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The private sector development and regional independent innovation in China: case studies in Zhejiang

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Abstract:

Entrepreneurs' motivation on innovation within the development of private sector is the important sources of power for China's regional independent innovation. The sustained growth of the private sector in Zhejiang and Jiangsu has gradually extended the innovational mechanism of privatization throughout China. Institutional innovation conducted by private enterprises has played the strong role in China's economic development and market transition in regional level as well as national level. It has efficiently promoted the reasonable allocation of resources and mobility of factors of production, has greatly improved the industrial structure and industrial division of labour in a wider areas of China. Along with the further development of China's market, the economic power of private enterprises will be continuously strengthened. With two cases studies in Zhejiang province-Yiwu Commodity market and Liushi electrical equipment manufacturing cluster, the paper passes on a positive view of the private sector in supporting regional innovation in China. Although the development of private sector in China is now being challenged by world economic crisis and enterprises closures heavily happened in China's east coastal areas at this moment, it is the market plays its role in cleaning the business society in China rather than a crisis of economy itself. Chinese government and society is ready and will able to counter the crisis and create new development opportunities. Traditional manufacturing industries based on simple goods have to be discarded in east coastal areas and relocated to west China, either taking direction of technology innovation for industrial upgrading or developing service sector in east China. This is the future development of China's private sector, and the private sector is the long term growth potential of China's economy.

Key words: the private sector; regional development; independent innovation; long term growth potential

JEL Codes: L120, O140, R110,

1. Introduction and current situation of private sector in China

The growth of industrial clusters in Jiangsu and Zhejiang, China, suggests that the vitality of industrial development and organisational innovation in the private sector has created a good environment for industrial, technological and market innovation, thereby improving the region's social and economic competitiveness. Indeed, in today's globalising era, it is now commonly accepted that establishing industrial clusters is the key measure for states, regions and cities to improve their industrial competitiveness.

Such process of clustering is necessary for industrial development, as it is the market's way of improving the allocation of resources and factors of production. Renowned economists such as Alfred Marshall (1920) and Paul Krugman (1998) have argued that industrial clusters may benefit social collaboration and competitiveness within a given region. Other economists agree that industrial clusters represent a means for multiple enterprises to develop their business through collaboration. Improved productivity in industrial clusters is thus induced via competition rather than discrete efforts by individual enterprises. The net result of industrial clustering is therefore to stimulate regional economic development. Since the implementation of China's reform and open door policy in the late 1970s, there has been a boom in private sector industrial clusters in unplanned industrial districts as well as officially registered industrial parks and development zones. From October 2003 to April 2004, the Chinese authorities ran a campaign to crack down on poorly regulated development districts. According to the Ministry of National Land and Resources in its '2003 Communiqué of China's National Land and Resources' (Ministry of National Land and Resources, 2004), some 3,763 of the

6,015 registered development districts and industrial parks across the country were ordered to be disbanded because of inefficient use of land and resources. The communiqué also reports many thousands of land use violations, with some 5,878 hectares of land recovered during the campaign.

On the contrary, the vast number of private sector industrial clusters from grass root—both planned and spontaneous – highlights the vitality and effectiveness of the development model in the contemporary economic climate. Indeed, the evidence indicates that private sector industrial clusters offer good opportunities for the restructuring and development of regional industries to improve regional economic competitiveness. Industrial clusters offer further advantages for private sector development, including promoting the development of SMEs; benefiting the formation of ancillary enterprises within associated industries (both upstream and downstream); benefiting local brands; and benefiting local and regional development. Moving on from this, the article will explore how the private sector innovates regional industrial growth and is responsible for the re-structuring of China’s regional economy. This will be done by examining the basic characteristics of geographical concentration, specialised division of labour and industrial collaboration from the perspective of independent innovation.

2. The private sector promotes development innovation for regional industrial growth

Via geographical clustering, the private sector can realise regional economies of scale. According to the laws of industrial development, private sector industries will tend to concentrate in areas with naturally located advantages. These industrial clusters consist of considerable numbers of SMEs, some of which lead the cluster development, while others expand the business scope through the formation of derivative industrial clusters or enterprise communities (Cai Ning, 2003). Thus, by geographically focusing production, industrial clusters will accumulate factors of production and develop economies of scale, thereby having a positive economic impact on a given region.

As enterprises within industrial clusters have different affiliations, so the effects of learning and business competition become obvious. Not only does cooperation between enterprises bring about production clustering and economies of scale, it also leads to information grouping, the convergence of talent, the merging of technologies, and intense competition. Together, these factors have greatly accelerated the pace of technological innovation in the private sector.

The development of specialised industrial clusters improves the organisational performance of regional industry, and creates a geographical hub for product and technology innovation. Industry clusters have very specialised features that enable them to grow continuously. Regional specialisation results in specialised labour markets with integrated personnel training, local sales networks, lower transport costs, and a better supply of raw materials. In turn, this acts as a regional incubator for the creation of new products and innovative technology, thus creating a virtuous circle for the creation and

development of enterprises and industrial clusters in the given region. Because of the high degree of specialised labour and industries, skilled workers can easily find jobs within industrial clusters. This not only eases the pressure on local employment, but also redoubles the efficiency of the local production system.

Effective collaborative networks of private sector industrial clusters can also improve regional urbanisation and industrial structure. As industrial clusters develop, so the basic level of production quality increases. Enterprises are gradually able to subcontract their service jobs to external providers, giving rise to a growing market of professional service providers (Dong Liyun, Wang Shaohua, 2007). Meanwhile, the development of industrial clusters can lead to the accumulation of people, goods, capital and information flow. This will lead to the development of transportation services, storage services, telecommunications services, restaurants, hotels, entertainment, education, health services, and intermediary services, such as finance and insurance services, real estate and other sectors. In turn, this will raise the standard of urbanisation.

Throughout China, the general public have observed the growing development of industrial clusters. Local governments should create a good environment for private sector development by developing the necessary policy guidance. They should not try to drive private sector development or support SMEs according to their own wishful thinking. Given the large number of errors made by local governments in the construction of development districts, the evidence suggests that private sector industrial clusters grow more successfully when left to develop naturally. Of course, if authorities can provide

proper planning and guidance for the development of industrial clusters, this could also support development of the private sector and promote industrial innovation in a given region. After all, local governments are in a position to enhance economic reform efforts and eliminate institutional obstacles to private sector development. For example, they could create good hardware and software environments, provide better services for SMEs, publish guidance to industrial development, and provide local support for private sector development. Local governments could also guide enterprise clusters to implement different competitive strategies (Porter, M. 1987), and help enterprise clusters to fully develop their comparative advantages and local characteristics by combining with local conditions.

The industrial organization, which is characterized by the advanced social division of labour, does work in conjunction with frequent market transactions (mainly via options of invisible markets) within clusters or among clusters in Zhejiang and Jiangsu provinces. This is well known as the soft and flexible modes of production of industrial organizations -- soft and flexible production complexes (Wang Jieci, 1997). Enterprises collaborate through subcontracting, strategic alliances, service contracts, sales contracts, so as to acquire external economies of scale within the scope of the market development. Flexible production complexes have possessed both market advantages of horizontal integration and vertical integration of industry organizations, such flexible production complexes are able to overcome non-efficiency scale economy of small sized enterprises, nor do flexible production complexes have the potential risk of rigid production like that

of vertical integration division of large sized enterprises' "boat is too big to turn back", whenever it encounters unexpected conditions.

The evolution of Liushi electrical industry has been the mixed integration of industrial organizations—soft and flexible production complexes, since 1996. The Liushi case of electrical equipment manufacturing clusters will be specifically addressed in the fourth part of this paper. It is the evolutionary trend of agglomerative economies development with industrial clusters of the private sector in Wenzhou territory as well as in the whole Zhejiang province after the 3rd Plenary Session of the 15th CPC Congress held in 1998.

3. Innovation and development of specialized markets: case of Yiwu Commodity City

Since the reform and open door policy implemented in 1978, Yiwu has resolved to execute the development strategy of Building the City by Prospering Commerce unswervingly, using the commodity industry as a leader to drive regional economy, and become a large market city and strong economy city from a traditional agricultural small county. Currently, Yiwu is one of the regions with the most development active in Zhejiang. It is well known that in the past nearly 30 years successful development in Yiwu, the Yiwu Commodity City, i.e. Specialized Markets group, has made tremendous contribution to this particularly successful development.

Yiwu has a long tradition for commercial activities. Local residents in Yiwu area used to journey north and south with street vendor's load and a drum shaped rattle for doing business, in most sense we could say that people in Yiwu they are good at doing business¹. At the beginning of market development, the Yiwu specialized market was indeed a self-motivated or voluntary provision of an open market place for goods transaction, it was primary the result of private action made by local family business through collective-choice mechanisms. In 1982, *when local government started to intervene* and invest in building up the Yiwu Small Commodity Market, since then the subsequent formal institution of market transaction has been introduced, and the dimension of the specialized market facility and its administration have been gradually defined. From then on, Yiwu appears a prosperous scene with a flourishing market, developing economy and wealthy, steady society. The Yiwu commodity industry, which has been emerged around specialized markets, has been the leading industry in the regional economy. This is in context of Coase's transaction cost theory, Coase once pointed out, as long as transactions are not completely regulated and contracts may be incomplete for parties with self-motivated or voluntary collective choice of mechanisms in open markets, the government's provision of formal institution of the market via infrastructure investment of specialized market, this would be an essential support (Coase, R. 1937) for the Yiwu Commodity Market to play its role in facilitating the development of clusters and rural urbanization from local level.

¹ Traditionally Yiwu Farmers had been good in doing commercial business with the way of "Using chicken feather to change malt suger", farmers with vendor's load and a shaped rattle this commercial tradition has a profound impact to Yiwu farmers.

Currently, the Yiwu commodity market possesses an area of more than 1.5 million sq.m. and has 58,000 stores, collects 40 categories and about 250,000 varieties of daily goods (Yiwu Bureau of Statistics, 2008). Throughput is nearly 10,000 tons, market business volume is on top of the nationwide large special markets for 12 successive years, and has been granted the unique market title of being one that *'pays attention to quality'*, and *'keeps promises'* by the State Quality Supervisory Inspection and Quarantine General Bureau (Data collected by conducting interviews at Yiwu Bureau of Industry and Commerce Administration in April 2007). Furthermore, the Yiwu market has been an international commodity distribution center and the important base for foreign merchants to purchase commodity. The industrial economy is also rapidly aggregating and strengthening, and currently has developed and is exploiting industrial park areas of 64 square kilometers, with more than 1300 enterprises with economies of scale. Today totally, there are more than 18 thousand enterprises relying on specialized markets-Yiwu Commodity City (Yiwu Bureau for Economic Development, 2007). It has cultivated a group of predominant industries, scale enterprises and famous products of socks, ornaments, zippers, cosmetics, shirts, cultural articles, pen-making, toys, etc, formed industrial developing structure of small commodity, large industry, small enterprise, and large colonization. The Transaction structure of Yiwu Small Commodity City today has been defined in table 1 with data of 2006.

Table 1. The transaction structure of Yiwu Small Commodity City (2006)

<i>Transactions volume</i>	
Total volume of trade	31.5 billion RMB
Value realized on the domestic market	11.5 billion RMB

Proportion of trade to domestic market	36.5%
Value realized on international market	20 billion RMB
Proportion of trade to international market	63.5%
Main destinations of flow of goods(export)	South Korea, USA, Emirates
Export through market	Yes
Proportion of local export	80%
Total salesrooms	40000
Total workers in the market	50000
Number of markets belonging to the market system	22
<i>Trade goods</i>	
Category of goods exchanged	Commodities
Wholesale function	Yes
Retail function	no
<i>Sourcing</i>	
Total number of firms selling	-
Presence of local traders as intermediaries	Yes
No. of local traders for local/foreign companies	-
No. of firms with own shop	-
Proportion of local sellers	40%
Number of Zhejiang sellers	30%
Number of Chinese sellers	29%
Number of foreign sellers	1%

<i>Buyers and market access</i>	
Total number of local buyers	mainly
<i>History of the market and the cluster</i>	
Local handcraft tradition	No
Existence of small market before cluster formation and government action	Yes
Year of institution introduced by local government	1982

Source: Data collected from ‘The Annual Report of Yiwu Commodity City 2007’, Yiwu city Economic Trade Bureau and Yiwu Commodity City.

The status of Yiwu commodity market in Zhejiang today does also manifest the truth that the role of Yiwu market is changing, and the replacement of enterprises to market is on the way. From ‘Zhejiang Provincial Report on Development of Agglomerative Economies 2006’(Zhejiang Research Association of Regional Economic and Social Development, 2007), we have already found that Yiwu commodity city ranks No.2 among the list of top twenty clusters with perfect network production system, and ranks No.3 among the list of top twenty clusters with economies of large scale, in Zhejiang-the leading province of agglomerative economies and specialized markets in China. And the total annual output was about 43.3 billion RMB as statistically shown in 2004(Zhejiang Research Association of Regional Economic and Social Development, 2007). In 1980s and 1990s, the Yiwu Small Commodity Market did support the rapid development of huge family firms, however, as SMEs growing up into large-sized ones, the role of Yiwu market changing either. From the entry of the new century, the total volume of trade

within the Yiwu Commodity City markets groups has still been increasing year by year, but the proportion of trade by enterprises declining constantly. Meanwhile, number of firms with own shop presence in the Small Commodity Market keeps declining as well.

In case of the fact that the declining of enterprises' trade proportion in the market trade volume, the market has been in transition to meet the new need of conference and exhibition services. Till now, Yiwu has successfully held China Yiwu International Commodities Fairs (Yiwu Fair for short term) thirteen times in succession; this is the new development trend of the Yiwu Commodity City. The Yiwu city is now making use of the Yiwu Small Commodity Market which is in fact composed by a set of multiple markets, to create the Yiwu International Trade City. And markets innovations are mainly focused on transformation of the products transaction, within multiple specialized markets in Yiwu Commodity City.

4. Innovation and industrial clusters evolution: case of Liushi electrical equipments manufacturing clusters

With the similar or same growth trend to all other industrial clusters and agglomerative economies which are inseparable to specific markets building in Wenzhou or even the whole Zhejiang, the growth of Liushi electrical industry was inseparable to the role of specialized market either. Despite the role of specialized markets in supporting the development of Liushi electrical equipment manufacturing industry, this electrical equipment manufacturing cluster was definitely inseparable to a man-Chen Qingyao. Paul

Krugman once said that some cases of rapid economic development happened in given regions were simply for accidental chances, the process of birth, growth and evolution of Liushi electrical equipment manufacturing cluster is one of the manifestations.

4.1. Accidental chance and personal motivation for the birth of Liushi electrical equipment manufacturing cluster

When Chen visited to his relatives in Huaibei coal mine plant in Anhui province in 1976, at that time, coal mine plant heavily needed a kind of touch-end of a small switch, since the touch-end was easy to break. At that time State owned companies were reluctant to supply electrical components, plus strong personal motivation of doing business, Chen started to make this and established his backyard switch plant in spite of his lack of knowledge in industry. Because of the stable and fixed large demand of market, Chen made profits immediately. In later 1978, He received 350 thousand RMB transfer from Huaibei Coal mine, that was incredibly huge money at that time, and this led to endless trouble to him immediately¹. His plant was closed down by local official, and he was sentenced into jail since at that time private plant was still deemed as illegal business, his property had been passed on to public property for there was no law to protect private property at that time in China².

¹ In 1978, 350 thousand Yuan RMB was like a money mountain, in fact Chinese civil servants' monthly salary was only about 200 Yuan RMB, thus people could imagine what a big money it was the 350 thousand Yuan RMB in that time.

² Luckily, The Third Plenary Session of the 11th National Congress of the Communist Party of China was held on Dec 18, 1978, this event meant that China would start to take reform and open door policy. Since then National political environment has been changing and started to encourage individuals to start their own business. Chen Qingyao was released from jail in June 1979, but he was unable to take his property back from local public property, thus he was unable to take leading role for the electrical equipment manufacturing sector in Liushi again.

Chen's plant was a means to an end under the political environment during that time, but his business was a trigger to the booming of lower voltage electrical equipments manufacturers. 1984, Hu Chengzhong and Nan Cunhui co-established the Qiuqing Switch Plant in Liushi with 3 shareholders, 50 thousand yuan as capital investment, 8 employees¹. The plant had got a rapid development by providing good quality of products and good service in the next 6 years.

In 1990, Qiuqing switch plant divided into two plants, one year later, two plants started to run business independently. Hu Chengzhong's plant renamed as DELIXI electrical manufacturer GROUP, Nan Cunhui's plant renamed as CHINT GROUP, they integrated other small firms into their groups, attained further rapid development in electrical equipment manufacturing.

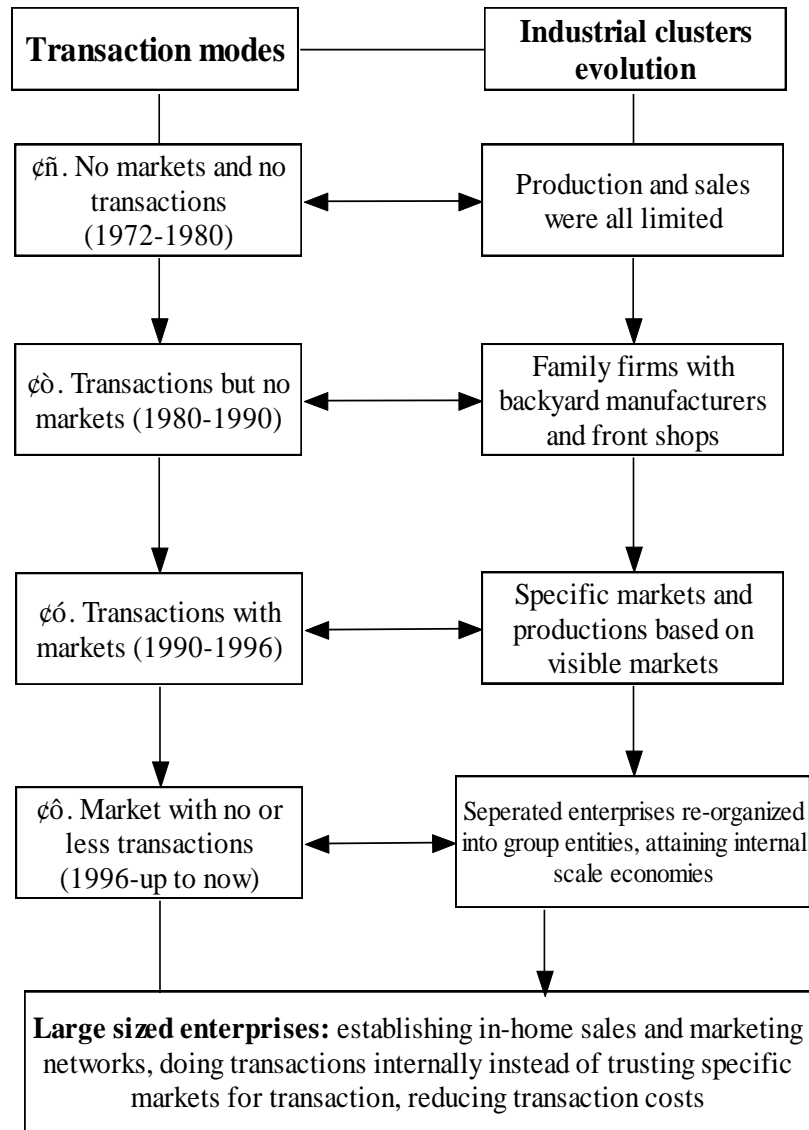
4.2. The definition of innovational evolution of Liushi electrical equipments manufacturing cluster

Looking through the development trend of Liushi low voltage electrical equipments supply market, we have easily found it has been experiencing different stages of “no market and no exchanges” to “exchanges with no market” to “exchanges with market”, and finally to “market but no exchanges”. This is the process of industrial development and evolution of industrial organization of Liushi electrical industry. The illustration¹ here below gives another good explanation for us to understand the empirical proof of

¹ See websites of CHINT and DELIXI, histories of CHINT and DELIXI, <http://www.51xue.org.cn/blog/u/32/archives/2007/296.html>, or <http://www.delixi.com/about/about5.asp>, retrieved on Dec 27, 2008.

industrial development with the replacement of enterprises to specific markets in transaction in Liushi electrical equipment clusters.

Illustration 1. Changes of transaction modes and industrial clusters evolution in Liushi electrical equipment



Note: This figure quoted from Author's previous publication (2008) *The private sector and China's market development*, Oxford: Chandos Publishing, p. 38.

Non market period of 1972-1980, this was the initial development period of low-voltage electrical equipments in Liushi town, the production and sales of low-voltage electrical

equipments did not get successful development, nor did the physical presence of the specific market exist. There were exchanges but no stable market site in 1980-1990, during this period Liushi low voltage electrical production and sales had amounted to a certain size, but sales and transactions were disorderly for there had no fixed, orderly trading platform—specific market. At that time, the popular form for production and marketing was so-called “the household front shop and backyard manufacturer” based on family plants. The period of transaction with market was from 1990 to 1996, during this period Liushi electrical industry had been tremendously expanded in its size of the production and marketing. The establishment and open of Liushi electrical equipments market site in September 1990; this was an important factor for rapidly expanding of agglomerative economy of specific electrical equipments industrial clusters in the first half of 1990s. Since then the largest specific market of low-voltage electrical equipments in China has been vigorously developing and growing up in Liushi town. Within a few years, over more than 1400 electrical equipment manufacturers had been clubbing together in 12 square kilometres in Liushi town around this specific market, its volume of transaction and total value of production ranked more than 1/3 of National electrical equipment markets. Averagely, there were more than 100 manufacturers in every per square kilometre ground in Liushi Town due to 1996.

A market without exchanges period started to happen and lasting from the end of 1996, this has been further expanding market share and the scale of production by large sized enterprises doing business with their in-home sales and marketing networks. These motivations of enterprises stimulated by local Governments, separated enterprises were

reorganized into group entities with development mode of economies of scale. The economies of scale of some giant enterprises groups were amount to larger scope enough for them to establish their own Nation-wide internal marketing networks, and they were no longer need for or depend on specific markets for providing platform for their products transaction. By 1998, the main market transaction for electrical equipments in the specific market were mainly belonged to those individual industrial and commercial householders, and amounts of transactions by enterprises as business entities presented in the visible market were declined to only 10% of the total market transaction performance.

In fact, grouping evolution of Liushi electrical industrial organization could be traced back in 1991. During 1991-1992, Liushi electrical enterprises employed joint and mergers of horizontal integration of production system for expanding the scale of production. The horizontal integration was developing under the condition of those small manufacturers and handcraft plants which had not got entitlement of confidential production permits, they bargaining-ly joined in CHINT and DELIXI (the two larger enterprises groups who had the certificates of permission for production). They enacted as branch plants or workshops of giant groups, depended upon giant group for products brands and production license, whilst small manufacturers and handcraft plants they still kept holding their own property rights independently. During this period (until 1994), the expansion of enterprises groups' production scale was still dependent on the specific market mechanism.

However, joint-ventures, mergers and grouping of enterprises with the horizontal integration of product specialization, there had been resulting in frictions among different property owners between Group Plants and branches, as well as between branches and branches, even within branches, this did increase costs of corporations collaboration, management and products transaction. In view of this, the electrical industrial groups in Liushi started to employ vertical integration of enterprises for industrial division from 1994 to 1996, the division of enterprises started to transfer from *product specialization* to division of *specialized production, design, services, transportation & sales, and etc.*, enterprises started to shift their sales and marketing from the visible markets transactions to options of the invisible market sales of network transactions (Xinhua News Agency, 2008a). The transformational forms of industrial organization and business structure from the horizontal integration to vertical integration in production division, this has brought about the expansion of economies of scale of enterprises and the quick evolution of business, resulted in development of modern corporations, and thus the technology innovations, industrial upgrading and changes of market transactions are inevitable. Today, electrical equipments manufacturing in Liushi are no longer restricted in simple goods, Liushi electrical equipments manufacturing now provides supplies and compliment supplies for, and as well as technology supports to China's aviation industry, high speed railway routes projects, national Olympic Sport Stadium and etc. Liushi electrical equipments manufacturing now does also provide supplies for and technology supports to world giant transnational corporations like Siemens, GM, LG, Samsung and etc. Today, CHINT and DELIXI, both of them have established R&D programs in Shanghai, Beijing and even Silicon Valley in North America, they have also been running

post-doctoral fellowship in electrical equipments manufacturing sector so as to further promote innovation within this industrial sector.

5. The sense of independent innovation and its motivation is increasing in the private sector in China

Indeed, after more than 20 years of development, China's private sector has attained a broader vision for development, and private enterprises are now greatly being encouraged to promote their independent innovation. For a long time, independent innovation is a threshold standing in front of the Chinese enterprises, which is not easy for them to cross in their further development. It is said that there are only 0.03% enterprises have their own independent intellectual property of core technologies in China mainland, it is really difficult for enterprises to grasp the core technology, and most enterprises attach importance to the import and introduction of technology from west world but underestimate the digestion and absorption of those imported technologies for further leading to new invention. These troubles, which have long been failed in effectively being addressed, have been plaguing the Chinese enterprises for some years and block them to grow up or attain business performance.

According to the statistics, in 2004, the expenditures for technology import of China's industrial enterprises was much more than the scale of 39.7 billion Yuan, among them only 6.1 billion yuan had been really invested for a new technology absorption and re-innovation spending, far below the level of that in Japan and South Korea (Institute of

Economics, Chinese Academy of Social Science, 2006). Due to a serious shortage of scientific and technological innovation capacity, many Chinese enterprises fall into the trap of passive position for being controlled by others. Fortunately, this situation is going to be broken by private enterprises.

The institutional innovation of Chinese private enterprises is the important basis for the formation of China's social market innovation; it is an important driving force for national economic development. Certainly we are aware that it is the congenitally deficient for private enterprises' industrial R&D and own invention in the premise of receiving the support of very limited resource from the community, thus independent innovation of private enterprises is in a relatively low level and even primitive stage. However, we do realize that the innovation system of the private enterprises is vitality; most enterprises have a good growth trend of profit gaining. So far there have been already some cases of innovation with deep-reaching influence among the private enterprises. In particular, the state has introduced a series of principles and policies to help the private enterprises tackle problems like unsustainable innovation, shortage of human resource and capital in technology innovation and management innovation, lacking of cooperation and integration in independent innovation, no options for raising more fund for innovation investment or risk resolve. So far the independent innovation and development environment for private enterprises has been gradually improved.

At present, there are 5,380,000 private enterprises nationwide (as authority announced in 2007), accounting for 80% more of the corporate enterprises throughout China. Private

enterprises have become China's largest enterprise groups. Individual and private economy account for 40% of the national GDP, have become an important force for economic development. Non-public ownership enterprises have provided for more than 70 percent of total urban employment in China, become the major provisions of employment increase in Chinese society. The private sector accounts for the vast majority of small and medium enterprises which have provided about *70 percent of technological innovation, 65% of invention patents and more than 80% of new products nationwide*, become an important source of independent innovation in China (Huang Mengfu, 2007).

Jiangsu and Zhejiang, two leading provinces of China's private sector development, there are a large number of private enterprises have been developing rapidly in the two provinces. Many private enterprises with certain large size in economy have also accumulated some experience of international cooperation in their practices of trans-national mergers and cooperation/exchanges with transnational corporations. In order to explore the truth of independent innovation within private sector for regional development, here the article interprets this logic with the combination of the concretely specific cases of innovation and development of private enterprises in Jiangsu and Zhejiang.

The case of independent innovation of Wanxiang Group Companies: Wanxiang Group is the enterprises group with township and village collective enterprise as the main corporation component. It is one of the 120 enterprises groups selected by the State Council for reform experimentation, one of the State selected 520 key enterprises, its

main business is for the auto parts industry. More than 30 years ago, in a small and poor village beside the south bank of the Qiantang River, 6 farmers led by Lu Guanqiu, they raised for 4000 yuan as investment and started to run a plant of black smithy. In order to avoid the risk of economic and political environment at that time, and not to be troubled by the so-called "cutting the tail of capitalism", they did hang out the business sign of Ningwei Commune Agricultural Machinery Plant which was commonly known as "wearing a Red Hat". This was the original source of the township and village collective enterprise-Wanxiang Group (Zhejiang Online, 2008).

When China started to implement reform and open door policy by the end of 1978, Ningwei Commune Agricultural Machinery Plant began *product innovation*, and since then it has been heavily involved in the production of automotive universal joints, and in just a few years it has obtained the dominant role of the supply of universal joints in China's domestic auto market. In 1984 Wanxiang Group Companies started to sell products in U.S market through a company in the United States, which was the earliest practice of internationalization development among China's private enterprises.

Fortunately, Lu Guanqiu's finest quality laid in the truth that he did not feel self-satisfied over Wanxiang's products going to overseas' markets, Wanxiang Group Companies did not let own auto universal joints market be fully controlled or monopolized by someone else.

Wanxiang Group Companies did not be satisfied with the situation of simply providing OEM manufacturing for Scheler Co.Ltd in US, on the contrary, Wanxiang did actively

develop its own product brand and trademarks, work hard in extending its business influence and market penetration in whole world. In accordance with Lu Guanqiu's view, Wanxiang was and is good at learning and innovation, and today's success of Wanxiang Group Companies cannot be separated from this. Wanxiang Group Companies did learn experience from transnational corporations and constantly improve own proficiency of production management while cooperating with international companies like General Motors, Delphi and etc. Wanxiang has been touched by those transnational companies' conscientious of not missing any details in their production management.

So far Wanxiang started to sell products to overseas market since 1984, it started to send managing staffs and technique staffs to work and study in overseas countries particularly to US and European countries, and then in 1994 Wanxiang did start to run its first overseas company in the United States. And till today, Wanxiang has been setting up, and launching mergers and acquisitions of equities, more than 26 enterprises in the United States, Britain, Australia, Canada and etc. 8 countries. Wanxiang's marketing networks reach more than 60 countries and regions; it is an unprecedented innovation in China as well as in world. Wanxiang American company has also successfully acquainted or done the mergers of the United States' Scheele company, ID company, LT company, QAI Inc., UQI listed company and etc. a number of overseas companies, and at present Wanxiang has more than 18 wholly-owned or share holding up companies (Zhejiang Online, 2004) in overseas countries. Wanxiang has become a real transnational corporation with total assets of more than 10 billion Yuan, its annual value of sales is also more than 10 billion Yuan at present.

Wanxiang Group Companies set up Wanxiang American Company in Chicago 1994, Wanxiang American Company takes responsible for developing international business and, realizing internationalization development of local enterprises. This strategic measure is intend to make full use of local resources, brand-name advantages and quality services so as to pass on the up-to-date information and technology from world market to mainland China. Along with this strategy, Wanxiang could successfully connect to the operation of transnational corporation, integrate international advanced technology and mainstream of international market, and thereby further stimulate the industrial growth of main industries for domestic corporations. The first year of the establishment of Wanxiang American company, its value of sales reached 3 and half million U.S. dollars, and its annual value of sales started to breakthrough 20 million U.S. dollars in 1997, in 2000 it achieved value of sales 60 million U.S. dollars, and by 2002 it achieved value of sales 15.2 billion U.S. dollars (Zhu Hui, 2006). Wanxiang Group Companies have now established the global customer service networks and provide warehousing, distribution, and other modern logistics services in the global market.

Along with the accelerating of economic globalization pace and science & technology integration, the capacity of independent innovation has become a key factor for Chinese enterprises to face competition from the world-class enterprises. China's private enterprises have significantly possessed the capacity of independent innovation after more than two decades of growth and development. From earlier 2005, China has settled down the creation of own brand of products, independent innovation and capacity of

independent innovation, industrial structure upgrading, as national strategy for economic development and international competition. National independent innovation as state key development strategy, it has and will have a positive effectiveness in promoting national independent innovation among the private enterprises, stimulating the rapid development of the private economy, and awakening the private entrepreneurs' awareness of independent innovation, in the future 5 to 10 years or even longer period from 2006. The development of the private sector and growth of entrepreneurship of the private entrepreneurs, in addition with the private entrepreneurs' strong awareness and motivation of independent innovation in today's China, this would undoubtedly boost China's independent innovation. And as the result of independent innovation, China's economic transformation and development will be ultimately accelerated, and then social development and social harmony will also be smoothly achieved.

6. Independent innovation of the private enterprises will dictate China's regional economic development

The regional economy and the private sector maintain an interdependent relationship based on coexistence and common prosperity. Without private sector development, it would be difficult for the regional economy to integrate resources for pursuing integrated regional development; without a coordinated regional economic development policy, private enterprises would fall into vicious competition and fail to grow into large-sized enterprises.

As the strongest profit-driven market players, private firms not only create social wealth but also boost market prosperity, accumulate investment capacity and experience, and bear the cost of reforming state owned enterprises. Such strong market players are necessary for the rational allocation of resources and the effective mobility of production factors, to say nothing about the regulation of industry structure and division of labour. There are three major factors of particular interest in the co-development of the private sector and regional economy: the scientific view of development and the implementation of macroeconomic regulation; the State Council's 36 articles for the development of the private sector (China State Council, 2005); and pressure from World Trade Organization (WTO) members and economic globalisation. Development of China's private sector and regional economy has been informed by the interaction of these three factors, as demonstrated in the following examples:

The entire eastern region is facing the enormous pressure of industrial restructuring and transition. Economic development in this part of China tends to be driven through investment in modern service industries and capital and technology-intensive industries. With the new round of economic growth across China, private enterprises have begun to enter a new round of expansion or transition, notably in heavy industry and real estate development. In some coastal areas, especially the Yangtze River Delta region and the Pearl River Delta region, a number of resource-based industries, including some labour intensive industries, are now being transferred to the central and western regions of China. The spatial planning for the remaining regions should be integrated with economic globalisation and the restructuring of domestic industries. Key future directions for

development include technological innovation and the service sector (means economic structure innovation).

The central and western regions face a developmental upsurge as labour-intensive industries are increasingly migrated from the eastern regions. In addition, there is currently massive investment in energy and resources projects and increasing foreign direct investment. At present, a number of multinational companies are moving their headquarters and R&D departments to the Bohai region and northeast China, while some foreign-funded enterprises are establishing production bases in Vietnam, Cambodia and elsewhere. Indeed, many Taiwanese businessmen in the Yangtze River Delta region and Pearl River Delta region have quietly started to withdraw their capital, while some entrepreneurs have relocated their equipment and machinery, or transferred it, along with factory buildings and plant, to other local companies. Others still have left ancillary departments or shell-structures at their original investment sites, while the main production force is shifted elsewhere. Domestic private enterprises are starting to behave similarly; this is the new development trend of regional innovation.

The private sector will enter a wide range of investment areas, and is likely to form a new industrial block in the upper and lower reaches of the monopoly industries, as well as in the extended local industrial chain. In early 2005, the State Council published 'A number of views of the State Council on encouraging, supporting and guiding non-public economic development including individual producers and private enterprises development'. This document has brought about unprecedented opportunities for private

sector development. At the time of writing, more than 14 privately-owned airlines have been set up or are being established in the domestic market, including Okay Airline, Eagle Alliance and the Spring and Autumn Airline. China's largest private integrated oil industry entity, Changlian Oil Shareholdings Limited, was established on 29 June 2005. At that time, nearly 50 private enterprises were shareholders of the giant Oil Holdings Limited, and the total capital investment in this giant private carrier was more than 5 billion yuan (Qianjiang Evening Post, 2005). Indeed, the promulgation and implementation of the State Council's 36 articles has provided equal market access for all kinds of market players, including investment and financing, and taxation support services. These endeavours will not only greatly stimulate private innovation and entrepreneurial passion, but will also promote a new pattern of regional economic development.

7. Conclusion: the private sector is and will be the long term growth potential of China's economy

Recently, world economic crisis does extend some influence to China's economy. This is a new economic phenomenon which we should not ignore at current time. In fact, there are a large number of small and medium sized enterprises closures happened along China's east coastal areas since the second half year of 2007. Particularly in the Yangtze River Delta Region and the Pearl River Delta Region, due to the rapid economic development in the two deltas has long been heavily relying on export with simple goods or processing trade. The comparative competitive advantages of China's manufacturing

are solely relying on low labour cost and intensive using of resources, plus environment pollution and resource deterioration¹. There is almost no competitive advantages of China's manufacturing sector in the international market, this is the rooted reason for the tens of thousands enterprises closures happened at this crucial time of world economic crisis brought about by troubles of financial industries in the United State. Chinese manufacturing sector has been participating in the global economic circulation at the lower end of global value chain of production, this condition has to be changed otherwise there would be no long term growth of China's economy.

The fluctuation of international trade during this turn of world economic crisis has certainly imposed negative effects on China's manufacturing sector. A great number of small and medium-sized enterprises (SMEs) went bankruptcy or are going to bankruptcy in China's east coastal areas, even in China's economic heartland-the Yangtze River Delta Region. SMEs are mainly private enterprises or individual producers, and we are aware that those private enterprises have provided 70 percent of total urban employment in whole China today, thus the closures of SMEs in China's east coastal areas at this moment have not only led to the fact that huge migrant workers have to leave their jobs and return back their homes in countryside in inland China, but also led to the fact that large part of urban employees have to leave their job positions. This is a tough pressure to China's society.

¹ Though the paper does address more positive development of the private sector in former parts, in general the author here has to acknowledge that most private enterprises are focused on traditional manufacturing industries with simple goods production. Private firms grow up and become giant transnational corporations like Wanxiang enterprises group, this is only one or two cases. Most private enterprises are still relying on lower labour cost, intensive use of resources and pollution of environment for chasing in the international market; this un-sustained development way has to be changed.

Facing this tough situation brought about by world economic crisis, Chinese government has launched multiple measures to stimulate the economic growth and manage to help private enterprises pass through difficulties, the central government has announced a relief scheme of 4 trillion Yuan for investment and intends to increase China's domestic demand, plus more than 18 trillion Yuan promise-ly offered by local governments for investment and stimulation of consumption in China (Xinhua News Agency, 2008b), the economic growth will undoubtedly be promoted.

However, at this time, it is natural for government especially those local governments to pay more attention to maintaining economic growth instead of promoting transition of economic development mode like restructuring industrial sector and upgrading product mix. This would be further strengthening the export reliance and even processing trade reliance of economic development in China. During this tough period, how to choose economic development policy? Should the government macro-economic policy be focused on stimulating economic growth or on promoting transition of economic structure/industrial structure? These are questions beg consideration.

Certainly, we should have the sense that this wave of enterprises closures does not mean the end of the private sector development model created Jiangsu and Zhejiang for regional economic development. On the contrary, from the historical evolution of world developed economies, we will easily understand that this wave of business failures happened in China from the following aspect: the enterprises closures should be regarded as a timely opportunity for the private sector in Jiangsu and Zhejiang to effectively

restructure industrial sector, upgrade product mix, implement the gradient mobility, relocation or transfer of industries between and among East China, Central China and West China. In the wave of closures in the Yangtze River Delta, it is a rather good turn for the private sector to integrate enterprises clusters and specify the division of labor and industries, and it would be of benefit to the effective promotion of the independent innovation of economy in local level and regional level. This turn of world economic crisis is also the market force to put pressure on China's private micro-entrepreneurship, and those private entrepreneurs now realize that they have to change their production system and invest more in R&D. Only in this way could China's private enterprises be able to achieve long run of economic growth.

International market fluctuation brought about by world economic crisis, this has already led to trade frictions and trade barriers between China's manufacturers and international market. In addition with the increase of China's labour cost, limited supply of land and resources, up-value of RMB yuan in world currencies market, China's privately owned traditional manufacturing based on simple goods has no comparative competitiveness any more in world market, nor will its development be sustained. China's long term growth potential lies in upgrading industrial structure and shifting business attention from overseas market to domestic market. Fortunately, Chinese government has decided to heavily invest in infrastructures in countryside in the next 5 years, and is doing the best to increase farmers' income, so as to effectively stimulate the consumer-power in countryside. Whenever the farmers' consumption power in China's countryside has been developed, then we will see the rapid growth of China's economy for another 30 years.

With Chinese government's essentially efforts in improving the financial environment, market environment and legislative environment for the private sector development, we could certainly believe the wave of enterprises closures is the opportunity for new lives of private enterprises in the Yangtze River Delta Region and the whole China.

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