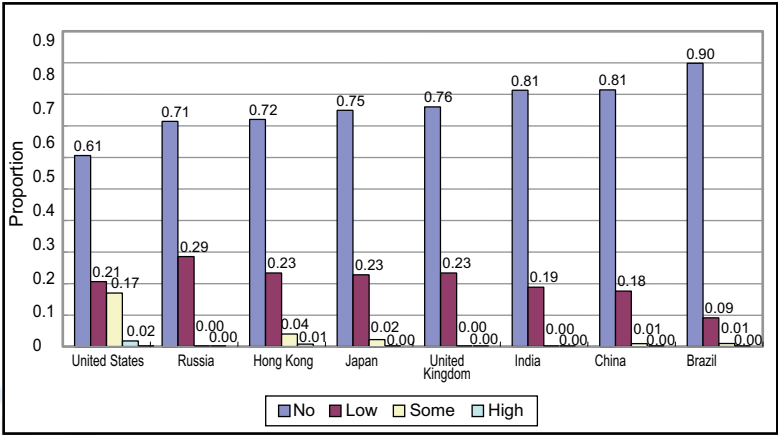
Here two words of caution are in order. First, the same service that is new to some region of, say, India or Russia, and therefore faces no local competitors, may be mature in Hong Kong or the US, where it has many competitors. We would interpret the service provider in India or Russia to have market impact, whereas we would conclude the US or Hong Kong provider has no impact. Moreover, we did not consider the market impact of improvements of efficiency. An improvement in providing the same service or producing the same good might actually have a market impact, yet we would miss it.

FIGURE 15: MARKET IMPACT OF EARLY-STAGE ENTREPRENEURS AND ESTABLISHED BUSINESSES

a. Early-Stage Entrepreneurship Market Impact



b. Established Business Market Impact



Note: Enterprises are categorized as “no” market impact if the entrepreneur responded that there were many business competitors offering the same product or service. Impact is “low” if the entrepreneur responded that there are few business competitors. Impact is “some” if the entrepreneur responded there are few business competitors and that the technologies required for the product or service have been available less than a year. Impact is “high” if there are no business competitors.

FIGURE 16: EXPORT MARKETS OF PRODUCT OR SERVICE

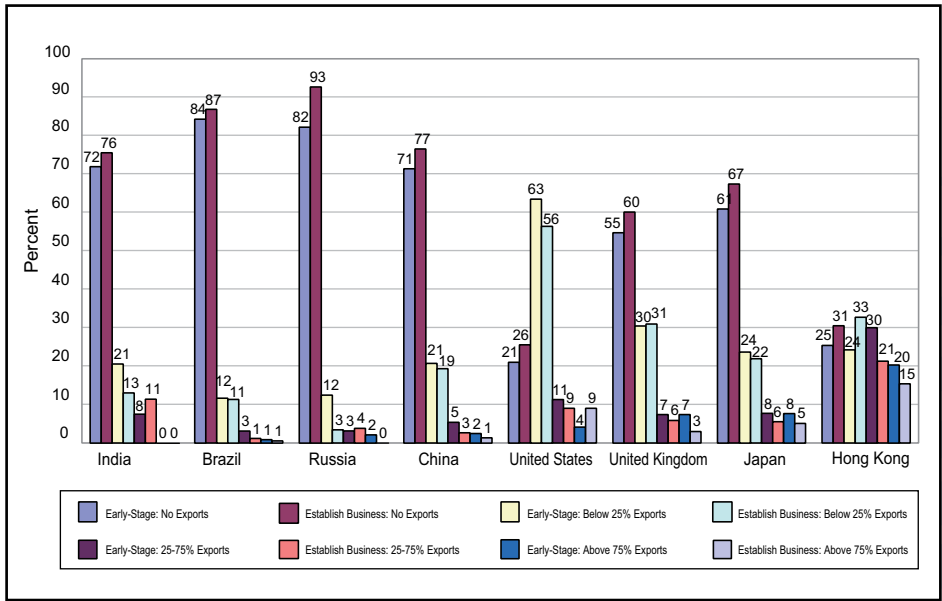


Figure 16 shows that Hong Kong's products and services compete in the international marketplace to a greater extent than other countries polled in the 2007 GEM study. Whereas India, Brazil, Russia and China have from 71 to 93 percent of goods and services from early-stage and established enterprises with no exports, the percentages for Hong Kong are 25 percent (for early-stage) and 31 percent (for established businesses), which are numbers comparable with the US. Moreover, 20 percent (for early-stage) and 15 percent (for established businesses) export more than 75 percent of their product or service, which are numbers well ahead of any other economy studied.

Enterprises range in market impact from the one-person, part-time to the ground-breaking companies that grow rapidly as they substantially alter the way business is done. To distinguish between these two types of business, we ask the entrepreneur how many people, not including the owners (but including all exclusive sub-contractors) will be working in the business in five years. We define a high growth start-up to be a business identified by the entrepreneur as predicted to have more than 20 people working for it in five years' time.

FIGURE 17: HIGH GROWTH EARLY-STAGE ENTREPRENEURSHIP PREVALENCE RATES

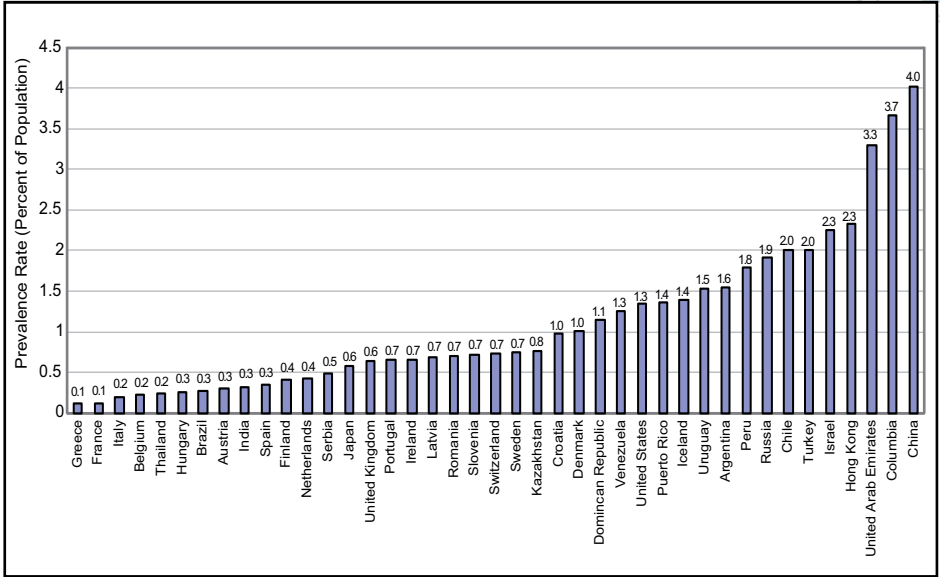


Figure 17 shows that Hong Kong has a high growth entrepreneurship rate of 2.3 percent, somewhat less than China's 4.0 percent but comparable with Peru, Russia, Chile, Turkey and Israel and substantially above the US, the UK and other European countries. This level is considerably above the rate we reported in our 2006 study. At that time, we reported the high growth entrepreneurship rate of 0.7 percent. However, our 2006 study used as its database, the three years of GEM data we collected in the summers of 2002, 2003 and 2004. As we discussed above, that data collectively relates to the period from January 1, 1999 to May to June 2004. We believe that our earlier figures illustrated an unusually depressed level of high growth entrepreneurship (see above "Hong Kong Entrepreneurship Prevalence Rates Compared with the Past"). Interestingly, when we compare per capital gross domestic product with high growth entrepreneurship (as we did for total entrepreneurship in Figure 4) no discernable pattern emerges.



9. EXIT

A common but mistaken myth of entrepreneurship is that 90 percent of new businesses fail in the first year. In the United States, Brian Headd, chief statistician of US Small Business Administration, shows that two-thirds of new businesses with employees survive at least two years, and about half survive at least four. In Australia, retailers located in large shopping malls recorded even better survival rates of 80 percent for three years and 60 percent for five years, perhaps due to good management and business environment.⁹ In Hong Kong, where entrepreneurs are among the most experienced in the world, we might expect no higher rates of failure. While we are aware of no Hong Kong studies on the matter, discussions with local entrepreneurs and those providing services to local entrepreneurs lead us to believe that the 90 percent myth is a gross exaggeration.

The GEM data do not allow us to construct mortality rates of businesses. We can, however, calculate Hong Kong's entrepreneurial exit rates relative to other countries. We asked telephone survey respondents, "Have you in the past 12 months sold, shut down, discontinued or quit a business you owned and managed, any form of self-employed or selling goods or services to anyone?" We further asked if the business continued after the respondent entrepreneurs exited and asked the reasons for exiting the business.

Figure 18 shows statistics on the two forms of exit (continued or not continued). We are unable to determine whether either form of exit is a failure or a success. A sold business may be a failure. A wound-up business may be a success. Nevertheless, we infer that exit is more likely to represent business failure if the business is shut down on exit. Figure 19 shows that the exit rates of Hong Kong (4.4 percent) are substantially above the average for high income countries and are on par with the US and with middle and low income countries. The figure also shows that only 21 percent of Hong Kong exits involve continuance of the business. This is well below both the GEM and the high income country average rates of about 32 percent.

Remembering that Hong Kong has high rates of entrepreneurship relative to other high income countries and that entrepreneurial exit should be positively correlated with entrepreneurial activity, we "normalize" exit by dividing exit prevalence by overall entrepreneurial prevalence rates which includes both early-stage entrepreneurs and established business entrepreneurs¹⁰. Such treatment is a normalizing transformation that allows fairer comparisons of turnover of business between countries. Figure 19 shows that Hong Kong enterprises have a slightly higher turnover (implying a slightly shorter lifetime) than the mean GEM rates.

⁹ See Watson, J., & Everett, J.E. 1996. "Do small businesses have high failure rates?" *Journal of Small Business Management*, 34(4): 45-62.

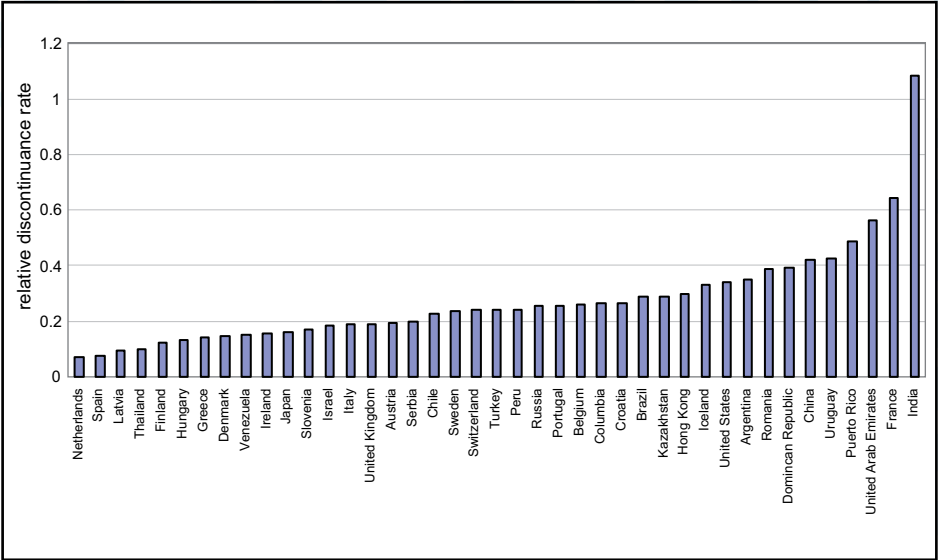
¹⁰ We do not show the results of dividing by early-stage entrepreneurship, but if we did it would reveal a ranking not substantially different from that shown in Figure 19. We do not use early-stage entrepreneurship because exit rates are not directly comparable with the entry rates of early-stage entrepreneurship. Early-stage entrepreneurship concerns entry activity within 42 months prior to the telephone interview whereas exit rates concern activity within 12 months. Secondly, GEM determines exit with a single question. There is no confirming of the validity of the answer with follow-up questions like those in Appendix 3 with respect to early-stage entrepreneurship. Hence, multiplying the exit prevalence rates by 3.5 (to convert to 42 months) would almost certainly bias upwards the exit figure in comparison with early entrepreneurship. So we simply treat division by our measure of overall entrepreneurial activity in Figure 19 as a normalizing transformation.

FIGURE 18: EXIT RATES

	Discontinuance of Business	Exit with Continuance of Business	Total Exit	Percent of Exit with Continuance of Business
High Income Countries				
Austria	1.3	0.3	1.6	21.1
Belgium	0.6	0.6	1.2	51.7
Denmark	0.9	0.7	1.6	42.6
Finland	0.7	1.0	1.7	59.0
France	2.0	1.1	3.1	35.2
Greece	1.8	0.8	2.6	29.8
Hong Kong	3.5	0.9	4.4	20.9
Iceland	1.6	0.9	2.5	34.7
Ireland	1.9	0.8	2.7	29.4
Israel	2.4	1.3	3.7	34.2
Italy	1.2	0.7	2.0	37.8
Japan	2.0	0.0	2.0	0.0
Netherlands	0.5	0.3	0.8	39.8
Portugal	2.6	1.3	4.0	33.8
Slovenia	1.2	0.3	1.6	21.8
Spain	0.6	0.4	1.0	36.4
Sweden	1.4	0.7	2.1	32.0
Switzerland	1.5	1.6	3.1	52.4
United Arab Emirates	4.7	1.9	6.6	28.8
United Kingdom	1.2	0.8	2.0	37.7
United States	3.0	1.8	4.8	37.3
Average	1.7	0.9	2.6	33.1
Middle & Low Income Countries - Europe and Asia				
China	6.1	4.2	10.3	40.7
Croatia	1.9	1.0	3.0	34.9
Hungary	1.3	0.2	1.6	15.4
India	10.2	4.9	15.1	32.7
Kazakhstan	2.5	1.8	4.3	41.4
Latvia	0.6	0.1	0.7	13.5
Romania	2.1	0.4	2.5	17.5
Russia	1.0	0.1	1.1	9.2
Serbia	2.0	0.8	2.8	27.6
Thailand	3.5	1.3	4.8	27.7
Turkey	1.8	0.8	2.6	29.5
Average	3.0	1.4	4.4	32.2
Middle and Low Income Countries - Latin America and Caribbean				
Argentina	6.5	2.0	8.5	23.7
Brazil	4.5	2.0	6.4	30.6
Chile	3.4	1.5	4.9	30.5
Columbia	5.9	2.9	8.9	33.2
Dominican Republic	4.8	4.4	9.2	47.6
Peru	6.2	3.2	9.4	34.0
Uruguay	5.9	2.0	7.9	25.3
Venezuela	2.1	1.7	3.8	44.8
Average	4.9	2.5	7.4	33.4
GEM Average	2.7	1.3	4.1	32.9

Note: Table records the percent of the population aged 18 to 64 who answered that they discontinued, sold or quit a business in the past 12 months.

FIGURE 19: EXIT IN PROPORTION TO OVERALL ENTREPRENEURSHIP



Reasons for Exit

Survey respondents who had exited their business were asked to state the most important reason for doing so. In Figure 20, we sort the selected countries by the percentage of the response “business not profitable”, the largest single reason for exit in most countries. If one adds to “business not profitable” the percentage of people who exit for “problems getting finance” we have a rough measure of business failure. Using this definition, in Hong Kong 55 percent of exits is due to failure. This is a substantially higher percentage than that in all the other nine featured economies but Brazil and Israel. Only Israel has a higher proportion of leaving a business for reasons of lack of profitability than Hong Kongers. The findings suggest that Hong Kongers and Israelis hold their ventures strictly to the test of financial feasibility. This is less so in say, the US where the largest reason for leaving a business is for “personal reasons”. In Japan the largest reason for exiting a business is retirement. Another way of looking at this fact is that, to a greater extent than the worlds’ other business people, entrepreneurs in Hong Kong tend to keep a business going as long as it is financially feasible.

Reflecting Hong Kong's propensity to serial entrepreneurship, a large proportion of those who recently discontinued a business were, at the time of the interview, either owner-manager of another business (39 percent) or actively trying to start another business (37 percent). The average among all the GEM countries was only 20 percent and 14 percent respectively. It seems that Hong Kong entrepreneurs are resilient, and the SAR has active entrepreneurial dynamism.

Although the rate of exit is correlated across time with early-stage entrepreneurship, Figure 21 suggests that it is not highly correlated. Exit today is high, representing a rise from 2003, but it is actually lower than the exit rate in 2002.

FIGURE 20: EXIT REASONS

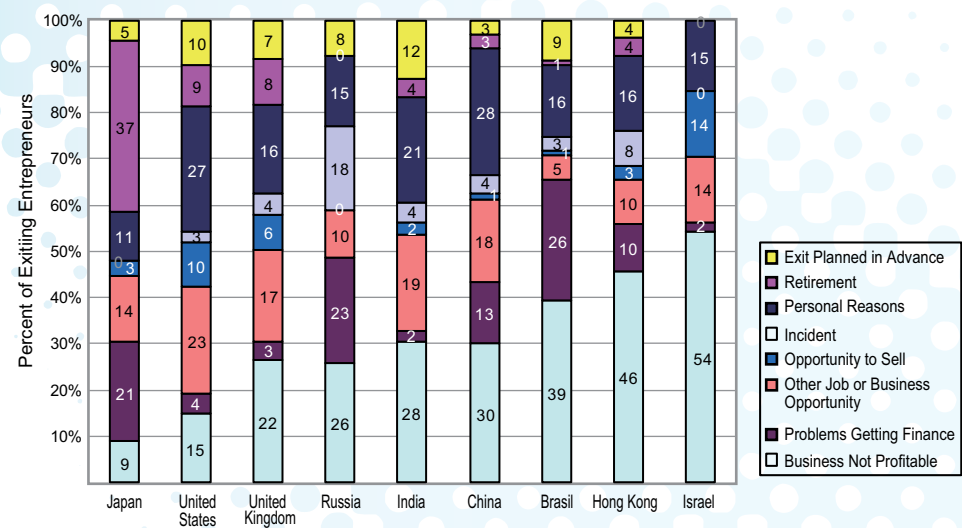
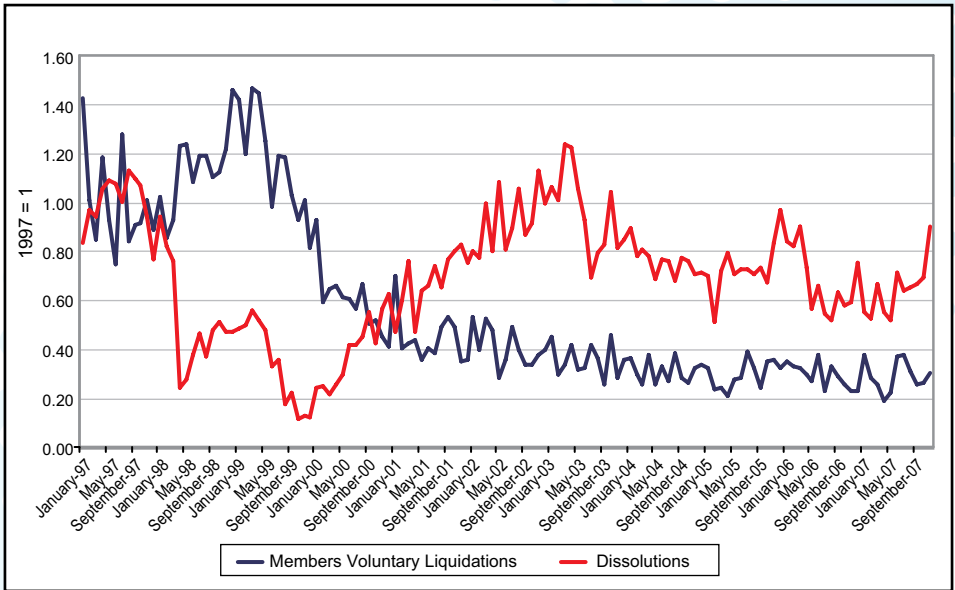


FIGURE 21: START-UP RATES COMPARED WITH EXIT RATES
(in percentages):

Year	Nascent Activity	New Business	Early-Stage Owner Manager	Exit (business not continued)
2002	1.7	1.7	3.4	3.6
2003	1.7	1.6	3.2	1.9
2004	1.5	1.6	3.0	2.1
2007	5.7	4.3	10.0	3.5

As we did for early-stage entrepreneurship, we turn to government statistics from the Companies Registry to add insight to our knowledge of business exit. Figure 22 shows no clear picture emerges that corroborates our finding of increased entrepreneurial exit over the last few years. But we re-emphasize, as we did above, that registering a company may or may not be entrepreneurial. For example, a real estate speculator in Hong Kong may avoid paying hefty registration fees by trading “shell” companies, which hold apartments as the only asset. Exit may simply be the sale of property. Or the shell company may continue dormant long after business ceases. Factors in addition to entrepreneurial exit and our limited polling of entrepreneurial exit across time limit our ability to interpret the Companies Registry data. Clearly exit is an important part of the entrepreneurial process and should be studied in greater depth in future.

FIGURE 22: DISSOLUTIONS AND LIQUIDATIONS



Source: Hong Kong Government Companies Registry
 Note: Figure shows the monthly dissolutions and liquidations expressed relative to average dissolutions and liquidations respectively in 1997. Dissolutions range from 4,033 in January 1997 to 4,353 in November 2007. Members voluntary liquidations commenced ranged from 314 in January 1997 to 67 in November 2007.



10. INFORMAL INVESTORS

Personal resources are often not enough to start a new venture, so the founder has to turn to the family, friends, and informal investors. (The four sources of start-up funding are sometimes known as the 4Fs – founders, family, friends and fools). Informal investments are based on personal requests and less formal agreements. Informal investors are also known as business angels, because of their role in saving otherwise doomed entrepreneurs. Venture capital, despite its high profile, funds less than one in a thousand start-ups and supplies less than a tenth of the total capital for start-ups. Seldom is venture capital available for true start-ups – proof of concept and a track record are usually necessary – and the amount of capital invested per project (around US\$7 million per investee) is usually beyond the needs of most start-ups. The threshold is high because venture capitalists are typically interested in scaling up a marketable product or service for a large and growing market¹¹. Hence informal investment is indispensable in filling the resource gap, with the informal investor typically providing mentoring as well as money.

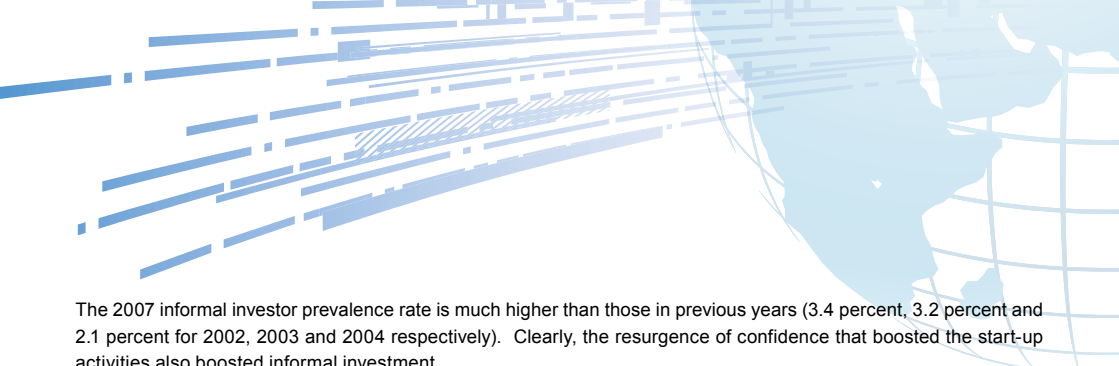
Figure 23, which gives the prevalence rates for informal investors in the 2007 GEM countries, shows that almost 8 percent of the population of Hong Kong aged 18 to 64 was an informal investor in the three years prior to May 2007. This rate is about twice the high income country average and also considerably exceeds the GEM average. Relative to Hong Kong entrepreneurs' needs, the figure is high, with investors being 79 percent of early-stage entrepreneurs.

Notwithstanding these high prevalence rates, however, we believe that the early-stage investment gap, noted elsewhere in the world, also occurs in Hong Kong. The 2007 GEM data shows that the median initial investment required for start-ups in Hong Kong is HK\$300,000. About 43 percent of founders plan to fund the start-up completely on their own and, as a result, invest a median amount of HK\$150,000 themselves. For the 57 percent of founders who planned to find other investors, they expected a median investment of HK\$250,000. Informal investors of Hong Kong are only willing to invest a median amount of HK\$100,000. This suggests a funding gap. Early-stage entrepreneurs may look for financing from other sources (e.g., angel networks and government programs) to help their start-ups to realize their potential.

¹¹ Bygrave, W. D. 2006. *Global Entrepreneurship Monitor: 2006 Financial Report*. Babson College and London Business School. (www.gemconsortium.org); see also Preston, S. L. 2004. *Angel investment groups, networks, and funds: A guidebook to developing the right angel organization for your community*. Kansas City: Kauffman Center for Entrepreneurial Leadership at the Ewing Marion Kauffman Foundation.

FIGURE 23: PREVALENCE RATES OF INFORMAL INVESTORS

	Informal Investor Prevalence Rate	Informal Investors as A Proportion of Early- Stage Entrepreneurs
High Income Countries		
Austria	2.03	0.83
Belgium	2.70	0.86
Denmark	2.06	0.38
Finland	3.31	0.48
France	5.59	1.76
Greece	2.61	0.46
Hong Kong	7.85	0.79
Iceland	1.93	0.35
Ireland	3.32	0.40
Israel	7.64	0.61
Italy	2.96	0.59
Japan	1.78	0.41
Netherlands	2.33	0.45
Portugal	3.78	0.43
Slovenia	3.23	0.68
Spain	3.22	0.42
Sweden	5.02	0.80
Switzerland	3.74	0.90
United Arab Emirates	7.89	0.93
United Kingdom	1.38	0.25
United States	4.94	0.51
Average	3.78	0.63
Middle & Low Income Countries - Europe and Asia		
China	9.56	0.58
Croatia	2.45	0.34
Hungary	0.85	0.12
India	37.28	3.67
Kazakhstan	4.19	0.45
Latvia	1.62	0.36
Romania	4.56	1.13
Russia	1.60	0.60
Serbia	4.10	0.48
Thailand	4.74	0.18
Turkey	4.69	0.84
Average	6.33	0.80
Middle and Low Income Countries - Latin America and Caribbean		
Argentina	2.82	0.20
Brazil	0.87	0.07
Chile	7.63	0.57
Colombia	7.22	0.32
Dominican Republic	7.18	0.43
Peru	9.72	0.38
Uruguay	4.20	0.34
Venezuela	2.37	0.12
Average	5.25	0.30
GEM Average	4.77	0.61

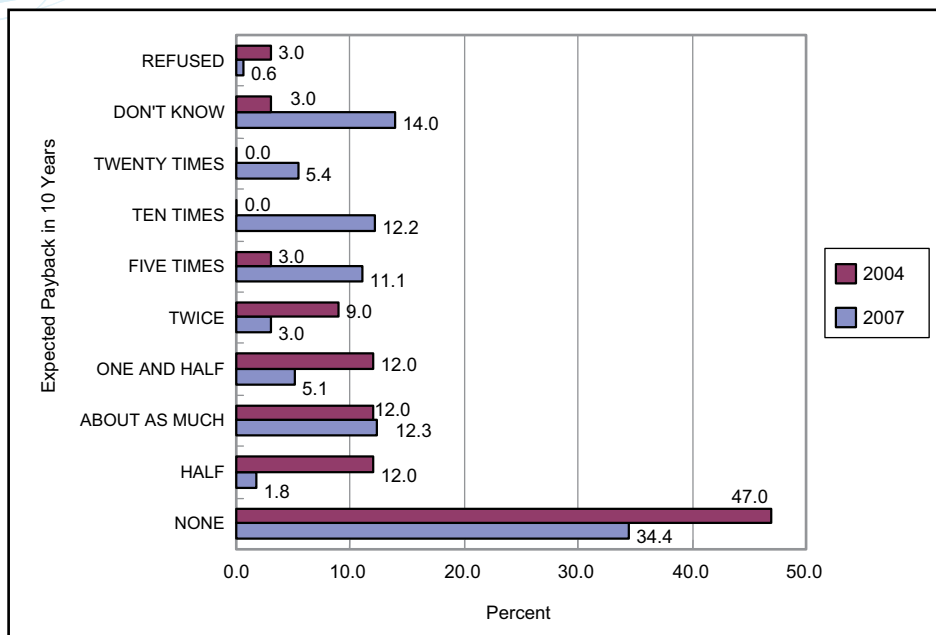


The 2007 informal investor prevalence rate is much higher than those in previous years (3.4 percent, 3.2 percent and 2.1 percent for 2002, 2003 and 2004 respectively). Clearly, the resurgence of confidence that boosted the start-up activities also boosted informal investment.

We can track the resurgence in confidence not just in the participation of informal investors but also in their expectations of returns. GEM studies have consistently reported that, the world over, just over half of informal investors state that their rates of return on their investments will be zero or negative (i.e., that they may recover their original invested capital but will gain no return on that capital). As Figure 24 shows, Hong Kong informal investors in 2007 overcame that pessimistic assessment, with 34.4 percent saying they would get back nothing, 1.8 percent saying they would get about half of their investments, and 12.3 percent saying they would just get back their original capital. While this does not seem to be particularly optimistic, it represents a massive improvement over 2004, when 71 percent considered that they would get back their original investment or even less. On the up-side, no informal investors that we polled in 2004 thought that they would receive 10 to 20 times their original investment in 10 years while in 2007 the figure had risen to 26.2 percent. Taking these predictions as unbiased, we calculate that the expected value of informal investors in the 2004 study was recovery of 73 percent of their original capital in 10 years. In 2007, that had risen to recovery of 365 percent of original capital in 10 years for a respectable expected annual rate of return of about 14 percent.



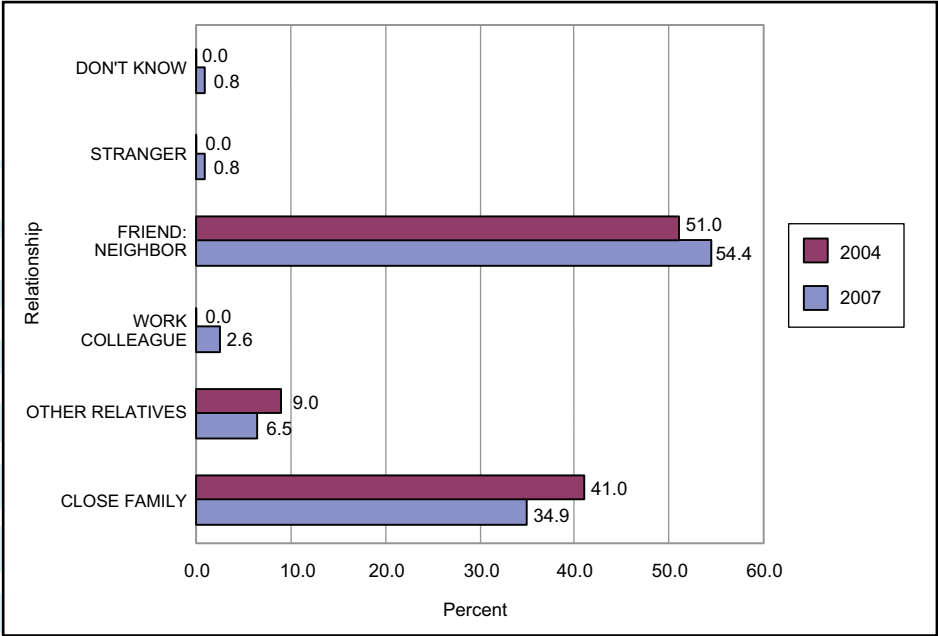
FIGURE 24: EXPECTED PAYBACK AMOUNT OF HONG KONG INFORMAL INVESTORS IN 10 YEARS



A feature of Hong Kong informal investment, first reported in our 2004 report, is that more investors appear to be friends of the investees (see Figure 25). In contrast, an average investor in GEM countries appears to be a family member. This finding seems to contrast with the common belief that the Chinese family supports its members in doing business. Some recent findings suggest that Chinese entrepreneurs worry about the interference of the family in their business and are concerned about the risk to the family, if they accept their investment¹². The implication of these findings is that informal investment is made by friends at least as commonly as by family members in Hong Kong. We do not have an “informal investor” or “angel capitalist” category. The GEM data does not show what proportion of the “friends” are in fact informal investors who are doing the investment for profit rather than for friendship. Nevertheless, we believe that informal investment should be strengthened in Hong Kong to improve entrepreneurship.

¹² Au, K., & Kwan, H. K. 2006. *Chinese Familism And Market Rationality In Start-Up Capital Seeking*. Presented in Babson College Entrepreneurship Research Conference, June, University of Indiana, USA. (Available at www.cuhk.edu.hk/centre/entrepreneurship)

FIGURE 25: RELATIONSHIPS BETWEEN INFORMAL INVESTORS AND THEIR INVESTEES IN HONG KONG: COMPARISON OF 2007 WITH 2004



11. FRAMEWORK FOR ENTREPRENEURSHIP

This section summarizes the strengths and weaknesses of the environment for stimulating entrepreneurship in Hong Kong. It concludes with recommendations as to what can be done to preserve and improve that environment.

Strengths and Weaknesses of Hong Kong's Entrepreneurial Environment

Each entrepreneur starts, grows, maintains and exits his or her business and each informal investor invests in the business within a social, cultural, economic and political context. Various factors, which GEM calls entrepreneurial framework conditions (EFCs) influence, stimulate and/or retard entrepreneurial development. This section discusses how EFCs shape the entrepreneurial climate of Hong Kong and how they should be cultivated to best stimulate entrepreneurship. We obtain data from (1) face-to-face hour-length interviews with 19 experts on various aspects of entrepreneurship in Hong Kong, (2) their responses to a standardized questionnaire, and (3) the questionnaire responses of another 16 experts who served as interviewees in our previous studies in 2002-4 (a total of 34 expert respondents to our questionnaire). Their names are listed in Appendix 4.

In the questionnaire, we presented the experts with a series of 88 statements about the EFCs, and asked them to indicate whether each of the statements was completely false, somewhat false, neither true nor false, somewhat true or completely true, and assigned scores from -2 to +2 respectively to these responses. We then scored the average responses to determine whether they were statistically significantly different from zero (neither true nor false). The responses of the 59 statements which were scored significantly different from zero together with their scores are given in Appendix 5. In the Appendix, the statements are ranked according to the degree to which the experts agreed with the statement. We also show for comparative purposes the responses of the expert interviewees from the years 2002, 2003 and 2004.

In contrast to the status of entrepreneurship in Hong Kong reported above, where there has been a dramatic improvement due to a renewed confidence in the future of Hong Kong, Appendix 5 shows that there have been no substantial changes to how the experts in our community view the EFCs of Hong Kong. The first 25 ranked statements, which reflect Hong Kong's strong framework for entrepreneurship, were also significantly agreed to by our experts in the early years of this decade. Particularly, respondents then and now gave high marks to the following EFCs:

- **Physical Infrastructure:** There is rapid and reasonably priced access to communications and utilities.
- **Culture:** Hong Kong's culture is highly supportive of success achieved through self-sufficiency, autonomy, personal initiative – where the individual has ultimate responsibility for managing his or her own life – and entrepreneurial risk taking.
- **Government:** Low tax rates are not a burden and regulations are predictable and consistently applied.
- **Status of Entrepreneurs:** Entrepreneurs are highly respected and reported in the media as competent, resourceful individuals whose start-up efforts are seen as an appropriate way to become rich.
- **Intellectual Property (IP) Rights:** IP rights are well protected by Hong Kong's comprehensive legislation and by widespread recognition that inventors' rights should be respected.

- **Services:** Good, professional legal, accounting and banking services are readily available to start-ups.
- **Women:** Society accepts that entrepreneurship is a viable option for women, and the women have the same level of knowledge and skills as men to take that option.
- **Innovation:** Consumers like to try out and value highly innovations in products and services.
- **Opportunities:** Individuals can easily pursue entrepreneurial opportunities.
- **Expertise:** Many people can react quickly to good opportunities for a new business.

In attempting to improve Hong Kong's entrepreneurship climate, it is important that these strengths be preserved.

Consistency is also evident among the EFCs where experts found Hong Kong to be lacking. Appendix 5 shows that 14 of the 16 statements where experts found the provision of Hong Kong EFCs to be significantly inadequate in 2007 were also significantly inadequate between 2002-2004. These conditions concern:

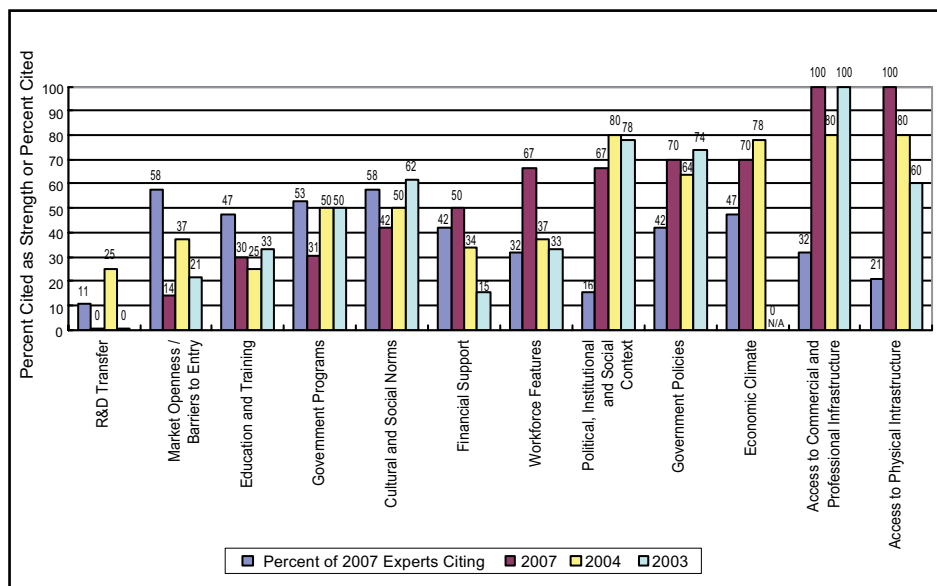
- **Education:** Primary and secondary schools do not encourage creativity, self-sufficiency, and innovation and do not teach enough economics or entrepreneurship.
- **Government Policies:** The government does not sufficiently support new and growing firms; its procurement policies do not favor new firms, and there are insufficient government subsidies available for new and growing firms.
- **Government Programs:** There is no "one-stop shop" where entrepreneurs can get assistance; moreover, government entrepreneurship programs are not easy to find or effective.
- **Science and Technology Transfer:** Transfer of technology from universities to the rest of the economy is not effective; there are inadequate government subsidies for new and growing firms to acquire new technologies, and new firms are unable to afford the latest technology.
- **Market Access:** Hong Kong lacks effective anti-trust legislation.

Although the EFCs are largely consistent in Hong Kong over the last few years, one should note some subtle changes.

- **A Growing Confidence in IP Protection:** The experts' confidence that people respect patents, trademarks and copyrights has increased.
- **Opportunities:** desirability of entrepreneurship as a career choice and start-up experience have improved.
- **An Increase in Calling For Government Intervention:** There is slight movement of opinion towards more government intervention in the economy with respect to entrepreneurship. This can be seen in the movement to significance of criticism of the government for having insufficient programs to stimulate entrepreneurship.

In wide-ranging open-ended interviews of about one hour each, we asked our experts to identify the three major factors that limit entrepreneurship activity and the three major factors that contribute to entrepreneurial activity in Hong Kong. Their responses in comparison to the responses in previous years' reports are summarized in Figure 26.

FIGURE 26: RELATIVE STRENGTH OF HONG KONG'S ENTREPRENEURIAL ENVIRONMENT 2003, 2004 AND 2007



Note: EFC Relative Strength Measure gives the percentage of the times that experts cited the EFC as a strength promoting entrepreneurship divided by the number of times it was cited as either a strength promoting or a weakness restricting entrepreneurship. The percent of experts citing gives the percent of experts that cited the EFC as any of the three strengths or the three weaknesses in our 2007 study.

It is interesting that the issues that most concern our experts about the factors that promote or impede entrepreneurship in Hong Kong do not necessarily coincide with the strengths or weaknesses of Hong Kong. Two EFCs concerning access to infrastructure – commercial and physical infrastructure – are considered absolute strengths, rating 100 percent in 2007. Yet they are only cited (in this case, both as strengths) by 32 and 21 percent respectively of our experts in any of the three most important strengths stimulating entrepreneurship and three most important weaknesses restricting entrepreneurship in Hong Kong. The most cited EFC concerned market openness and barriers to entry: 58 percent of experts cited it as either a strength or a weakness, with most considering it a serious weakness and only 14 percent considering it a strength. Education and training, government programs, and cultural and social norms are all cited by about half of our experts as important EFCs for entrepreneurship. All of these factors were cited more than other factors as strengths and as weaknesses.

In previous reports, we have detailed the strengths and weaknesses of Hong Kong's EFCs. As the above discussion and data indicate, these have not substantially changed over the last three years and so we will not repeat them here. The focus in the rest of our report, will be on what, if anything, should be done to improve entrepreneurship in Hong Kong.

12. RECOMMENDATIONS

All of our interviewees agreed with our premise that entrepreneurship is a positive force within society. We injected a sense of urgency into the question of what should be done, because we reported to our interviewees our previous findings which showed an unusually low rate of entrepreneurship for Hong Kong.

FIGURE 27: SUMMARY OF EXPERT RECOMMENDATIONS

Topic	Recommendation	Number of Recommending Experts
Education and Training	Educational institutions should offer practical business training courses with input from and meeting the needs of business in Hong Kong.	12
Government Policies	Hong Kong should more closely integrate itself into the Pearl River Delta.	6
R&D Transfer	Applied R&D funding from government should be increased and universities should place more emphasis on facilitating R&D transfer to industry.	5
Education & Training	Education systems – from primary through post-secondary – should stimulate creativity, exposure to new ideas and learning for life, rather than being exam-based and stifling.	5
Cultural & Social Norms	The people of Hong Kong should re-orient its culture to be less materialistic, more creative and more respectful of intellectual property.	5
Government Policies / Land	The government should release land and further liberalize land use to reduce the artificially high costs of land.	4
Government Policies	The government should limit its intervention in the economy, should not intervene to increase the rate of start-ups and should reduce bureaucratic impediments to business.	4
Education & Training	Experienced entrepreneurs should mentor the youth.	3
Cultural & Social Norms	Society should celebrate the successes of entrepreneurs.	2
Government Policies	The government should promote Hong Kong as a regional entrepreneurial hub.	2
Government Programs / Workforce	Hong Kong should recruit immigrants from the global and especially the mainland talent pools.	2
Government Programs	Hong Kong should have a design based Science Park.	1
Government Programs	The government should improve the running of its incubator programs.	1
Government Programs / Finance	The government should implement a US-like Small Business Administration to administer loan scheme.	1
Government Programs / Finance	The government should encourage venture capitalists to come to Hong Kong.	1
Education & Training	The public education system should be reformed to implement and properly assess elite schools.	1
	Total Recommendations	55

Notwithstanding our misplaced urgency, we believe that the opinions of our experts were not unduly swayed by our past results. In fact, several volunteered their opinion that entrepreneurship had bounced back in the years since our last study. There was considerable divergence of opinion, however, on what, if anything, should be done by the government, industry, non-profit organizations, educational groups, other organizations and individuals to improve the climate for entrepreneurship. Figure 27 contains a summary of the 55 recommendations we received (although all experts were invited to give three recommendations, two in fact gave only two). Below we discuss the recommendations.

Education and Training

Although education and training was only the fourth most discussed EFC when citing the strengths and weaknesses of Hong Kong, it was featured first in number of recommendations and the recommendations were the most consistent. In all, 21 of the 55 individual recommendations concerned improvements to education and training. Their content was remarkably consistent with each other and with recommendations that we have made in the past.

Recommendation 1: Educational institutions should offer practical business training courses with input from and meeting the needs of business in Hong Kong.

Many business failures are caused not because of the lack of ideas, but the lack of implementation and operational skills. As one entrepreneur stated,

"We have to change the belief that entrepreneurship is equal to being creative. Entrepreneurship is first and foremost implementation. If people want to be a boss, they first have to learn the skills and be tenacious to survive long enough. After that they can talk about innovation."

The 12 experts who made the first recommendation felt that the Hong Kong education system failed in providing skills that would help entrepreneurs. Why don't Hong Kong's schools teach required skills? One pointed the finger at the Hong Kong people by saying, "Here, the opportunities and aspirations are there for diplomas and degrees. But for entrepreneurs, you do not measure it by degrees."

The skills needed are accounting, finance, budgeting, writing a business plan, logistics, finding clients, and marketing. These should be offered in tandem with the teaching of specialties. One commented that Hong Kong had good designers, but they did not know about business. Another said the Academy of the Performing Arts trained students in various aspects of performing arts but not the business of the movie industry.

Many pointed to the need for schools to teach how to learn rather than to memorize facts. In line with the need for teaching relevant skills is the need to motivate students to understand how these skills are used in the real world through extra-curricular activities involving industry. We should adopt a holistic approach to educate the future's entrepreneurs.

In this recommendation, the interviewees were not actually asking that schools teach students to be entrepreneurs. Clearly, a young person leaving school is unlikely to become a successful entrepreneur. He or she has to understand what businesses do first. Only after they understand the value of an opportunity to an established business can they successfully create a new business themselves.

Hong Kong's education system is elitist. While one respondent thought that the elitism should be further perfected, several pointed to the gap whereby those not destined for university after reaching 15 or 16 feel they are finished and doors will not open to them. As one commented,

"A diploma in catering would help people. The problem is now that they all do a degree in the university and they come out of with a degree in hotel management. They all do a degree and they all want to work in the Mandarin Hotel. They come out of school at 21 knowing nothing and wanting to boss people who are twice their age. There is a desperate need for a real hotel school."

The emphasis should be on useful skills for future life. To design and teach these new courses, qualified instructors who are in touch with industry needs, such as field practitioners, would be needed. Yet, the present incentive mechanism encourages educational institutions to pursue academic recognition rather than industry acceptance. Therefore, incentive schemes and career paths for attracting and motivating qualified individuals from industry to pursue careers in the education have to be worked out.

Recommendation 2: **Education systems – from primary through post-secondary – should stimulate creativity, exposure to new ideas and learning for life, rather than being exam-based and interest stifling.**

Five of our expert interviewees recommended the schools should stimulate creativity and alleviate the stifling nature of the exam-based education system. One commented that young people are often channeled into studying courses that seem to promise high income regardless of student interests. A better way is to allow and encourage people to study a subject in which they have passion. Only with passion can a person become entrepreneurial. Another interviewee noted that Hong Kong people are actually quite creative, but that their creativity was based on

"... the daily experience of youth living in a very international city. So young people are exposed to new ideas. But the education system does not help and may even be dragging people away from being creative."

A third commented that Hong Kong schools do not teach students either to get on well with people or about life. They are so focused on the absolute need for students to pass examinations. He commented that

"... more and more parents are sending their kids overseas to be educated. When they come back, they are different. It is changing but slowly. Time is going to change this as we get to a younger generation of parents who are more enlightened and are more used to mixing in the world. It is an attitude."

However, the tolerance for ambiguity, experimentation, and even failure in the learning and creative process is missing in the present school culture. In creativity, there is no standard answer. But most of our parents, teachers and school administrators are still obsessed with quantifiable grades. The challenge is to encourage not only the students but their parents, teachers and school administrators to explore alternate means to learn and to give recognition to other talents and achievements.

Recommendation 3: Experienced entrepreneurs should mentor youth.

Three of our respondents placed the onus on entrepreneurs themselves. Programs like Junior Achievement, Youth Business Hong Kong and YDC School-Company Partnership working in tandem with the chambers of commerce and other commercial community organizations can improve on efforts of individual businesspersons who can make themselves available to educational institutions and to start-up entrepreneurs.

One respondent sketched out a social enterprise that might provide such mentoring.

"Get groups of new retiring baby boomers to help by forming advisory groups. These would not become board members. They would just be advisors. We can help you screen your plans. These should be entrepreneurs and successful businessmen to help prospective entrepreneurs. These new organizations should not be a part of government. They should charge people and be a social enterprise and should be viable."

Past Years' Recommendations on Education and Training

Our recommendations this year are consistent with recommendations we made in past years. Then, we suggested:

- Review the design of school curriculums to promote entrepreneurship. Teach students about investment, how to manage personal finances, attributes of an entrepreneurial spirit, and relationships between risk, success and rewards. Encourage and set priorities for education in the sciences, biotechnology and mathematics to promote the entrepreneurship environment for more technology-related areas. Train students for the knowledge-based and services-related businesses.
- Provide a balance of liberal arts and technical education – liberal arts in the early part of the education and technical training towards the end of the education program. Teach students that hard work, determination and creativity are keys to success, even in the entertainment industry, from where many youth role models are currently drawn.
- Give students the challenge of starting business and working in businesses as part of the educational process. Increase the participation of business mentors in secondary schools and tertiary institutions, whereby people with much experience and success in running and starting businesses from any sectors become mentors to students and would-be entrepreneurs.

As we observed in 2006, Hong Kong is still far from realizing the goal of becoming a knowledge-based society in which technology and innovation are created and supported by a ready and abundant pool of high caliber professionals and entrepreneurs. While Hong Kong has an excellent education system that has helped build a literate and educated populace, there are still insufficient graduates who desire careers related to research and development of science and technology. The long standing examination-oriented education system has not helped develop in its graduates the capacity for creativity, curiosity and independent thinking, which is essential for innovation and entrepreneurship.

In recent years, numerous initiatives have been implemented bringing the concepts of business into the classroom, and many schools have implanted business plan competitions and business fairs for student teams to try out their business ideas. The need for creativity is well understood in schools, even as we increase the pressure on our youth to perform well in examinations. Business mentors have become more frequent in the classroom and students understand the extra-curricular activities are important, if only for resume building. But as the comments of our experts this year make clear, much remains to be done before Hong Kong's education is a truly inspiring experience, providing useful skills and incentive for all students to become productive members of an entrepreneurial society.

Government Policies

Government Policies – the activities of government not specifically dedicated to entrepreneurship but providing the public sector environment for private entrepreneurship – have traditionally been seen as a strength of Hong Kong. So it is with some surprise that we note its relative strength measure in Figure 26 above has declined substantially from the early years of the decade (54 to 74 percent) to a slightly negative 42 percent. This indicates that our respondents are increasingly critical of the government's overall policies. This criticism gave rise to three general recommendations that distill 14 separate recommendations as follows.

Recommendation 4: Hong Kong should more closely integrate itself into the Pearl River Delta.

Our fourth recommendation was advanced by six of our experts making it the second most important recommendation, after Recommendation 1 above. It is not a criticism of the government's direction but of the speed and commitment of the government in following that direction. As one commented, "...CEPA is a good start but more has to be done." Many of our respondents echoed the opinion that Hong Kong's position within the Pearl River Delta would be severely undermined unless active engagement with Shenzhen, Guangzhou and the smaller municipalities was pursued at many levels of government.

Hong Kong should be "... a primary hub for entrepreneurship for the global Chinese community..." "...the catalyst for spearheading the development of the Pan Pearl River Delta Super Zone..." and "...the primary service hub powering the industrial growth of the region from engaging in OEM to ODM and OBM production...." China is moving from being "the factory of the world" to "the office of the world", and Hong Kong can play a major facilitating role in this vital process. The theme "Bring China Closer" was repeated by experts for use in research and development zones, urban planning with Shenzhen, high speed rail links, pollution control planning, and airports and container port planning.

Many cited as a barrier to entry Hong Kong's small market size. What would make people pay more attention to an investment in Hong Kong? A larger market! Business must expand its market and scope to Shenzhen and the rest of the Pearl River Delta.

Recommendation 5: The government should release land and further liberalize land use to reduce the artificially high costs of land.

The high cost of land has consistently been cited by our interviewees as an impediment to entrepreneurship in Hong Kong. Four of our respondents this year suggested that government take action to reduce these high costs.

One adamantly said,

"The bureaucrats are always talking about low taxes. But Hong Kong really does not have low taxes. We have very high taxes. Look at the real estate taxes. We don't call it tax but it is de facto tax we pay. The whole real estate situation should be looked at. Real estate is so lucrative. ... Look at Kwun Tong. It is just sitting there unless you pay this hefty land premium fee. Change the land premium and redevelopment so that the little guy can play.... Tong Chee Hua was right to release new property into the market. But he just timed it wrong."

A recurring theme was that the high cost of land was enjoyed particularly by Hong Kong's large property developers. One suggested that empty land held for development be taxed to encourage its use.

Recommendation 6: The government should limit its intervention in the economy, should not intervene to increase the rate of start-ups and should reduce bureaucratic impediments to business.

A strong contingent of experts on entrepreneurship in Hong Kong are steady supporters of positive non-interventionism. They believe that the *laissez faire* policies of the past have served Hong Kong well, are largely consistent with liberal economic thinking and work well. Commented one,

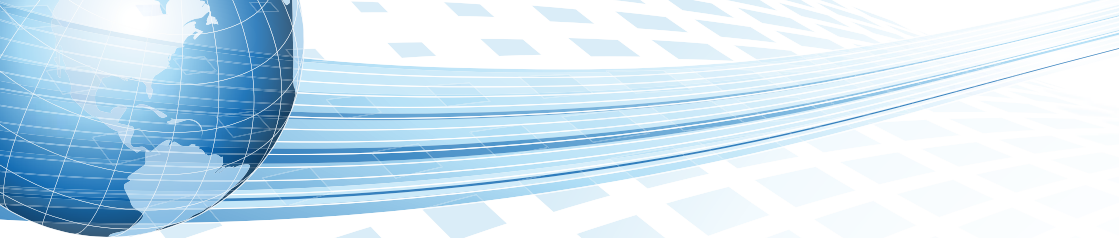
"It is pretty hard to fault the Hong Kong government on what they do. They may not do too much to help, but at least they do not get in your way. I do not think it is the job of government to do a lot of these things. Yes, the government should fund universities and provide the educational framework. Keep things are they are. Hong Kong is a free society. It scores well. You should be very careful about tinkering about things that work."

And among these respondents, there is a suspicion of any government program that encourages people to do something other than what they wish to do. One said

"I feel that can be very lonely in a community of seven million to be screaming, 'Hurry! Hurry! Start-up! Start-up!' I am uncomfortable with that."

Another commented:

"I am not sure that there should be any encouragement to start up. It is a big blow to people to encourage them to start a business and have them fail. It comes back to the competition policy.... I have a very mixed feeling on whether the government should be encouraging entrepreneurship. We have to be very choosy."



Another expressed his ideas this way:

"Encouraging too many low-quality start-ups may not be economically benefiting because valuable resources may be drained away and copy-cats, without advantage, can only opt to compete on price. As a result, it hurts even the well-run businesses."

This opinion injects a caution into any industrial or competitive policy the government may advance. At the same time the fear of the government growing large and becoming bureaucratic and inefficient drives these supporters of *laissez faire* to attack inefficiencies in any aspect of government's intervention into industry,

"The government has to improve the coordination between departments that are responsible for issuing licenses to small businesses. It is fortunate that most government officers are honest and upright. Otherwise, the trouble of getting through the bureaucracy and lack of transparency would have invited business owners to bribe their way out. ...The government may consider to set up a unit that coordinates or even provides one-stop services for license issuing, and gives clear rulings on grey areas for business owners to follow."

Recommendation 7: **The government should promote Hong Kong as a regional entrepreneurial hub.**

Notwithstanding the caveat expressed in Recommendation 6, the government does have a role in promotion of Hong Kong throughout China and overseas. One of our respondents suggested that by having a government agency looking into the interests of new and rapidly growing businesses, Hong Kong's role as a regional entrepreneurial hub could be advanced. Another respondent suggested that Hong Kong's aspiration to be a world class city on par with London, Paris, Tokyo and New York required that entrepreneurship and culture be stimulated by leadership in government. He made a comparison with the UK,

"Like London, when the Blaire government first came to power, they promoted the hip, cool, Britannia. London being a center, not just financial. There was a convergence of arts, design, music, fashion following one vision. ... Maybe we need a second cultural revolution. If Hong Kong wants to be a cultural hub it must put its energies into being cultural hub. ... Maybe the person at the top has no vision. A lot of designers think this cultural hub will not work unless someone has the vision to pull it through. Hong Kong has the potential. But we do not have somebody in charge to pull the whole thing together. It does not have to be the Chief Executive, [but] if we want to be a cultural hub, we must have a coordinator."

Past Years' Recommendations on Government Policies

Our recommendations mirror those that we made in previous years. The first, fourth, sixth and ninth recommendations in our first study (2002) were

- Implement no policy change that will cause substantial increases in government spending
- Simplify applications procedures for small business
- Do not attempt to prop up property prices, and
- Increase access to and links with the PRD

While we basically stand by these recommendations, it is noteworthy that we made the first recommendation when the government was running a fiscal deficit. The requirements for no spending increases may be relaxed today, especially concerning our next topic.

The word “intervention” means different things to different people. Instead of saying whether there should or should not be intervention, it will be more fruitful to discuss where, how, by whom and to what degree such intervention should be conducted. Also, all the policy recommendations have to be rested on the premise of “trust”. If there is an absence of trust between the government and the stakeholders, any kind of intervention or lack of it will be politicized. However, such trust takes more than just good intention. Results must be aligned with public opinion.

Research and Development Transfer

The third most common recommendation, which was given by five of our experts concerned R&D Transfer.

Recommendation 8:

Applied R&D funding from government should be increased and universities should place more emphasis on facilitating R&D transfer to industry.

Laissez faire notwithstanding, the government does have a role to play to encourage local industry to be technologically active. As we discussed at length in our 2006 study, there are strong economic arguments based on the concept of externalities for government funding of research and the transfer of R&D from research institutes to the economy. Because knowledge, even in the presence of IP protection, can easily leak from the developer of the knowledge to those who did not develop it, there are fewer incentives to develop knowledge than is economically optimal. To restore optimality, the governments should subsidize R&D and its dispersion.

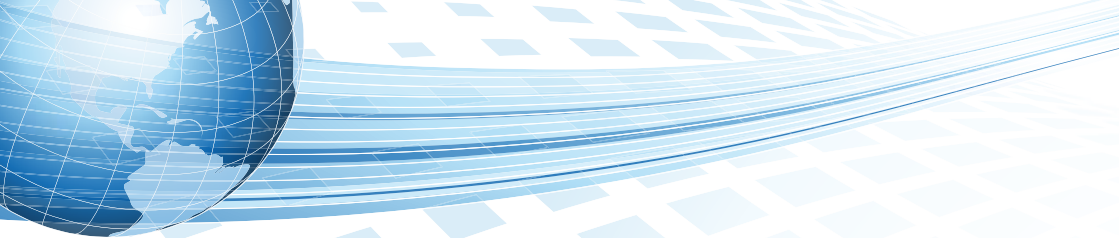
The Silicon Valley model in the US is admired by many entrepreneurship experts. As one respondent identified it,

“Universities should be in bed with industry. Money follows the market. So I don’t know how much one can do about this. [At] Stanford University ... the whole university is funded by the big industries. The best students are being poached by industry while they are at school. The universities generate a huge amount of knowhow. The thing feeds on itself. Industry is involved with the universities. The universities therefore generate patents and inventions and the VCs are swarming around these. That is the classic case of universities, industry and VC. I don’t think that happens in Hong Kong.”

“Universities here have to be a lot more open to industries. If the industries are looking at what the universities are doing, the money will come. They should be a little less controlling of their researchers.”

Interviewees commented on the stingy attitude of the Hong Kong government on R&D when compared with the US, China and Singapore. Said one respondent,

“I visited the Chinese Medicine Center at CUHK. It has a budget of US\$1 million. What can you do with \$1 million? All you can do is pay a few researchers to do toxicology. ...Singapore has invested enormous amounts of time money and energy into medical research and Hong Kong has done almost nothing to develop that kind of applied research.”



Notwithstanding these arguments, however, even some of those who recommended increased R&D funding were uncomfortable with the role of the government as a picker of winners. As one stated, "The trouble with government funding is that it creates a bureaucracy." He had no clear-cut answer, but he was not impressed by the current system of funding applied research:

"The present systems of getting grants for applied research just aren't working. It is biased towards university professors, who know how to write grant requests and fill out the required forms and away from those who would start up companies."

Currently, the incentive mechanism at our universities places more emphasis on academic recognition than industrial applications. To ensure universities are in touch with the markets without sacrificing their missions to advance theoretical knowledge and nurture human minds, bridges through intermediary organizations, such as HKPC, ASTRI and the six Hong Kong R&D Centres, have to be built and further developed to encourage collaborations, so as to facilitate technology transfer from basic research to applied research and commercialization.

Past Years' Recommendations on Research and Development Transfer

The conclusions of our experts are in accord with the analysis we did in past studies. Our 2002 and 2003 work concluded that universities should create a better atmosphere for communication and sharing of information and research with entrepreneurs. Technologists within firms and the government, professors active in relevant areas, and entrepreneurs should meet to discuss possible innovations and how to work together to bring needed products and processes to market. In our 2006 study *High Growth Start-ups and Government Policy*, we suggested the following policies, which we still favor:

- We argued for measured increases in R&D funding to bring Hong Kong into line with other advanced economies.
- We opined that given the prevailing principles of positive non-intervention in Hong Kong policy-making, and the national and international trend towards emphasizing the primacy of market forces as drivers of innovation, support schemes need to be targeted carefully.
- We recognized the success of early-stage R&D transfer debt financing for SMEs in the SERAP program.
- We supported the growth of R&D clusters and a coordinated package of policies involving the cooperation of governmental agencies, research organizations and industrial associations that could provide vital assistance to high-growth firms in such clusters.
- We supported the coordination of cross-border policy initiatives for high growth entrepreneurship to tap the very dynamic and well-qualified entrepreneurial resources in Shenzhen.

Cultural and Social Norms

Five experts' comments are combined in the following recommendation which forms perhaps the most diffuse recommendation we make – a call for an increase in the level of Hong Kong culture into a more refined, respectful, creative society, as efficiency, compliance and standardization need to give way to novelty, variety, and experimentation.

Recommendation 9: The people of Hong Kong should re-orient its culture to be less materialistic, more creative and more respectful of intellectual property.

Preservation of IP rights is essential for incentives for innovation and creativity among entrepreneurs. Interestingly, the same experts who called for increase in respect for IP rights also called, in the same recommendation for Hong Kong's culture to become less materialistic and more respectful of other intellectual and cultural pursuits. One expert expressed it is follows:

"People say Hong Kong is such a free market. But for my daughters and their friends, it seems that for someone starting from scratch the opportunities in the UK seem wider and more open than in Hong Kong. They find it harder because there are entrenched likes and dislikes in the market. People are not prepared to have space for the creative among consumers. Perhaps Hong Kong is too utilitarian, too practical. Everything is so direct. Please deliver that dollar. The value system needs to be widened so that people are appreciative of the intangible as well as the tangible.... There must be promotion of thought among your people. You must promote culture and thought in your people in school and extracurricular activities in the community. In Hong Kong everything is very quantitative. I do this. Do I deliver a result? Now there is more demand for a better quality of life. I want to widen the value system. ... Now we need to ensure that the entire community values incorporate the intangibles, so the consumers will be prepared to pay for these intangible values."

One of these intangible values is respect for ideas. But in Hong Kong today, as one of our interviewees said:

"There is no respect for design. There is no respect for intellectual property. They buy fakes and they download materials from the Internet. People do not see it as a big deal. It is not taken seriously. Until we respect design and intellectual property, we will never become good designers ourselves. Even at the education level, people should be taught that it is wrong. Ethics mainly should be taught. I do not know how you can instill a sense of moral obligation, but maybe you can instill artistic appreciation. A lot of westerners would find piracy unacceptable. But in Hong Kong it's alright. They don't understand why I should be paying more for something that is well designed. If we are a cultural hub – I think [Hong Kong] has very good potential for being that – we have to address the problem of appreciation for intellectual property."

One took the question to a philosophical level:

"Hong Kongers have to adjust their lifestyle and way of looking at things. They should slow down their pace and take a step back from materialism and selfishness. Instead they should strive to discover the spiritual side (from Buddhism) and look to achieve serenity. This way, they could find more love and use this new balance to discover opportunities they have overlooked. The underlying idea is that if a person is busy all the time, one cannot concentrate to look into things and could not establish good human relationships for getting things done."

Opportunities for pursuing social and cultural values besides economic ones have to be promoted and integrated into the social fabric, media sector, and education system of Hong Kong. We believe that the current interest in social enterprises and cultural industries are positive evidence that cultural re-orientation may be occurring. If creation of values through innovation is at the heart of entrepreneurship, then we need to increase tolerance for ambiguities, experimentations, individual expressions, and failures. We need a broader view of value beyond the dollar sign. Passion for excellence, for products and services, serving the needs of the target customers, paradoxically, is more important than the financial gain that results from it, because it is where the drive for entrepreneurship is. Our young should develop a passion for learning and creativity without the fear of being rejected. This is easy to say but hard to do given our prevailing view on success and our obsession with the dollar sign. But still, this is what we have to do.

Recommendation 10: **Society should celebrate the successes of entrepreneurs.**

A more concrete recommendation, suggested by two of our experts, echoed a recommendation that we made in past studies. Successful entrepreneurs should be celebrated. These should include not just the largest tycoons but those who have contributed by developing the many Hong Kong small and medium sized companies that compete locally, regionally, and globally in goods and services production. These same entrepreneurs should be encouraged to give back to society, not just financially, but also with their time. They should share their stories to the public and teach from their experiences and help continue the tradition of successful entrepreneurship.

Recommendation 11: **Hong Kong should recruit immigrants from the global and especially the mainland talent pools.**

Our final recommendation also mirrors one recommendation we made in 2002. Then as now, we believe that our immigration policy should be that anyone in China who has a university degree should be permitted to immigrate to Hong Kong, although rights of permanent abode should be based on years of tax-paying residence and rights to social welfare, free schooling, etc. should accrue only with rights of permanent abode. In our 2006 study, we expanded on the recommendation. The shortage of domestic talent can be remedied with immigration and the government should take a pro-active stance in recruitment of talent.

The benefits of immigration to Hong Kong were expressed by one of our experts in our GEM 2007 study as follows:

"The best way to create opportunity for growth is to disturb equilibrium. If you can get the top one percent of China to come (to Hong Kong), you have won. Bring in the best from China. Now there is quick money coming into Hong Kong, for speculation. But you have to get them to stay. ...They get incompetent people at the top and you get a gang war. Reverse the brain drain. This needs to be thought through. You have to bring in permanent talent. How did Hollywood get the best in the world to go there? What about Silicon Valley? Why do these things happen? How do you do this? I have no idea. But it's worth studying."

Among all of the major cities in Greater China, spanning the PRC, Taiwan, Hong Kong, and Macau, Hong Kong has the most appeal to serve as the primary hub for entrepreneurship for the global Chinese community. Talent from throughout the world should be encouraged to come to take advantage of Hong Kong's unique position as the most sophisticated, open, reliable, exciting, and well connected Chinese city.

13. PRACTICAL INSIGHT AND ADVICE

Our final section in this report presents practical advice to Hong Kong entrepreneurs on four critical aspects of their businesses. Since most readers interested in entrepreneurship in Hong Kong are in fact concerned about “being a boss” rather than “being Bill Gates”, we focus on the SME. We are grateful to Mr. Edwin Lee of Hong Kong Business intermediary Co. Ltd. for providing the following four articles.



Edwin Lee CPA, CFA, CBI
Founder and CEO
Hong Kong Business Intermediary Co. Ltd. (HKBI)



Edwin Lee is the Founder and CEO of HKBI, the first and leading business broker for small businesses in Hong Kong. Winner of the HKMA's 2008 Quality Award, the highest business accolade in Hong Kong based on the Presidential Malcom Baldrige Award in the USA, HKBI is dedicated to promoting entrepreneurship in Hong Kong through the most efficient way of starting a business: Buy a Business.

Named the Innovative Entrepreneur of the Year 2007 by City Junior Chamber of Hong Kong, Edwin is currently a Director of the Board and Chairman of International Committee of the International Business Brokers Association (IBBA), the world's largest association for business brokers, based in Chicago, USA.

Edwin is a US Certified Public Accountant (CPA), a Chartered Financial Analyst (CFA) and a Certified Business Intermediary (CBI). Edwin received his B.S. Finance and M.S. Accounting from University of Southern California, USA. He is currently earning his degree in Doctor of Business Administration at the Hong Kong Polytechnic University.

NEGOTIATION SKILLS FOR BUYING AND SELLING BUSINESS

For all its importance to a successful transaction, the art of negotiation is often overlooked by both buyers and sellers of businesses. Negotiation defines the final value of the business. It is often the most dramatic segment of a business sale.

Negotiation from Buyer's Perspective

Negotiation is a basic means of getting what you want from others, while ideally still being able to make the others feel good about themselves. You have to negotiate with substance, knowledge and skills, but negotiating successfully to buy a business also requires a greater understanding of the dynamics of a deal.

- **Adequate Preparation** – You can never obtain enough information on the industry and the business. In addition to having formal proper site visits, casual visits when the seller is not present can give the buyer additional insights of the key issues of the business. Also, one of the most important skills a negotiator can possess is the ability to see the situation from the other side. You should go into the meeting understanding the seller's perspective in order to optimize meeting efficiency.
- **Beware of Seller's Emotion** – Sellers often have deep pride in and derive self-respect from their businesses as they have invested years of sweat and tears into them. Sellers' business support their employees and customers as well as their own families. Respect the sellers' businesses and appreciate their efforts. Building a goodwill bridge between you and the seller is of utmost importance to setting a strong foundation for negotiation going forward. Show the seller that you will take care of the employees, suppliers and customers and that you will live up to the reputation that the seller has established. I have seen too many cases where a seller accepts a buyer with a lower offer because he/she sees a better "fit" and "appreciation of the business." Don't be the victim of offering to pay a higher price but still not getting the deal!
- **Sincere Presentation of Offer** – Face to face presentation is important to show the seller that you are sincere about making the offer. First you should express interest in the business give the reasoning behind the offer. Then you should give the offer itself. You should also realize that the seller may need time to digest the offer. After all, many sellers do not get a second chance to sell their businesses.
- **Be Prepared for Seller Demeanor** – You should be prepared for a seller's negative reaction that you may feel is unwarranted. The seller may become very upset and disagree vehemently with your offer upon first presentation. The reaction could be an honest one, or it could simply be the seller's negotiation technique. You should find out where the agreements and disagreements are, and start resolving the easy issues first, leaving the most difficult issues to be resolved later.
- **It's Not a Zero Sum Game** – You should think of alternative ways to resolve the differences with the seller so that there is a win-win situation. Each side can work to establish a mutual understanding: you and the seller most likely have different needs that can be addressed with some compromising on non-critical points. However, you should always get something in return for any substantial concession. For example, you could increase price but simultaneously ask for a later payment. Focus on the needs of both parties. Think win-win.

- **Be Aware of the Dynamics of Price and Terms** – Most buyers focus mainly on price rather than the other terms of the sale. However, in many business sale transactions, the other terms are often the deal breakers, not the price. You should first focus on getting agreement on the other terms before getting to the price. Adjusting the price can compensate for most of the issues in other terms, but usually the reverse is not true. The most important non-price terms involved in a business sale transaction include:

- **Assets and Liabilities List** – What are the assets and liabilities included? How are the payables and receivables accounted for? How does the buyer discover, assess and limit hidden liabilities and contingency items from adversely affecting the value of the business?
- **Length of Transition Period** – How long is the transition period between you and the seller? What role and duty does the seller play during the period?
- **Due Diligence Arrangement** – What financial accounts and operation information should be examined? What are the maximum allowed discrepancies from those warranted in the sales document?
- **Covenant Not-to-Compete** – Is the seller willing to sign a covenant not to compete following the sale? If so, what is the scope and period of the non-compete agreement?
- **Payment Method and Terms** – How do you pay for the transaction? In cash or in stock? In one lump-sum payment or by installments over time? If delayed payment is contemplated, does interest accrue? If payments are delayed, what recourse does the seller have?
- **Lease and License Arrangement** – Who has the responsibility for lease and license transfer? What are the consequences if such transfers are not successful?
- **Performance Guarantees and after-Sale Support from Seller** – Is there is a profit guarantee, earn-out agreement, etc after sale? How does the sales agreement to provide incentives to the seller to support the business so that its performance remains strong prior to closing and after the sale?

- **Preserve the Relationship** – You and the seller should keep your mutual respect intact and remain cordial and professional at all times. When an impasse is reached, break off and reconvene some other day in the near future. After all, a positive relationship is essential not only during negotiation, but most importantly, during the handover stage in order to ensure a smooth transition of ownership beneficial to all stakeholders of the business.

Negotiation from Seller's Perspective

Many of the negotiation skills of the seller are simply the reverse of the above techniques of the buyer. You should make preparations similar to the to-do list of the buyer. You also need to pay attention to proper preparation before meeting your counterpart, understanding the dynamics of terms and price, and thinking win-win to preserve the relationship. The following is an additional watch list for you during the negotiation process.

- **Listening More Than Talking** – Many sellers spend most their time talking about how much effort they have put into building the business but forget about listening to what the buyer wants. Over-talking makes you appear anxious to sell the business and blocks you from gaining invaluable information from the buyer that may give you hints on negotiating for a better price. Focus on the buyer, not on yourself.
- **Avoid Undesirable Surprises** – There is an old adage concerning the disclosure of strengths and weaknesses of the business: "Start low and go high - buyers pay good prices. Start high and go low - buyers walk away." A buyer will understand that there are always weaknesses in a business. Truthful disclosure from you makes the buyer more comfortable about your integrity. On the other hand, discovery of unpleasant surprises by the buyer will make him or her walk away from the deal as he or she sees it as an early sign of more hidden problems in the future. I have seen too many sellers hiding weaknesses in their business. Trust me, they will come out sooner or later. Don't hide and don't lie. Buyers hate bad surprises.
- **Demonstrate Room for Improvement** – Contrary to what many sellers believe, weaknesses in a business are good. They evidence the room for improvement. But too many sellers hide them. Remember, the buyer pays a price, which is a fact. But the buyer buys expected value, which is an opinion. The buyer buys your business mostly based on the belief that he or she can do better than you do. He or she can do that because of the weaknesses in your business. Lead the buyer to find them. Room for improvement will enhance the price of your business.

How much you pay or receive hinges on how well you negotiate as a buyer or seller. Seeing the deal from both perspectives can greatly enhance your understanding of the key deal dynamics. Getting what you want may not necessarily cost the other party anything. Keep in this mind: it is not a zero-sum game. Think win-win.

WHERE TO GET YOUR START-UP CAPITAL

Don't be shy about it. You need money. All successful start-ups typically go through four stages: (1) Start-up Stage (no income is generated yet), (2) Strive-for-Survival Stage (cost is more than income), (3) Paying-Back Stage (income is more than cost) and (4) Excess-Return Stage (investment has been paid-back: any return is considered excess). In order to survive and succeed, you will need sufficient personal savings to support the business throughout the different stages. I know, however, that you may not be so fortunate as to have the required cash on hand.

Raising money is one of the most basic business activities, yet this need is underestimated and unplanned by many entrepreneurs. Traditionally, it has been hard for small entrepreneurial ventures to obtain capital, especially in the start-up stage. The following options may be available to you.

Self Financing

In most cases, your business is born out of your personal savings. Many lenders and investors refrain from risking any capital on your proposed business unless you have a vested interest in it. By utilizing your own money, you risk your finances but do not relinquish control of the business. Your required rate of return is typically lower than equity financing by a third party because part of your return comes from your personal satisfaction and sense of achievement that cannot be quantified in financial terms.

Debt Financing

You may think that debt financing offers a wide choice of capital needed for your business start-up. Yet debt is usually not available for start-ups. Debt is a form of external funding based on receiving a loan from an outside source, repayable over a specified period of time at specific interest rates. Similar to self-financing, debt financing does not require that you relinquish control of the business as long as you meet the repayment terms.

Debt financing from formal institutions – banks, finance companies, credit unions etc – includes loans that are either secured or unsecured.

- **Secured** – Secured loans simply offer the lender some form of security (collateral) as an assurance that the loan will be repaid. If you default on the loan, you forfeit the collateral to satisfy the repayment of the debt. Most lenders will ask for security of some sort on a loan. Such security typically includes a personal guarantee, equipment, real estate, account receivables, saving account, etc. Unless the personal guarantee is very strong, or unless you are prepared to borrow against the equity in your apartment, secured loans from banks are hard to obtain for a new business. This is because new businesses typically do not have a substantiated track record, strong balance sheet or stable earnings history.
- **Unsecured** – Unsecured loans are simply loans that do not require any form of collateral. Typically only an established business can obtain unsecured lines of credit and term financing. Alternatively, you could rely on a personal unsecured loan. Here, your personal credit reputation is generally the only security the lenders can rely on. Unless you are rich and have a good credit history, unsecured loans are typically small, short-term oriented and carry significantly higher interest rates than secured loans. The classic unsecured loans include credit lines from the credit cards and finance companies.

Sorry to tell you, but it's best that you forget about debt financing from formal institutions for your small business start-up. Instead, you should consider informal borrowing.

- **Friends and Family** – Although you may not like the idea of borrowing from friends and family members, they remain some of the most popular avenues for financing to start a business. These loans are typically unsecured and some may not even carry interest. In fact, some informal lenders do not even expect a payback as your friends and families may be fully aware that many start-up businesses fail. They just want to be supportive of you.

Government and Non-Government Organization (NGO) Backed Financing

Given the difficulty in obtaining bank financing at the early stage of business start-ups, many economies have government and non-government organization-backed financing to assist entrepreneurs to get the business started. In Hong Kong, some of the available financing sources are:

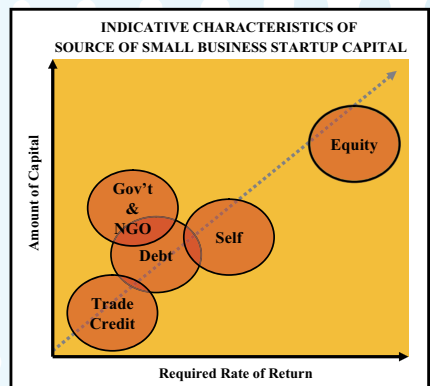
- SME Loan Guarantee Scheme (SGS) from the Trade and Industry Department of Hong Kong SAR – It aims to help small and medium enterprises (SMEs) to secure loans from banks for acquiring business installations and equipment, and meeting working capital needs of general business uses. SGS provides government guarantee of 50 percent of the loan approved by participating banks. Because half the loan is bank financed, however, the terms of the SGS loans are typically no less stringent than bank loans. SGS covers the following two types of loans:
 - Business Installations and Equipment Loans (up to a maximum guarantee limit of HK\$5,000,000)
 - Working Capital Loans (up to a maximum guarantee limit of HK\$1,000,000)
- Youth Business Hong Kong (YBHK) from the Hong Kong Federation of Youth Groups – YBHK was set up in 2005 as part of a worldwide program dedicated to helping young people (between the ages of 18 to 35) in Hong Kong to start their own businesses. Seed money of up to a maximum of HK\$100,000 is provided to each successful applicant as an interest-free business start-up loan.
- Incubation Programs from the Hong Kong Science and Technology Park – Mainly dedicated to technology and design start-up businesses. Each eligible incubatee has an opportunity to access a package of financial aid valued over HK\$500,000 during the incubation period.
- The Innovation and Technology Fund of the Hong Kong government runs a Small Enterprise Research Assistance Program that provides up to \$2 million dollars in 50-50 match funded non-guaranteed loan for research and development expenditures for small enterprises that will result in upgrading the technological level of Hong Kong industry.

External equity financing involves selling off a portion of your equity interest in the business to outside investors who may or may not actively participate in the management. The key variables involved in equity financing are how much control you give up, to whom you give it, and at what price. Potential investors are:

- **Active Management Partner** – This is the most common form of equity financing where you find another partner(s) to invest the capital and jointly manage the business. While partner(s) may assist you for securing the initial capital, a well-thought and proper execution of a partnership agreement can prevent significant management disputes as the business grows in the future. I'm sorry to tell you that, based on my experience of dealing with hundreds of businesses for sale, most partnerships fail when two or more partners are active managers. There is usually nothing wrong with the business or either partner's management style, but people are simply different.
- **Passive (Silent) Partner** – This is among the most popular ways of equity financing for small businesses as it helps to avoid management conflicts in the day-to-day operational matters. The partner(s) are typically your friends and family members. They are either eager to take part in a potential business venture success or to demonstrate their support to you through capital commitments, but may not expect much financial gain in return.
- **Venture Capitalists** – Professional institutional investors, known as venture capitalists, are an important source of capital for very rapid growth businesses and businesses needing capital prior to initial public offerings. Only a few venture capitalists invest in start-ups; most prefer to invest in proven or existing business poised for rapid growth. Typically used in financing high tech businesses, venture capital is also available for a wider range of businesses, as long as those businesses promise strong returns. However, most venture capitalists will not invest less than US\$1 million, an amount beyond the needs of most entrepreneurs starting small businesses. It's my advice that you forget about this source for now.
- **Business Angels** – Individual investors interested in providing seed and start-up financing are commonly referred to as angels. Business angels, unlike venture capitalists, prefer to invest their money in operation as early as possible. They elect to take high risk for high returns. Most are veteran business people looking for an investment they can monitor and help to grow, which is why a business angel usually invests in a business where he or she has industry expertise. Angels typically rely less on the numbers in projected financial statements than on personal insights, belief in a business idea and its growth potential and the passion for success and competence of the entrepreneur.

Trade Credit Financing

This is often the most neglected source of financing for your business. Trade credit financing comes from the business suppliers. Although suppliers seldom extend credit to newcomers, there is no harm in trying to secure such financing by suggesting a better price to the suppliers in return for favorable payment terms. The suppliers may end up giving you half the order on credit with balance due upon delivery or several days later. Now the trick is how you can secure the orders and payments from the customers before settling payments with the suppliers.



HOW TO MAXIMIZE THE VALUE OF YOUR SMALL BUSINESS FOR SALE

Through my experience of selling hundreds of businesses, while your small business might be performing well by itself, you often pay little attention to taking the proper steps towards maximizing business value on sale. Business value is largely a function of business performance, which can be greatly enhanced by financial clarity, management efficiencies and deal process effectiveness.

Clear Financial Records

Clear, verifiable and recastable financial records which clearly show the true historic earning power of the business are needed to secure confidence from potential business buyers.

- **Keep Good Record of Receipts** – While buyers of small businesses often understand expenses are hard to track, they expect you to have solid proof of the financial top line – Revenue. When hard evidence of receipts cannot be provided, you may have a tough time justifying your company's value. Allowing the buyer to observe company operations over a specific period may offset some of the negative impact of providing insufficient proof of revenue. Many sellers, however, may not like such an idea as they think it may be disruptive to the business and may lead to breaches in confidentiality.
- **Maintain Detailed Records of Verifiable Expense Items** – You should separate personal and unusual expenses from normal expenses of the company. Do not bury them in the business' daily operational expenses. Most buyers understand that you may charge personal expense to your company's accounts. However, clear separation of these expenses would help to enhance transparency of financial statements raising the business' value.
- **Be Crystal Clear on Outstanding Liabilities** – Many small businesses, particularly those in the service industries, have customer prepayments (e.g. outstanding service packages). While you may consider those packages to be a valuable "assets" to ensure customer returns, many buyers also see them (accurately, from an accounting perspective) as major liabilities that require fulfilling without receiving further payments from the customers. You should be crystal-clear about the outstanding amount and expiration dates, if any. Buyers may expect you to be liable for some or all of them and must take them into consideration when valuing the business.
- **Dispose of Non-Productive Assets** – Your non-operating machinery and outdated inventory should either be sold or scrapped and removed from business premises. Excessive non-productive assets may give buyers the false impression that the business has low asset utilization rates. Take away your personal collectibles too. Buyers want to keep what they see.

Proper Management and Operation

Financials are important, but a good management and a smooth operation are also key factors for buying decisions. Buyers are affected by the appearance of the business and their perception of room for operation improvement in the future.

- **Lower Dependence on Owner (You)** – Buyers buy a business for two reasons: (1) The business can continue successfully without you and (2) The buyer can do better than you. Buyers highly value a smooth handover. They want the business to run profitably without your minute-by-minute attention. They want to see weaknesses in your business as they are signs of room for improvement. Show them that you are not needed in the business. Lead them to find weaknesses in your business. Room for improvement will make them pay a better price for your business.
- **Tidy-Up Premises and Practice Good Housekeeping** – The appearance is important. You should not let the business look as if it has been neglected. Spruce the premises up! Buyers like a pretty business.
- **Eliminate Irregular Practices** – Many small business owners may engage in practices that stretch the limits of the law. You should make every effort to eliminate irregular practices. Buyers will be wary of the impact of such practices after handover, particularly if the legal authorities are required to be notified of the change of ownership.
- **Maintain a Clear Operation Flow and a Keep a Complete Customer Database** – Buyers are more confident in businesses where routine decisions are made and standard procedures are followed. Buyers want to see a customer base in your notebook or in your computer. Write down the operation flow; describe how you do it and who your customers are. A clearly written operation manual and customer database can help facilitate a smooth transition of business owners, thus raising the value of your business.

Professional Deal Process

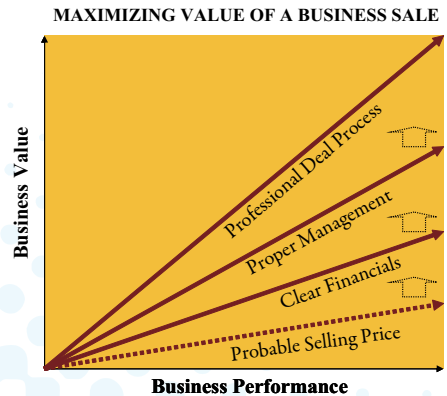
Professional handling of the deal process is essential to protect the value of the business.

- **Targeting the Buyers** – There are at least six types potential buyers for your business. They are known as horizontal (your competitors), vertical (along the supply chain), complimentary (also known as strategic), financial (purely for returns), overseas, and individuals. They often see different values in your business due to their personal and investment needs being different. Target the right ones.
- **Avoid Last Minute Surprises** – Many sellers exaggerate the strengths of the business but neglect, or even hide, the weaknesses. Many weaknesses or flaws do not emerge until the later stages of due diligence. Such negative surprises often scare the buyers away or disproportionately affect business values as buyers see those surprises as early signs of more hidden problems. Don't hide weaknesses! They will come out sooner or later... the sooner the better.
- **Focus on Your Business** – Don't let the numbers drop! If you can, put extra effort into the business and make the figures better in the final months. Outperform the past! The more recent the financial figures, the more important they are to business valuation.
- **Maintain Confidentiality** – Rumors hurt confidence of your existing employees, suppliers, customers and alliance partners: they may vanish if the company's future seems in doubt. Loss of employees, suppliers, customers and partners would adversely affect valuation significantly, and might jeopardize the success of the business handover. Hence, confidentiality is a must during the whole preparation and the sale process. As the golden rule says, the best sale is: "Sell it quickly and discretely."

- **Set Up a War Room** – Sooner or later, buyers will want to see various documents pertaining to your business, probably at the due diligence stage. It is advisable to plan ahead and locate all the documents in one file drawer or location. These documents include lease agreements, bank and clients agreements, employee contracts, financial statements, etc. The location of these documents is known as a War Room in the business brokerage and mergers and acquisitions world.

- **Working with Professionals** – Professionals are valuable in optimizing the value of the business for sale. Experienced financial advisors, lawyers, accountants, business appraisers, business brokers / mergers and acquisitions specialists know how to position your business, broaden the buyer search and structure the transaction to achieve optimal valuation. Selling your business should never be done as a first time experience alone.

Over 80 percent of my sellers were first time sellers, and many would probably never sell another business in their life-times. Don't waste the years of sweat and tears you put into the business. Plan well ahead and achieve the maximum price for your business. You deserve it!





VALUATION OF BUYING YOUR SMALL BUSINESSES

All business purchase and sale transactions require some type of valuation. In fact, by definition, the final price is the *de facto* valuation of the business. However, some bargaining is virtually always required before buyers and sellers can settle on a mutually acceptable price. Valuation depends on one's perspective, the valuation methods employed, market conditions, and countless other variables. My experience tells me that the value of a business can vary significantly under a wide range of circumstances.

A Few Principles to Keep in Mind for Valuation

Here are a few key principles and tips for you to keep in mind before engaging in business valuation.

- **There is No Single “Correct” Method of Valuation** – It's a good idea to use all reasonable methods to see which one makes the most sense for you. After all, is it in line with what others are paying in the market?
- **The Deal Structure Has a Significant Impact on Valuation** – Regardless of the methods you use for a business valuation, company value realized on sale is greatly affected by the actual deal structure or terms. Terms include, for example, payment methods, covenant not-to-compete, transition period, etc. Therefore, valuation should not be performed alone without considering what are the terms acceptable to buyers and sellers.
- **Different Buyers Pay Different Prices** – There are at least six types potential buyers for a business. They fall within the following categories: horizontal (the competitors), vertical (along the supply chain), complimentary (also know as strategic), financial (purely for returns), overseas, and individuals. Their valuations of the same business may vary greatly due to the difference in their respective personal and investment needs.

Three Main Valuation Methodologies for Small Businesses

While there are many valuation methodologies in the market, the following three methodologies are predominately used. They are the Discounted Cash Flow (DCF) Method, Payback Period Analysis and Net Asset Value Method. Balancing among the three methods would give you best estimates of the “right” price for the sale.

- **Discounted Cash Flow Method (DCF)** – Essentially, DCF looks at a business as a pure financial investment. You estimate future cash flows and discount them into present values.
 - **Step 1: Cash Flow** – The Future cash flow of the business is estimated based on the projected income of the business. However, net income is profit from an accounting perspective. It is not the actual cash flow of a business. To determine the cash flow, one should adjust the net income figures by the following steps:
 - Add any noncash accounting expenses to net income – They include, for example, depreciation and amortization and tax differences.
 - Add any excess cash paid to the owner – This applies mostly to private companies where the owners often take out cash from the business either as added compensation or personal expenses.

- Subtract any increase in net working capital – Increases in inventory and account receivables cashflow. Increases in account payables and other current liabilities enhance cashflow.
 - Estimate growth rate – The growth rate of cash flow is estimated based on economic and industry outlook, business competitive environment and the historical growth rates in the recent years.
- o Step 2: Projected Period – You need to determine how many years will be used in the analysis. As a rule of thumb, five to ten years are the maximum period that one can foresee in a small business. Any period beyond that would be unrealistic to project.
 - o Step 3: Discount Rate – Since the point of a business purchase is to receive future income, the DCF method is aimed to help establish the present value of the future cash flows. This is accomplished with a discount rate, which is a percentage rate of return, based on the inherent risk of the business, which renders investors indifferent between current and future income. The higher the risk, the higher the discount rate. For riskless income, the discount rate is the risk-free rate, which is typically between 3-6 percent. On top, we add a risk premium for the risk. Typical risk premium for small businesses range between 15 and 35 percent, depending on the level of reliance on the owner and stability of earnings.

DCF is the most commonly used method in the academic world as well as in larger mergers and acquisitions transactions. However, it is rarely used in the small business world because the future performance of the business is largely dependent on who the owner is. Also, most business owners in the real world do not understand the DCF concept. Therefore, there is no point explaining it to them if they suspect your motives are to reduce their selling prices anyway.

● **Payback Period Method** – Much easier than DCF, the payback method is the most commonly used approach for valuation of profitable small businesses.

- o Step 1: Define the Maximum Payback Period – Rent is always an important factor for small businesses in Hong Kong. Therefore, maximum period is usually the duration of the lease. For example, if the lease expires in two years, the maximum period allowed for payback would become 24 months. After such period, no one can guarantee if the lease can be renewed.
- o Step 2: Determine the Required Payback Period – In order to be profitable within the maximum period, you need to apply a discount rate ranging between 20 percent to 60 percent, depending on factors like dependence on owner, room for improvement, rent as percentage of revenue, etc. For example, if a business has high dependence on its owner, low room for improvement and high rent as percentage of revenue, for a lease duration of 24 months, a discount rate would be as much as 60 percent – meaning a required payback period of 9.6 months.
- o Step 3: Determine the Profit Before Owner's Salary – One full-time operating owner's salary is not counted toward the profit of a small business because (1) the owner can pay him/herself any salary, and (2) such profit figure should most accurately reflect the economic value brought to you by the business.

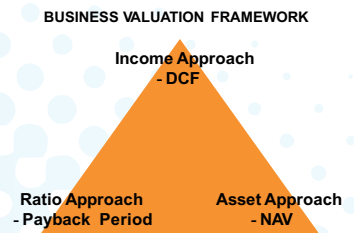
- o Step 4: Apply the Profit Figure to the Required Payback Period – You can determine the value of the business by multiplying the profit figure by the payback period. For example, if the profit before owner's salary is \$50,000 per month, a required payback period of 9.6 months would make the business valued at \$480,000.

Most business buyers and sellers find the payback period method the easiest to understand and communicate. From my experience of completing hundreds of small business transactions, super-majority of them were done on this basis.

- **Net Asset Value (NAV) Method** – Based on assets, this method is typically used in businesses making losses or with very small profits, but with a large asset bases. Goodwill of the business is completely ignored. The definition of assets also varies across different circumstances.

- o Replacement Cost – Costs that you would need to replace all the operating assets of a business to duplicate operation. This is typically the highest estimate among the three NAV Methods.
- o Market Value – Assets are valued at market price rather than at depreciated or amortized value recorded on the books. This is the best estimates of fair value.
- o Liquidation Value – Assumes the assets are sold separately and not as an on-going business. Liquidation value is the lowest amount that you can expect to get from the sale of a business; it puts a floor under the sale price of a business.

The NAV method is only used for businesses in distress situation. Most sensible buyers and sellers that I have dealt with do not pay much attention to the NAV method as their primary objectives in running a business are mostly – make profits. They would much rather look at whether or not they can get their investment paid-back within a reasonable period or for the more sophisticated ones – the DCF method.





APPENDIX 1: THE GEM CONSORTIUM

Team	Institution	National Team Members	Financial Sponsors	APS Vendor
Argentina	Center for Entrepreneurship IAE Management and Business School Universidad Austral	Silvia Torres Carbonell Hector Rocha Valeria Romero	Center for Entrepreneurship, IAE Management and Business School Banco Rio	MORI Argentina
Austria	FH JOANNEUM GesmbH, University of Applied Sciences University of Graz	Gerhard Apfelthaler Ursula Schneider Martin Neubauer Eva Maria Tusini Thomas Schmalzer	FH JOANNEUM GesmbH –University of Applied Sciences Wirtschaftskammer Österreich – Austrian Federal Economic Chamber Federal Ministry of Economics and Labour AWO – Außenwirtschaft Österreich – Austrian Foreign Trade Promotion Organisation AWS – Austria Wirtschaftsservice Zukunftsfonds Steiermark	OGM -Österreichische Gesellschaft für Marketing
Belgium	Vlerick Leuven Gent Management School	Hans Crijns Miguel Meuleman Sabine Vermeulen	Flemish Government (Steunpunt Ondernemerschap, Ondernemingen, en Innovatie)	TNS Dimarso
Brazil	IBQP - Instituto Brasileiro da Qualidade e Produtividade	Simara Maria S. S. Greco Paulo Alberto Bastos Junior Joana Paula Machado Rodrigo G. M. Silvestre Carlos Artur Krüger Passos Júlio César Felix Marcos Mueller Schlemm	IBQP - Instituto Brasileiro da Qualidade e Produtividade SEBRAE- Serviço Brasileiro de Apoio às Micro e Pequenas Empresas Sistema Federação das Indústrias do Estado do Paraná (FIEP, SESI, SENAI e IEL) MCT - Ministério da Ciência e Tecnologia	Instituto Bonilha
Chile Regional Teams: Región Antofagasta Región Valparaíso Región del Bio-Bío Región de los Ríos	Universidad Adolfo Ibáñez Universidad del Desarrollo Regional Universities: Universidad Católica del Norte Universidad Técnico Federico Santa María Universidad del Desarrollo Universidad Austral de Chile	Jorge Miguel Carrillo Germán Echeopar José Ernesto Amorós Massiel Guerra Regional Members: Gianni Romani Choce Miguel Atienza Ubéda Cristóbal Fernández Juan Tapia Jorge Cea Olga Pizarro Stieповic José Ernesto Amorós Christian Felzensztein Pablo Díaz Madariaga	Santander Universidades (Grupo Santander) Universidad Adolfo Ibáñez- Centro de Entrepreneurship Universidad del Desarrollo- Facultad de Economía y Negocios. Regional Sponsors: Corporación para el Desarrollo Productivo (CDP) Universidad Católica del Norte – Centro de Emprendimiento y de la Pyme Universidad Técnico Federico Santa María-Departamento de Industrias, Economía y Negocios Universidad del Desarrollo- Facultad de Economía y Negocios. Universidad Austral de Chile- Facultad de Ciencias Económicas y Administrativas	Benchmark
China	National Entrepreneurship Centre, Tsinghua University	Jian Gao Yuan Cheng Xibao Li Wei Zhang Lan Qin	Beijing Municipal Science & Technology Commission	SINOTRUST Marketing Research & Consulting Ltd.

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Croatia	J.J. Strossmayer University in Osijek	Slavica Singer Natasa Sarija Sanja Pfeifer Djula Borozan Suncica Oberman Peterka	Ministry of Economy, Labour and Entrepreneurship CEPOR – SME Policy Centre, Zagreb J.J. Strossmayer University in Osijek – Faculty of Economics	Puls, d.o.o., Zagreb
Denmark	University of Southern Denmark	Thomas Schøtt Torben Bager Kim Klyver Hannes Ottosson Kent Wickstrøm	International Danish Entrepreneurship Academy (IDEA) National Agency for Enterprise and Construction	Institut for Konjunkturanalyse
Dominican Republic	Pontificia Universidad catolica Madre Maestra (PUCMM)	Guillermo van der Linde Maribel Justo Alina Bello José Rafael Pérez Tania Canaán	Grupo Viciñ Independent Financial Center of the Americas Consejo Nacional de Competitividad Centro de Exportación e Inversión de la República Dominicana Cámara de Diputados de la República Dominicana	Gallup República Dominicana
Finland	Turku School of Economics	Anne Kovalainen Tommi Pukkinen Jarna Heinonen Pekka Stenholm Erkko Autio Pia Arenius	Ministry of Trade and Industry	TNS Gallup Oy
France	EM LYON	Olivier Torres Danielle Rousson	Caisse des Depots	CSA
Greece	Foundation for Economic and Industrial Research (IOBE)	Stavros Ioannides Irene Staggel Aggelos Tsakanikas	Hellenic Bank Association	Datapower SA
Hong Kong	The Chinese University of Hong Kong Center for Entrepreneurship	Hugh Thomas Kevin Au Louis Leung Bernard Suen Sandy Yip Rosanna Lo	The Chinese University of Hong Kong The Asia-Pacific Institute of Business	The Chinese University of Hong Kong Center for Communication Research
Hungary	University of Pécs, Faculty of Business and Economics	László Szerb Zoltan J. Acs Attila Varga József Ulbert Siri Terjesen Krisztián Csapó Gábor Kerékglyártó	Ministry of Economy and Transport University of Pécs, Faculty of Business and Economics Ohio University (USA)	Szocio-Gráf Piac-és Közvélemény-kutató Intézet
Iceland	RU Centre for Research on Innovation and Entrepreneurship (Reykjavik University)	Rögnvaldur Sæmundsson Sijla Björk Baldursdóttir	Reykjavik University The Confederation of Icelandic Employers New Business Venture Fund Prime Minister's Office	Capacent Gallup
Ireland	Dublin City University	Paula Fitzsimons Colm O'Gorman	Enterprise Ireland Forfás NDP Gender Equality Unit of the Department of Justice, Equality and Law Reform	IFF

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India	Pearl School of Business, Gurgaon	Ashutosh Bhupatkar I. M. Pandey Janakiraman Moorthy Gour Saha	Pearl School of Business, Gurgaon	Metric Consultancy
Japan	Keio University Musashi University Shobi University	Takehiko Isobe Noriyuki Takahashi Tsuneo Yahagi	Venture Enterprise Center	Social Survey Research Information Co.,Ltd (SSRI)
Latvia	The TeliaSonera Institute at Stockholm School of Economics in Riga	Olga Rastrigina Vyacheslav Dombrovsky Andrejs Jakobsons	TeliaSonera AB	Latvijas Fakti
Kazakhstan	Innovative University of Eurasia	Guzal Baimuldinova Vilen Elisseev Zauresh Omarova Natalya Smernitskaya Denis Valivach	USAID	BRIF Research Group
Netherlands	EIM Business and Policy Research	Jolanda Hessels Sander Wennekers Kashifa Suddle André van Stel Niels Bosma Roy Thurik Lorraine Uhlander Ingrid Verheul	Dutch Ministry of Economic Affairs	Stratus marktonderzoek bv
Norway	Bodoe Graduate School of Business	Lars Kolvereid Erlend Bullvaag Bjoern Willy Aamo Erik Pedersen	Ministry of Local Government and Regional Development Ministry of Trade and Industry Innovation Norway The Knowledge Fund, at Bodoe Knowledge Park Ltd.	TNS Gallup
Peru	Centro de Desarrollo Emprendedor, Universidad ESAN	Jaime Serida Nishimura Keiko Nakamatsu Yonamine Armando Borda Reyes Liliana Uehara Uehara Jessica Alzamora Ruiz	Universidad ESAN	SAMIMP Research
Portugal	Sociedade Portuguesa de Inovação, S.A.	Augusto Medina Douglas Thompson Sara Medina Anders Hyttel Miguel Taborda Inês Luis António Vieira	IAPMEI (Apoio às Pequenas e Médias Empresas e à Inovação) FLAD (Fundação Luso-Americana para o Desenvolvimento) BES (Banco Espírito Santo)	GfK Metris
Puerto Rico	University of Puerto Rico School of Business Rio Piedras	Luis Rivera Oyola Joaquin Villamil Jaquelina Rodriguez Mont Juan M. Roman Bartolome Gamundi David Zayas Anibal Baez Enid Flores Maritza Espina Marcos Vidal Laura Gorbea	Compañía de Comercio y Exportación de Puerto Rico Banco de Desarrollo Económico para Puerto Rico DISUR INTECO Pontifice Universidad Catolica de Puerto Rico	Programa de Desarrollo Empresarial

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	Moscow Team State University - Higher School of Economics, Moscow	Alexander Chepurenko Olga Obraztsova Tatiana Alimova Maria Gabelko	State University - Higher School of Economics	Levada-Center
Serbia	The Faculty of Economics Subotica	Dusan Bobera Bozidar Lekovic Stevan Vasiljev Pere Tumbas Sasa Bosnjak Slobodan Mari	Executive Council of Vojvodina Province - Department for privatization, entrepreneurship and small and medium enterprises Chamber of Economy of Vojvodina	Marketing Agency «Mark-Planetak» doo
Slovenia	Institute for Entrepreneurship and Small Business Management, Faculty of Economics & Business, University of Maribor	Miroslav Rebernik Polona Tominc Ksenja Pušnik	Ministry of the Economy Slovenian Research Agency Smart Com Finance – Slovenian Business Daily	RM PLUS
Spain	Instituto de Empresa	Ignacio de la Vega Alicia Coduras	Dirección Gral. Política PYMES Instituto de Empresa Cámaras de Comercio Junta de Andalucía Gov. del Principado de Asturias Gov. De Canarias, Cabildo Fondo Social Europeo Centros de Innovación Europeos (Navarra, Murcia, C y León) Generalitat de Catalunya Junta de Extremadura Air Nostrum, CEG, BIC Galicia IMADE, FGUAM Fundación Caja Murcia Eusko Ikaskuntza Instituto Vasco de Competitividad FESNA Universidad de Granada and others	Instituto Opinómetro S.L.
Regional Teams: Andalucía Asturias Canary I. Castille Leon Castille la Mancha Catalonia C. Valenciana Extremadura Galicia Madrid Murcia Navarra Basque Country Ceuta Melilla	Regional Universities: Cádiz Oviedo Las Palmas & La Laguna León Castille la Mancha Autónoma de Barcelona Miguel Hernández Fundación Xavier de Salas Santiago de Compostela Autónoma de Madrid Murcia Pública de Navarra Deusto & Basque Country Granada Granada	Regional Team Directors: José Ruiz Navarro Juan Ventura Victoria Rosa M. Batista Canino Mariano Nieto Antolin Miguel Angel Galindo Martin Carlos Gualarte José M ^o Gómez Gras Ricardo Hernández Mogollón J. Alberto Díez de Castro Eduardo Bueno Campos Antonio Aragón Sánchez Iñaki Mas Erice Iñaki Peña Legazkue Lázaro Rodríguez Ariza María del Mar Fuentes	Confederation of Swedish Enterprise (Svenskt Näringsliv) NUTEK – Swedish Agency for Economic and Regional Growth VINNOVA – Swedish Governmental Agency for Innovation Systems	SKOP
Sweden	ESBRI – Entrepreneurship and Small Business Research Institute	Magnus Aronsson Mikael Samuelsson		

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Turkey	Yeditepe University	Nilüfer Erican Esra Karadeniz	Endeavor, Turkey Country Office Akbank	Akademetre Research & Strategic Planning
United Arab Emirates	Zayed University	David McGlennon Kenneth J Preiss Declan McCrohan Raed Daoudi David Goodwin	Mohammed Bin Rashid Establishment for Young Business Leaders	IPSOS-STAT (Emirates)
United Kingdom	London Business School Northern Ireland Unit: Small Business Research Centre, Kingston University Scotland Unit: Hunter Center for Entrepreneurship, University of Strathclyde Wales Unit: National Entrepreneurship Observatory for Wales, University of Glamorgan	Rebecca Harding Mark Hart Jonathan Levie David Brooksbank Dylan Jones-Evans	BERR Enterprise Directorate One North East North West Development Agency, Yorkshire Forward Advantage West Midlands East Midlands Development Agency South of England Development Agency Agency South East Development Agency Doncaster District Council Barking and Dagenham District Council InvestNI Department of Enterprise, Trade and Investment (NI) Belfast City Council Hunter Centre for Entrepreneurship, University of Strathclyde Scottish Enterprise Wales European Funding Office Welsh Assembly Government	
United States	Babson College	I.Elaine Allen William D. Bygrave Marcia Cole Zoltan Acs Erlend Bullvaag	Babson College	Opinion Research Corporation (ORC)
Uruguay	IEEM Business School - Universidad de Montevideo	Jorge Pablo Regent Vitale Leonardo Veiga Adrián Edelman Cecilia Gomez	IEEM Business School - Universidad de Montevideo	Mori, Uruguay
Venezuela	IESA – Centro de Emprendedores	Federico Fernandez Dupouy Rebeca Vidal Aramis Rodriguez	Mercantil Servicios Financieros Fundacion Iesa Petrobras Energia Venezuela	Datanalisis
GEM Global Coordination Team	London Business School Babson College Utrecht University Imperial College	Michael Hay Maria Minniti Niels Bosma Mark Quill Mick Hancock Erkko Autio Marcia Cole Chris Aylett Jackline Odoch Jeff Seaman	London Business School Babson College	

APPENDIX 2: DEFINITIONS OF TERMS & MEASURES OF GEM

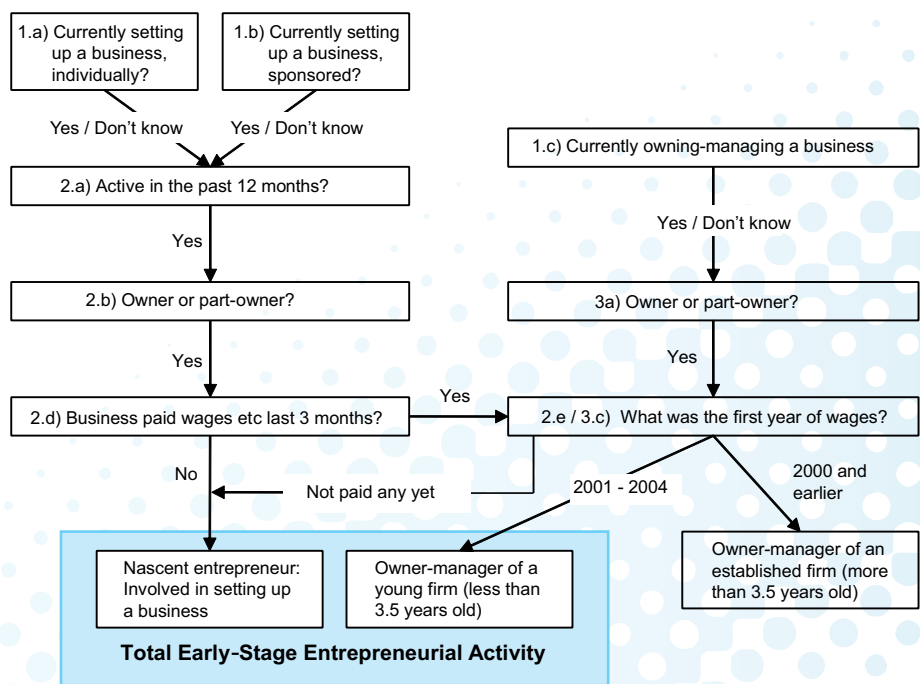
Measure	Description
<i>Entrepreneurial activity prevalence rates in adult population</i>	
Nascent entrepreneurship rate	Percentage of 18-64 population who are currently nascent entrepreneurs, i.e. actively involved in setting up a business they will own or co-own; this business has not paid salaries, wages or any other payments to the owners for more than 3 months
New business ownership rate	Percentage of 18-64 population who are currently owner-managers of a new business, i.e. owning and managing a running business that has paid salaries, wages or any other payments to the owners for more than three months, but not more than 42 months
Early-stage entrepreneurial activity	Percentage of 18-64 population who are either a nascent entrepreneur or owner-manager of a new business (as defined above)
Established business ownership rate	Percentage of 18-64 population who are currently owner-manager of an established business, i.e. owning and managing a running business that has paid salaries, wages or any other payments to the owners for more than 42 months
Overall entrepreneurial activity rate	Percentage of 18-64 population who are either involved in early-stage entrepreneurial activity or owner-manager of an established business (as defined above)
High growth expectation early-stage entrepreneurial activity	Percentage of 18-64 population who are either nascent entrepreneur or owner-manager of a new business (as defined above) and expect to employ at least 20 employees five years from now
Business discontinuation rate	Percentage of 18-64 population who have, in the past 12 months, discontinued a business, either by selling, shutting down or otherwise discontinuing an owner/management relationship with the business. Note: this is NOT a measure of business failure rates.
<i>Characteristics of early-stage entrepreneurial activity</i>	
Opportunity motivated entrepreneurial activity: relative prevalence	Percentage of those involved in early-stage entrepreneurial activity (as defined above) who (i) claim to be driven by opportunity as opposed to finding no other option for work; and (ii) who indicate the main driver for being involved in this opportunity is being independent or increasing their income, rather than just maintaining their income
High growth expectation early-stage entrepreneurial activity: relative prevalence	Percentage of early-stage entrepreneurs (as defined above) who expect to employ at least 20 employees five years from now
New product-market oriented early-stage entrepreneurial activity: relative prevalence	Percentage of early-stage entrepreneurs (as defined above) who indicate that their product or service is new to at least some customers and indicate that not many businessseos offer the same product or service.
International oriented early-stage entrepreneurial activity: relative prevalence	Percentage of early-stage entrepreneurs (as defined above) who indicate that at least 25% of their customers are from foreign countries

Measure	Description
Entrepreneurial perceptions	
Perceived opportunities	Percentage of 18-64 population (individuals involved in any stage of entrepreneurial activity excluded) who see good opportunities to start a firm in the area where they live
Perceived capabilities	Percentage of 18-64 population (individuals involved in any stage of entrepreneurial activity excluded) who believe to have the required skills and knowledge to start a business
Potential entrepreneurial activity rate	Percentage of 18-64 population (individuals involved in any stage of entrepreneurial activity excluded) who are not involved in entrepreneurial activity, but have a positive perception of their own entrepreneurial capabilities and the entrepreneurial opportunities in the area where they live
Entrepreneurial intention	Percentage of 18-64 population (individuals involved in any stage of entrepreneurial activity excluded) who are latent entrepreneurs and who intend to start a business within three years
Fear of failure rate	Percentage of 18-64 population (individuals involved in any stage of entrepreneurial activity excluded) who indicate that fear of failure would prevent them from setting up a business



APPENDIX 3: SURVEY QUESTIONS TO ESTABLISH RESPONDENT'S ENTREPRENEURIAL STATUS

The GEM framework addresses the ambiguity and disburse definitions of “starting up a business” by using the following flow of questions to determine whether or not the respondent actually qualifies as an entrepreneur.



The following questions are excerpts from the adult population questionnaire

Which of the following would apply to you?

- 1a. You are, alone or with others, currently trying to start a new business, including any self-employment or selling any goods or services to others
- 1b. You are, alone or with others, currently trying to start a new business or a new venture for your employer-an effort that is part of your normal work
- 1c. You are, alone or with others, currently the owner of a company you help manage, self-employed, or selling any goods or services to others
- 1d. You have, in the past three years, personally provided funds for a new business started by someone else, excluding any purchases of stocks or mutual funds
- 1e. You are, alone or with others, expecting to start a new business, including any type of self-employment, within the next three years
- 1f. You have, in the past 12 months, sold, shut down, discontinued or quit a business you owned and managed, any form of self-employed, or selling goods or services to anyone.....
- 2a. (You mentioned that you are trying to start a new business. / Perhaps we were not clear on a previous question.) Over the past twelve months have you done anything to help start a new business, such as looking for equipment or a location, organizing a start-up team, working on a business plan, beginning to save money, or any other activity that would help launch a business?
- 2b. Will you personally own all, part, or none of this business?
- 2c. How many people, including yourself, will both own and manage this new business?
- 2ci. Are you, or do you expect to be, working full-time in this business?
- 2d. Has the new business paid any salaries, wages, or payments in kind, including your own, for more than three months?

2di. What was the first year the owners received wages, profits, or payments in kind?

3a. (You said you were the owner and manager of a company. / Perhaps we were not clear on a previous question. If you personally share in the profits of selling any goods or services to others that can be a business.) Do you personally own all, part, or none of this business?

3b. How many people both own and manage this business?

3bi. Are you working full-time in this business?

3c. What was the first year the owners received wages, profits, or payments in kind?

APPENDIX 4: ENTREPRENEURSHIP EXPERTS

Mr. Bernard Auyang
President
Computime Ltd.
Computime Corporate HQ

Mr. Felix Chan
Immediate Past President
The Hong Kong Chamber of Small and
Medium Business Ltd.

Ms. Brenda Cheung
Founder
Bonny Food-Serve Concept

Ms. Kin-Wo Chong
Founder
Wan Chai Pier Beijing

Hon Mrs. Shuk Yee Selina Chow Liang, GBS
Legislative Council Member
Hong Kong Legislative Council

Mr. Po Chung
Co-Founder
DHL International Ltd.

Mr. Andy Chworowsky
Co-Founder
Fat Angelo's chain of restaurants
(Gotham City Management Limited)

Professor Tony R. Eastham
President, CEO
RandD Corporation Limited

Mr. Lawrence Fok
Deputy Chief Operating Office
Hong Kong Exchanges and Clearing Limited

Ms. Michelle Garnaut
Owner
M Restaurant Group

Ms. Shirley Ha
Director
Champion Technology Holdings Ltd.

Mr. Shut-Kan Ho
Executive Director
Kerry Properties Ltd.

Mrs. Regina Suk Yee Ip Lau
Chairperson
Savantas Policy Institute

Ms. Cally Kwong
Jewellery Entrepreneur

Mr. Stanley Lau
Managing Director
Renley Watch Group
Deputy Chairman of the Federation of
Hong Kong Industries

Mr. David Lee
Chairman
Team and Concepts Limited

Mr. Edwin Lee
Founder & CEO
Hong Kong Business Intermediary Co. Ltd.

Dr. G. Lam Lee
Director
Monte Jade Science and Technology
Association of HK

Mr. Sing-See Lee
CEO
Hong Kong Science and Technology Parks
Corporation

Ms. Venus Lee
Managing Director
e-Crusade Marketing Co. Ltd.

Mr. Adrian Li
General Manager & Head of Corporate Banking
Division
Bank of East Asia

Professor Tai-Lok Lui
Professor
Department of Sociology
The Chinese University of Hong Kong

Mr. Charles Mok
Chairman
Internet Society Hong Kong

Mrs. Grace Ng
CIIF Secretariat
Labour and Welfare Bureau
The Government of the Hong Kong Special
Administrative Region

Professor Mike Pendleton
Professor, School of Law
The Chinese University of Hong Kong

Mr. Neil Pryde
Founder
Neil Pryde Sails

Mr. Mike Rowse
Director-General
Invest Hong Kong
The Government of the Hong Kong Special
Administrative Region

Mr. Simon Kai-Biu Shi
President
Hong Kong Small and Medium Sized Enterprises
Association

Mr. Peter Sun
Chairman
Kingdom Group

Mr. Richard Tsang
Founder and CEO
Strategic Financial Relations Ltd.

Mr. Conrad Wong
Vice President
Yau Lee Group Ltd.

Mr. Nick Yeung
Chief Executive Officer
Hong Kong Cyberport Management Company

Mr. Douglas Young
Founder and CEO
G.O.D. Ltd.

Professor Kenneth Young
Pro-Vice Chancellor
The Chinese University of Hong Kong

APPENDIX 5: RESPONSES TO THE EXPERT INTERVIEW QUESTIONNAIRE, COMPARING 2007 TO 2002-04

EFC	Statement	2007 Response	2007 Score	2004 Response	2004 Score	2003 Response	2003 Score	2002 Response	2002 Score
Infrastructure	A new or growing firm can get good access to communications (telephone, internet, etc) in about a week.	Agree	1.81	Agree	1.77	Agree	1.79	Agree	1.77
Infrastructure	New or growing firms can get good access to utilities (gas, water, electricity, sewer) in about a month.	Agree	1.68	Agree	1.76	Agree	1.91	Agree	1.67
Infrastructure	It is not too expensive for a new or growing firm to get good access to communications (phone, Internet, etc).	Agree	1.62	Agree	1.56	Agree	1.77	Agree	1.59
Infrastructure	New and growing firms can afford the cost of basic utilities (gas, water, electricity, sewer).	Agree	1.53	Agree	1.65	Agree	1.65	Agree	1.72
Culture	The national culture is highly supportive of individual success achieved through own personal efforts.	Agree	1.39	Agree	1.76	Agree	1.65	Agree	1.59
Policies	The Intellectual Property Rights (IPR) legislation is comprehensive.	Agree	1.39	Agree	1.61	Agree	1.59	Agree	1.70
Status	Most people think of entrepreneurs as competent, resourceful individuals.	Agree	1.32	Agree	1.26	Agree	1.37	Agree	1.49
IP Rights	The Intellectual Property Rights (IPR) legislation is comprehensive.	Agree	1.31	Agree	0.98	Agree	1.28	Agree	1.16
Status	Successful entrepreneurs have a high level of status and respect.	Agree	1.26	Agree	1.30	Agree	1.55	Agree	1.51
Serves	It is easy for new and growing firms to get good, professional legal and accounting services.	Agree	1.19	Agree	1.07	Agree	1.26	Agree	1.28
Status	The creation of new ventures is considered an appropriate way to become rich.	Agree	1.15	Agree	1.05	Agree	1.40	Agree	1.49
Culture	The national culture emphasizes self-sufficiency, autonomy, and personal initiative.	Agree	1.12	Agree	1.37	Agree	1.26	Agree	1.23
Status	You will often see stories in the public media about successful entrepreneurs.	Agree	1.12	Agree	1.42	Agree	1.42	Agree	1.49
Policies	The amount of taxes is NOT a burden for new and growing firms.	Agree	1.06	Agree	1.53	Agree	1.40	Agree	1.56
Women	Starting a new business is a socially acceptable career option for women.	Agree	1.06	Agree	1.26	Agree	1.51	Agree	1.36
Innovation	Consumers like to try out new products and services.	Agree	1.03	NA	NA	NA	NA	NA	NA
Women	Men and women have the same level of knowledge and skills to start a new business.	Agree	1.00	Agree	0.95	Agree	1.28	Agree	0.95
Opportunities	Individuals can easily pursue entrepreneurial opportunities.	Agree	0.97	Agree	0.79	Agree	0.88	Agree	0.87
Innovation	Innovation is highly valued by consumers.	Agree	0.88	NA	NA	NA	NA	NA	NA
Serves	It is easy for new and growing firms to get good banking services (checking accounts, foreign exchange transactions, letters of credit, and the like).	Agree	0.84	Agree	1.12	Agree	1.35	Agree	1.38
Culture	The national culture emphasizes the responsibility that the individual (rather than the collective) has in managing his or her own life.	Agree	0.82	Agree	1.07	Agree	1.09	Agree	1.05
Expertise	Many people can react quickly to good opportunities for a new business.	Agree	0.82	Agree	0.60	Agree	0.88	Agree	0.95
IP Rights	It is widely recognized that inventors' rights for their inventions should be respected.	Agree	0.79	Agree	0.48	Agree	0.70	Agree	0.55
Culture	The national culture encourages entrepreneurial risk-taking.	Agree	1.06	Agree	1.05	Agree	1.12	Agree	1.08
Expertise	Many people know how to start and manage a small business.	Agree	0.79	NS	-0.23	NS	0.00	NS	0.36
IP Rights	The Intellectual Property Rights (IPR) legislation is efficiently enforced.	Agree	0.79	Agree	0.40	Agree	0.63	Agree	0.63
Women	Men and women get equally exposed to good opportunities to start a new business.	Agree	0.74	Agree	0.95	Agree	1.14	Agree	1.05
Opportunities	There are plenty of good opportunities for the creation of new firms.	Agree	0.70	Agree	1.58	NS	0.26	Agree	0.64
High Growth	Potential for rapid growth is often used as a selection criterion when choosing recipients of entrepreneurship support.	Agree	0.67	NA	NA	NA	NA	NA	NA
Market Access	The markets for consumer goods and services change dramatically from year to year.	Agree	0.59	Agree	0.67	Agree	0.60	Agree	0.51

<i>EFC</i>	<i>Statement</i>	<i>2007 Response</i>	<i>2007 Score</i>	<i>2004 Response</i>	<i>2004 Score</i>	<i>2003 Response</i>	<i>2003 Score</i>	<i>2002 Response</i>	<i>2002 Score</i>
IP Rights	New and growing firms can trust that their patents, copyrights, and trademarks will be respected.	Agree	0.59	NS	0.02	NS	0.35	NS	0.26
Innovation	Innovation is highly valued by companies.	Agree	0.56	NA		NA		NA	
Women	There are sufficient social services available so that women can continue to work even after they start a family.	Agree	0.53	Agree	0.45	Agree	0.86	Agree	0.97
Opportunities	There are plenty of good opportunities to create truly high growth firms.	Agree	0.52	NS	0.14	NS	0.14	NS	0.18
Innovation	Consumers are open to buying products and services from new, entrepreneurial companies.	Agree	0.52	NA		NA		NA	
Finance	There is sufficient funding available through initial public offerings (IPOs) for new and growing firms.	Agree	0.50	NS	0.33	NS	0.32	Agree	0.44
Opportunities	There are more good opportunities for the creation of new firms than there are people able to take advantage of them.	Agree	0.45	Agree	0.41	NS	0.00	Agree	0.41
Expertise	Many people have the ability to organize the resources required for a new business.	Agree	0.44	NS	-0.02	Agree	0.40	Agree	0.47
Opportunities	Good opportunities for new firms have considerably increased in the past five years.	Agree	0.42	NS	0.14	NS	0.29	NS	0.19
Culture	The national culture encourages creativity and innovativeness.	Agree	0.41	Agree	0.60	Agree	0.47	Agree	0.49
Status	Most people consider becoming an entrepreneur as a desirable career choice.	Agree	0.39	Agree	0.33	Agree	0.47	Agree	0.77
Expertise	Many people have experience in starting a new business.	Agree	0.34	NS	-0.28	NS	-0.10	NS	0.32
S&T Transfer	New technology, science, and other knowledge are efficiently transferred from universities and public research centers to new and growing firms.	Disagree	-0.32	Disagree	-0.37	Disagree	-0.43	Disagree	-0.47
Programs	There are an adequate number of government programs for new and growing businesses.	Disagree	-0.39	NS	-0.38	NS	-0.05	NS	-0.22
Programs	Almost anyone who needs help from a government program for a new or growing business can find what they need.	Disagree	-0.43	Disagree	-0.51	Disagree	-0.36	Disagree	-0.38
Programs	In my country, government programs aimed at supporting new and growing firms are effective.	Disagree	-0.45	Disagree	-0.68	Disagree	-0.43	NA	
S&T Transfer	New and growing firms have just as much access to new research and technology as large, established firms.	Disagree	-0.45	Disagree	-0.39	Disagree	-0.44	Disagree	-0.43
Finance	There are sufficient government subsidies available for new and growing firms.	Disagree	-0.58	NS	-0.28	NS	-0.36	NS	-0.32
Market Access	The anti-trust legislation is effective and well enforced.	Disagree	-0.58	Disagree	-0.66	Disagree	-0.74	Disagree	-0.97
Education	Teaching in primary and secondary education provides adequate instruction in market economic principles.	Disagree	-0.63	Disagree	-0.90	Disagree	-0.71	Disagree	-0.68
Policies	The support for new and growing firms is a high priority for policy at the local government level.	Disagree	-0.71	Disagree	-0.55	NS	-0.38	NS	-0.21
Education	Teaching in primary and secondary education encourages creativity, self-sufficiency, and personal initiative.	Disagree	-0.73	Disagree	-0.93	Disagree	-1.05	Disagree	-0.85
S&T Transfer	New and growing firms can afford the latest technology.	Disagree	-0.76	Disagree	-0.66	Disagree	-0.75	Disagree	-0.55
Policies	The support for new and growing firms is a high priority for policy at the national government level.	Disagree	-0.76	Disagree	-0.60	NS	-0.37	Disagree	-0.39
S&T Transfer	There are adequate government subsidies for new and growing firms to acquire new technology.	Disagree	-0.77	Disagree	-0.69	Disagree	-0.67	Disagree	-0.83
Programs	A wide range of government assistance for new and growing firms can be obtained through contact with a single agency.	Disagree	-0.79	NS	-0.26	NS	-0.28	Disagree	-0.47
Disagree	In my country, government policies (e.g., public procurement) consistently favor new firms.	Disagree	-0.80	Disagree	-0.71	Disagree	-0.49	Disagree	-0.51
Education	Teaching in primary and secondary education provides adequate attention to entrepreneurship and new firm creation.	Disagree	-1.17	Disagree	-1.21	Disagree	-1.02	Disagree	-1.14

Note: The above records the average responses of the experts whose names are given in Appendix 4. Only statements where respondents' average responses differed significantly from "neither true nor false" in 2007 are recorded. Significance is at the 95percent confidence level. Responses are ordered by difference from neutrality. Minimum possible score is -2.00. Maximum possible score is +2.00. Responses from 2002-2004 are given the final three columns. NS = responses are not significantly different from zero. NA = question not asked.

APPENDIX 6: HONG KONG RESEARCH TEAM



Dr. Kevin AU

Dr. Kevin AU is associate professor of Management at CUHK and serves as associate director for the MBA programme and Center for Entrepreneurship. His research interests span across micro and macro issues in global management, social network, entrepreneurship, and research methodology. He serves on the editorial boards of several academic journals and conducts consulting projects for business and government organizations.



Dr. Louis LEUNG

Dr. Louis LEUNG (PhD, Texas) is Associate Professor in the School of Journalism & Communication, The Chinese University of Hong Kong, where he received the Vice-Chancellor's Exemplary Teaching Award in 2007. Currently he serves as Director of the Center for Communication Research and Program Leader of the MSc in New Media since 2000. His research interests focus on the uses and impact of the new communication technologies especially the Internet.



Mr. Bernard SUEN

Mr. Bernard SUEN has worked in the ICT industry for over twenty years with domestic, PRC, and international consulting and management experiences. He founded and engaged in launching several IT and new media companies, serving in a full spectrum of responsibilities in acquisition, initial public offering, valuation, operation, sales and marketing, project management, and software development throughout his career. Since 2001, Bernard has developed and taught courses in new media entrepreneurship and new media product development for the Master of Science in New Media Programs at CUHK. His research, teaching, consulting, and project management interests have been in information architecture, interaction design, narrative prototyping, and business model. His most recent CFE project in collaboration with the Hong Kong Design Centre was the development of an entrepreneurship programme for the design and creative business.



Dr. Hugh THOMAS

Dr. Hugh THOMAS is Director of the Center for Entrepreneurship and Associate Professor of Finance at The Chinese University of Hong Kong. He is an active academic researcher and pedagogical case writer in banking and financial institutions management, international finance and securitization. Prior to obtaining his PhD in International Business and Finance from New York University, he acquired six years of banking and consulting experience.



Dr. Sandy YIP

Dr. Sandy YIP founded V.ABC Group Limited in Hong Kong in 1992, dedicated to pioneering the research and development of environmentally friendly coatings. Products obtained USA Green Seal Certificate in 2005, the first-ever such award in China. With the vision of contributing to society by cultivating the talents, Dr. Yip identified her company culture in 2002 and founded V.ABC Education Foundation.





To Inspire a Passion for Entrepreneurship

**The Chinese University of Hong Kong
Center for Entrepreneurship**

Tel : (852) 2609-7542

Fax : (852) 2609-7180

Email : entrepreneurship@cuhk.edu.hk

Website: www.cuhk.edu.hk/centre/entrepreneurship



香港中文大學
THE CHINESE UNIVERSITY OF HONG KONG

SUMMARY

- The GEM consortium of more than 200 scholars in 42 economies sampled over 150,000 members of the population and hundreds of experts to poll entrepreneurship worldwide.
- Hong Kong has high levels of nascent and new business entrepreneurship which combine to give the SAR relatively high early-stage entrepreneurial activity, comparable with the United States. The early-stage entrepreneurial prevalence rate of Hong Kong is 10%.
- In our GEM reports of 2002, 2003 and 2004 the early-stage entrepreneurial prevalence rate, which we used to call Total Entrepreneurial Activity (TEA) was only around 3%.
- When the 5.4 percent of the population that owns and manages established business is considered together with the early-stage entrepreneurial prevalence rate, the overall entrepreneurial activity of Hong Kong is 15%. That means, about 15 out of 100 people between the ages of 18 and 64 are involved in entrepreneurial activities, either setting up or running their own businesses.
- The slump in entrepreneurial activity reported in our previous studies reflected a low level of confidence and few perceived business opportunities in the uncertain years of 1999 to 2004.
- Hong Kong's entrepreneurs are 2.6 times more likely to be starting a business to pursue an opportunity rather than being forced into entrepreneurship by necessity. This ratio is low, when compared with most other rich countries, where necessity entrepreneurship is even less prevalent than in Hong Kong, but is similar to that of the US.
- Only 58 percent of Hong Kong's entrepreneurs start their businesses on a full time basis. This is lower than most countries under study. But once the business is established, Hong Kong entrepreneurs are far more likely than entrepreneurs in the average GEM country to be full time rather than part-time entrepreneurs.
- Early-stage entrepreneurship in Hong Kong tends to be male (2.5 times female rates), young (25 to 34 year olds are 1.4 times more likely to be entrepreneurs), well educated (those with post-graduate degrees are 1.4 times more likely to be entrepreneurs while those who have not finished high school are only 0.6 times as likely); experienced (55 percent started up before) and well off (entrepreneurship prevalence rates are over five times more in the top third of income groups than in the bottom third).
- New enterprises in Hong Kong are overwhelmingly service oriented, with consumer services (59 percent) being far more important than business services (18 percent).
- The market impact of Hong Kong start-ups is relatively low, with most entrepreneurs entering markets with competitors and using mature technologies. About two thirds of the early-stage entrepreneurs provide no market impact and only 3 percent provide profound market impact.

SUMMARY

- Hong Kong's products and services compete in the international marketplace to a greater extent than other countries'; 20 percent of early-stage companies and 15 percent of established businesses export more than 75 percent of their product or service.
- Hong Kong has a relatively high prevalence rate of start-up firms with high growth expectations: about 2.3 percent of the adult working population expects to start up enterprises with the expectation of having more than 20 people working for the business in five years' time.
- Approximately 4.4 percent of Hong Kong's population between 18 and 64 years of age exited a business over the last year. Fifty-five percent of exits are due to financial problems and the rest are due to reasons that ought not be counted as failure (such as opportunity to sell and retirement). The common myth that "90 percent of new businesses fail in the first year" is a gross exaggeration.
- A large proportion of those who recently discontinued a business were, at the time of the interview, either owner-manager of another business (39 percent) or actively trying to start another business (37 percent).
- Almost 8 percent of the adults in Hong Kong was involved in informal investment in the three years prior to May 2007. This rate considerably exceeds the GEM average. Informal investors are more optimistic about their return than in our previous studies: 26.2 percent expect to receive 10 to 20 times their original investment in 10 years.
- More informal investors appear to be friends (54.4 percent) than family members (41.4 percent) of the investees.
- The median initial investment required for start-ups in Hong Kong is HK\$300,000. About 43 percent of founders plan to fund the startup completely on their own and, as a result, invest a median amount of HK\$150,000 themselves. For the 57 percent of founders who planned to find investors, they expected a median investment of HK\$250,000. Informal investors of Hong Kong have reported to invest a median amount of HK\$100,000. These figures suggest that an early-stage investment gap exists in Hong Kong.
- We interviewed 19 experts to assess the Entrepreneurial Framework Conditions (EFCs) that influence, stimulate and/or retard entrepreneurial development. Their assessment is similar to the assessments in past years (2002, 2003 and 2004) in terms of Hong Kong's advantages (such as infrastructure and entrepreneurial culture) and its disadvantages (such as education and R&D). Three notable changes from earlier years are more confidence in IP protection, an increased belief that entrepreneurship is a good career option, and an increased belief in the need for government intervention to stimulate entrepreneurship.

RECOMMENDATIONS

Based on the survey results and the experts' interviews, we made several recommendations for promotion of entrepreneurship further in Hong Kong:

- Educational institutions should offer practical business training courses with input from and meeting the needs of business in Hong Kong.
- Hong Kong should more closely integrate itself into the Pearl River Delta.
- Applied R&D funding from government should be increased and universities should place more emphasis on facilitating R&D transfer to industry.
- Education systems – from primary through post-secondary – should stimulate creativity, exposure to new ideas and learning for life, rather than being exam-based and stifling.
- The people of Hong Kong should re-orient its culture to be less materialistic, more creative and more respectful of intellectual property.
- The government should release land and further liberalize land use to reduce the artificially high costs of land.
- The government should limit its intervention in the economy, should not intervene to increase the rate of start-ups and should reduce bureaucratic impediments to business.
- Experienced entrepreneurs should mentor the youth.
- Society should celebrate the successes of entrepreneurs.
- The government should promote Hong Kong as a regional entrepreneurial hub.
- Hong Kong should recruit immigrants from the global and especially the mainland talent pools.

ACKNOWLEDGEMENTS

On behalf of The Chinese University of Hong Kong Center for Entrepreneurship (CfE) I thank the many people and organizations whose efforts made this study possible.

First and foremost, thank you to the more than 8,000 Hong Kongers who responded to our telephone interviews in 2002, 2003, 2004 and 2007. Only through your patient and honest responses (together with the more than 700,000 respondents worldwide since the start of GEM) have we been able to poll entrepreneurship in the SAR and to benchmark it globally.

I also extend our sincere thanks to the 19 expert interviewees and 34 expert survey respondents whose names appear in Appendix 4. Your insights gave us a coherent picture of Hong Kong's entrepreneurial strengths, weaknesses, evolution, prognosis and needs.

We would never have undertaken the GEM Hong Kong 2007 study had we not done the studies of 2002, 2003 and 2004. Those three studies were largely sponsored by the Trade and Industry Department (TID) of the Hong Kong Government. We were as disappointed as they when we found that Hong Kong had low entrepreneurship rates in those years, but we were impressed by TID's impartiality and stoicism as they continued our funding, regardless of the bad news. Although that funding has long since ended, we remain indebted to TID for financing our GEM entry and hope that it can share in the good news of our 2007 study.

We are grateful for the generous contributions, both financial and written, of the Hong Kong Business Intermediary Co. Ltd. and its founder and CEO Edwin Lee, who wrote for this study the four concluding briefs giving practical advice to entrepreneurs on financing, valuation negotiations and strategy.

At The Chinese University of Hong Kong, the Asia Pacific Institute of Business under the direction of Leslie Young has funded various activities of the CfE, among which the GEM study has been prominent. Support for the CfE's activities by the Committee for Advancement of Student Innovation and Entrepreneurship under the direction of Jack Cheng has also helped our GEM efforts. I would also like to thank the CfE's current advisory board members K.O. Chia, P.C. Ching, Roger King and Alice Ngan as well as former advisory board member Kenneth Young for their steadfast support and well-considered advice.

The members of the research team have pulled together admirably to produce this study. Without Kevin Au's energy, we would not have attempted it. Louis Leung's Center for Communications Research efficiently conducted the population survey. Both Bernard Suen and Sandy Yip provided crucial, enthusiastic support in the interview process; Rosanna Lo was our trustworthy logistics and production manager, and Dennise Tsang, Angela Ng and Jason Lee provided excellent help. We appreciated the rapid and competent translation services of Laura Au Yeung who rendered the study into Chinese. Thank you, all.

This replaces the draft study released in January, 2008. It is substantially the same as the draft of January with some minor corrections suggested by the readers of that draft. I apologize for any remaining errors in the study, for which I take responsibility.

Finally, let me thank the founder and former director of the CfE, Bee-Leng Chua, without whom there would be no CfE and, certainly no GEM Hong Kong 2007 study.

Sincerely

Professor Hugh Thomas
Director
Center for Entrepreneurship
The Chinese University of Hong Kong
July 2008

Entrepreneurship has a long tradition at CUHK. The university counts among its benefactors the leading entrepreneurs of Hong Kong. CUHK faculty and alumni have started numerous companies – Varitronix, Group Sense, Champion Technology, CitiTelecom, Mobile Player and Wisers to name just a few – that have increased the wealth of the SAR. In response to the growing challenges of global competition for innovation and entrepreneurship, CUHK has in the past few years put important emphasis on instilling innovation and entrepreneurial attitudes in both the undergraduate and postgraduate students. Through course work, interaction with business persons and extra-curricular activities, students are encouraged to embark on the ceaseless search for value that is at the heart of entrepreneurship. Every year, the university supports student teams to local, national, regional, and global competitions to represent CUHK and to experience and learn from the best in the world how to improve Hong Kong's competitiveness.

CUHK is one of the top research universities in Asia that has recently contributed to applied scholarly research on entrepreneurship. Our membership in the leading international consortium of scholars in entrepreneurship, the Global Entrepreneurship Monitor, shows that CUHK is committed to high quality research. GEM Hong Kong 2007 documents, analyzes and explains the entrepreneurial resurgence in Hong Kong since 2004 and provides a set of useful policy recommendations for government, industry, the educational sector and individuals.

It has been my pleasure to chair the CUHK Committee on Advancement of Student Innovation and Entrepreneurship, working with students, researchers, teachers and staff in all faculties of CUHK to help them implementing new business models, commercializing university-developed innovations and contributing to socioeconomic development. GEM Hong Kong 2007 complements the work of the Committee and I commend the Center for Entrepreneurship for completing it.

Professor Jack Cheng Chun Yiu

Pro-Vice-Chancellor

The Chinese University of Hong Kong

The popular imagination certainly celebrates Hong Kong's entrepreneurship, but is that merely an urban legend?

Global Entrepreneurship Monitor: Hong Kong 2007 by the Center for Entrepreneurship, one of the inter-faculty research centers of the Asia Pacific Institute of Business at The Chinese University of Hong Kong, provides hard evidence on the matter, including the demographic profile of entrepreneurs and the types of business that they seek to enter. It shows that entrepreneurship is alive and well in Hong Kong, but vulnerable to cycles of public confidence that are loosely correlated with the business cycle. It provides useful comparisons with other economies and suggestions for promoting entrepreneurship in Hong Kong.

This study will provide illuminating reading for anyone with an interest in the future of Hong Kong as a centre of entrepreneurship.

Professor Leslie Young

Executive Director

The Asia Pacific Institute of Business

The Chinese University of Hong Kong



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