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The Effects of Economic Transition on Chinese Entrepreneurship

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ABSTRACT

The environment is an important initial factor in influencing the strategy, structure, and processes of any organized endeavors, including entrepreneurial startups. Some researchers suggest that the socio/political environment may be so powerful as to create or destroy entrepreneurship in a country. By applying social cognitive theory to entrepreneurship, previous research demonstrated how environmental dynamism and hostility significantly discourage entrepreneurial outcomes in transitional economies. Recent changes in China have made entrepreneurial behaviors legitimate and thus promoted the founding of new ventures. The transition of China from planned economy to a market-based economy represents a major paradigm shift and during which substantial improvement has occurred in the political, legal, and administrative environment to meet the needs for new economic structure. This paper provides empirical evidence of how environmental changes in China may support a climate that facilitates the birth of new entrepreneurial ventures. Also addressed is the important role that entrepreneurial self-efficacy plays in process of entrepreneurial outcomes.

Key Words: Entrepreneurship, Self-Efficacy, China

One consequence of the economic reform programs in planned economies, such as the former Soviet Union, China, and other Eastern European countries, has been a substantial change in environmental conditions associated with the creation of new ventures. This has been true to such an extent that Johnson and Loveman (1995) have argued that the creation of new business through entrepreneurial development is the principal source of economic renewal at the enterprise level in transitional countries. Among transition economies, China may provide process that uniquely supports new venture creation.

In contrast to the “back to zero” approach exhibited in countries such as the former Soviet Union, in which the entire prior economic system is broken down and a market economy structure built, China seeks to integrate a market-driven economic structure in its previously centrally-planned economic system step by step, resulting in a “soft landing.” Recent statistics strongly support China’s approach. Since 1979, the Chinese economy has experienced growth of over eight percent a year (Bruton, Lan, Lu, & Yu, 2000). This rapid economic growth, combined with the fact that the nation has an estimated twenty-five percent of world’s population, makes China an emerging economic giant (Bruton, et al., 2000). China’s entry to the WTO is expected to fuel the speeding economic growth. Despite the probability of periodic corrections, most observers expect this rapid growth will continue. China will continue to be of increasing importance to the future global marketplace (Ralston Holt, Terpstra & Kaicheng, 1999). Some scholars predict that the 21st century will see China emerging as the world’s largest economy (Leonard, 1997). Undoubtedly, these positive environmental factors provide a warm “bed” for Chinese entrepreneurs to be born.

Of course, as with the other transitional economies, China has also faced a combination of factors such as resistance to change in their prevailing bureaucratic- administrative business culture, underdeveloped legal and financial infrastructure, considerable administrative discretion and corruption by some government officials, restrictive taxation, high interest rates, and a lack of management expertise and skills (Connor, 1991; Kaser, 1995; Kornai, 1995; Luthans, et al., 2000). Thus, it can be expected that environmental context also partly impedes new venture creation in China.

Because an entrepreneur exists within a complex matrix of social interactions within an even larger context of community, society, and culture, Carsrud & Johnson (1989) see the entrepreneurial process as a

response to environmental conditions. Aldrich & Wiedenmayer (1993) suggest that the sociopolitical environment may be so powerful as to create or destroy entrepreneurship in a country. Stinchcombe (1965) argues that environmental forces significantly affect organizations during their emergence, constraining and imprinting the new form in distinctive ways.

The environmental changes in the recent twenty years in China have made entrepreneurial behaviors legitimate and thus promoted the founding of new ventures. While the transition from China's planned economy to a market-based economy represents a major paradigm shift, rapid changes and substantial improvement have occurred in the political, legal, and administrative environment in order to meet the needs for new economic structure. This paper attempts to identify and analyze the effect of China's political, economic, legal, and cultural environment on the Chinese new venture creation and then examine the role that entrepreneurial self-efficacy may play in the relationship between this external context and new venture start-up.

Political Environment

The Chinese Communist Party (CCP) was built by a few young and idealistic students in 1921, who sought to establish a new China in order to rescue the people from the "deep water and fiery fire" (poor living conditions and high compression). These same idealists became the Chinese Party leaders in 1949. The newly built, complex Chinese political system combined the rich culture and history of the country with a similarly deep-rooted feudal political and social heritage (Hodgetts & Luthans, 1996).

Since that time, Chinese society has experienced a pattern of "ups and downs" or "speed-ups and slow-downs" as it adjusts and readjusts on the political, economic, and business scenes. This "bumpy ride" has been due in large part to the poor fundamentals resulting from the previous underdeveloped economy and a lack of managerial knowledge and skills in CCP members (Schermerhorn and Nyaw, 1990). A broad array of political struggles (Chinese people defined as "the Massive Movements") such as "the Great Jumping," "Fighting the Left," "Fighting the Right," and the worst, "the Cultural Revolution," resulted in a long series of consolidations in Chinese politics and economics. Over time, the communist ideology became seriously distorted even for those who used to be very loyal to the CCP, and particularly for those who suffered during any of "Massive Movements." Moreover, outrage over the Tiananman Square incident in

Central Beijing on June 4, 1989, weakened support from the international community.

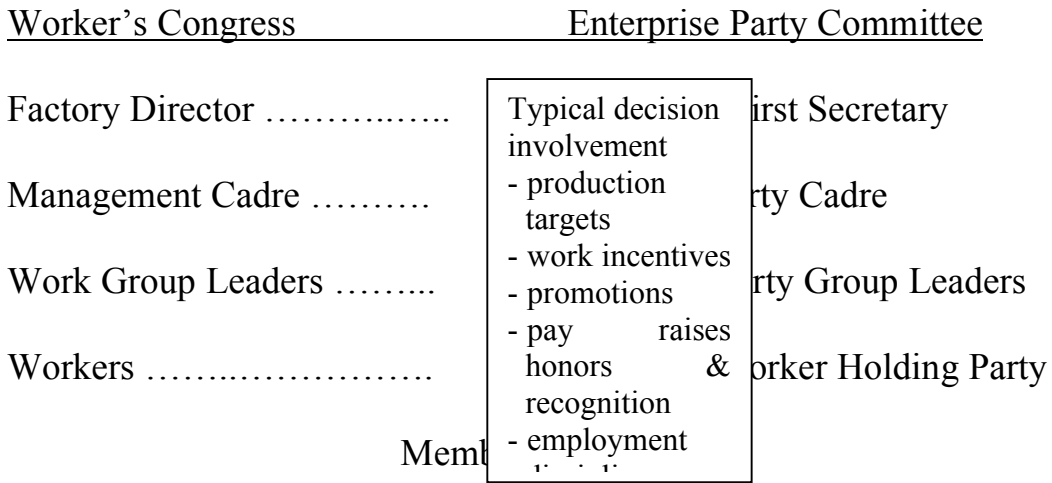
Along with the changes in CCP leadership came political diversity. Since 1979, a new age headed by Deng Xiaoping started with redirecting government focus from politics to economic development. This change in focus led China into an “open-door” policy, which dramatically sped China’s economic development and brought China into the global market stage. Consequently, Chinese enterprises have had to face the pressure to increase productivity and business performance (Schermerhorn, 1987).

The Chinese economic system that is encouraging post Marxist-Leninist reform is characterized by the independence of government and economic enterprises, and has led to a uniquely Chinese form of capital (Leonard, 1997). Even though there still is a socialist suit on the body, the political essence has already been changed to market-based development. For example, China’s entry into WTO, an issue that China struggled with for thirteen years, clearly demonstrates the political leaders’ determination for economic development. However, because the heritage of face-saving, connection, and private interest are still ingrained in Chinese politics, the current leaders understand that it is treacherous for them to use internal power to destroy existing political patterns too quickly. Therefore, the leaders promoted the WTO issue to “open the door, let the wolf come in” to use external power to weaken entrenched internal coalitions which resist the economic reform. For doing this, they have earned extra credit from the majority of the Chinese population.

Even though the general enterprise still maintains an internal authority structure parallel to the communist party (see Figure 1), the essence of the economic structure has dramatically changed in the power system. The directors or managers of the enterprises, who substantially run the factories, have the real power.

The previous party cadre members have gradually lost control of the core economic operations and their power is on the wane. Particularly in the southern part of China, political influence on both personal life and business has been limited or absent since the China’s open policy in 1978. People in this area shifted their interest from politics to profit-seeking business. Work centrality has clearly become market-based business development. For example, the per capita GNP of Candon Province is the same as that of France. Owing to high

Figure 1. Parallel internal authority structures in the traditional Chinese industrial enterprise



(Source: Schermerhorn & Nyaw, (1990) "Managerial leadership in Chinese industrial enterprises.")

independence of business operations, less political influence from the central government, and geographical advantage (close to Hong Kong and Taiwan), entrepreneurs have been mushrooming in the last twenty years and have become the mainstream of economic growth. These developments suggest the following:

Hypothesis 1. The frequency of new business start-ups in China is inversely related to the strength of political influence.

Hypothesis 2. The frequency of new business start-ups in China is positively related to the freedom of business conduct.

Legal Environment

The practices of the past, such as the dominance of personal over institutional control in politics and lack of organized democratic forces, made the reconstruction of the political and economic environment at best contradictory and inconsistent, and at worst chaotic and destructive (Luthans, et al., 2000). The ongoing political and economic reforms in China have been changing the traditional administrative, bureaucratic structures to private ownership. Thus, the structural heritage of socialism is in many ways fundamentally incompatible with new market changes, which make reform a partial and lengthy process (Luthans, et al., 2000).

Despite new forms of economic activities now allowed by state authorities, the post communist governments (many of which consists of the

same people and same thinking, only with change rhetoric) still have countless administrative and ideological instruments to control not only the state, but also the private sector. The conflict between a new political and economic reform construct and old ideological instruments results in the absence of well-designed policies and infrastructure to support the private sector and often forces fledgling entrepreneurs to quit their business early on (Luthans, et al., 2000).

Peng & Heath (1996) argue that the necessary legal framework of a market economy such as well-defined property rights is still lacking in transition economies. Without a legal regulatory framework, both efficiency and equity are adversely affected and crime and corruption are encouraged. Therefore, potential entrepreneurs may believe that the new system is not on their side because they are not protected from the powerful old party holdovers and new criminal outfits (Luthans, et al., 2000).

Merrifield (1991) claims that in a socialist redistributed economy, state banks and official sources of credit generally offer loans more on the basis of political rather than economic considerations. The legitimacy and legality of entrepreneurial development become a privilege that must be bought by illegal bribes and expensive forms of compliance. Li Ruihuan, the Chairmen of Central Political Consulting Committee, pointed out that China still has many officials who use their personal discretion over the law in judging and solving economic disputes. Even though commercial laws, such as those guiding domestic and international contracts, joint ventures, and sole investment, have been reformed and formally adopted for a long time, local protectionism still exists in many parts of China, particularly in the remote areas. Some lawyers who investigated for court cases in these areas are often blocked or even physically harmed.

The central government in China is not unaware that the conflict between the ideological needs for new economic structure and the existing ideology embedded in the old economic system impedes the economic development. A large number of emerging economic criminal structures with state power have been in the court systems. Many high-ranking officials across the whole country of China have been sued for taking illegal bribes and other unearned money. The Chinese central government realizes that the turbulence of economic development, enhanced by the globalization and competition, is challenging the both the political and economic system to “feed” the fledgling Chinese entrepreneurs in order not to be “eaten” by the Western “wolves”.

A significant achievement of the central government in the recent years has been attacking smuggling. One case, investigated by Prime Minister Zhu Rongji, involved 2000 people in Xiamen (the largest smuggling ring in Chinese history), including auditors, lawyers, police, and court officials, eventually led to the jailing of more than 500 high ranking officials. A clean and fair business environment encourages Chinese entrepreneurs.

A basic requirement for entrepreneurs to conduct business is autonomy or freedom. Entrepreneurs need to use their own discretion over resources to seize business opportunities. Moreover, aspiring entrepreneurs need to have the freedom to “pitch” their new ideas to capital holders for financial support, who are critically important for entrepreneurs because capital holders are always looking for the most profitable business. In addition, entrepreneurs require protection from the illegal activities of others that reduce the incentive to choose business ownership. While still early, there are indications that the Chinese government is pursuing legal policies that impact both business discretion and protection. Enforcing commercial law and reducing personal discretion over legal issues may facilitate Chinese entrepreneurship, suggesting that:

Hypothesis 3: The frequency of new business start-ups in China is inversely related to the degree of personal discretion allowed in the interpretation of commercial laws.

Hypothesis 4: The frequency of new business start-ups in China is inversely related to the strength of illegal business activities

Cultural Environment

Entrepreneurship has not enjoyed a high standing in the Chinese socialist regime (Armstrong, 1983). The previous Chinese power system placed a particularly strong emphasis on officially recognized ranks. In the socialist culture, persons involved in commerce were held in low esteem. Even more seriously, private business in China used to be considered as the “tail of the Capitalism,” which was regarded as one of the most serious anti-revolutionary criminal activity.

For almost 40 years, the Chinese government has provided its citizens with a comprehensive social safety net with universal access to health care, education, and employment. A whole array of goods and services (including housing and utilities) were provided either free of charge or at subsidized prices. The population has become accustomed to accept many features of this system as granted rights or the “Iron bowl.” A specific work culture was formed that linked expected employment security with a low level of

effort, along with modest material expectations. Since 1978, the Chinese government has transferred its employment focus from politics to economic development. A series of policies, regulations and strategies aimed at speeding up economic growth were issued and greatly motivated the national workers and farmers to work hard for more profit. Farmers began to cultivate their own fields and workers were not protected with the “Iron Bowl” any longer.

The size of unemployment in China has also influenced new venture creation. China has three distinct classes of business that operate in different institutional environments: state business, joint ventures, and village and township enterprises (Bruton et al., 2000). The state businesses, or state owned enterprises (SOEs), dominate the heavy and strategic infrastructure industries. China’s SOEs employ over 110 million workers, approximately the same number as the entire work force of the United States (Bruton, et al., 2000). However, China’s SOEs, like most state-run enterprises throughout the world, are in extremely weak financial condition and at least 60 percent of them are losing money (Bruton et al., 2000). Currently, the central government is pursuing a policy to withdraw its involvement in the existing state-owned enterprises. An estimated 20 to 30 million of workers in the SOEs are considered unnecessary resources for production. This labor surplus must be redistributed in order to restore the financially troubled firms to the acceptable and sustainable performance levels.

Even though CCP’s legitimacy rests on protecting workers, a large number of prior employees have been removed from their posts. Large scale of downsizing (50% downsizing within three years) in governmental offices has also resulted in displaced workers. Many of these displaced or underpaid workers began to explore new challenges by exploiting the resources available to them. Many of them become small business entrepreneurs. Increasingly, to improve employment, the government has provided necessary conditions for enhancing and facilitating them to be re-employed or to start their own private businesses. For example, Chinese government holds an array of conferences under the title of “Entrepreneurship” in order to motivate more entrepreneurial development. In today’s Chinese culture, persons involved in business have been receiving more and more respect and esteem. Successful entrepreneurs are gaining more and more official recognition, indicating that:

Hypothesis 5. The frequency of new business start-ups in China is related to the degree of public support provided by government agencies.

International Leadership Development

The selection of young knowledgeable people as the leadership group members has become a popular way to confront the conflicts inherent in this period of change. Many high-ranking administrative positions call for the applications from young knowledgeable people (by written examination and interviews). More significantly, a large number of young government officials, who are responsible for economic development, have been sent to the United States for “brainstorming” process -- even though many of them are poor at English language. In order to attract knowledgeable and young people obtaining overseas doctoral degrees, Chinese central government issues a favorable regulation that international doctoral degree holders are allowed to register private companies in a so-called “Doctoral Economic Development Square” and are provided with sufficient loans with normal interest rates. This use of young intellectuals to lead the transition suggests that:

Hypothesis 6. The frequency of new business start-ups in China is related to the number of foreign-trained young intellectuals in important positions.

Entrepreneurial Self-Efficacy and Entrepreneurial Outcomes

Self-efficacy is a central construct in Bandura’s social learning theory (1977a, 1982; Wood and Bandura, 1989). There have been extensive discussions of self-efficacy and its implications for management and entrepreneurship (e.g., Gist, 1987; Boyd and Vozikis, 1994; Wood and Bandura, 1989). Although it is beyond the scope of this paper to systematically delineate the construct, some of the salient issues are addressed so as to clarify the concept.

Self-efficacy is defined as a personal judgment of “how well one can execute courses of action required to deal with prospective situations” (Bandura, 1982: 122). Stajkovic and Luthans (1998) described self-efficacy as an individual’s convictions (or confidence) about his or her abilities to mobilize the motivation, cognitive resources, and courses of action needed to successfully execute a specific task within a given context. Self-efficacy refers to people’s beliefs about their ability to influence the event that affect their lives. It is concerned not with the actual skills one has, but with judgments about what one can do with those skills (“I know I can play ‘The

William Tell Overture' on the violin while blindfolded") (Mager, 1992). Studies with self-efficacy focus on how employees weigh, evaluate, and integrate information about their perceived capabilities before they select their choices and initiate their effort (Stajkovic & Luthans, 1998).

Self-efficacy is a serious matter (Mager, 1992). It affects a person's choice behavior, motivation, perseverance, and is facilitative through patterns. Low self-efficacy can make a person vulnerable to stress and depression (Mager, 1992). It is found in the prior studies that employees with high self-efficacy will activate sufficient effort in a task to produce a successful outcome, and vice versa. Three dimensions measure self-efficacy: magnitude, strength, and centrality (Stajkovic & Luthans, 1998).

Many studies in the organizational science have touched self-efficacy simply because of its significant impact on an individual's behavior or work-related performance. Bandura (1986) claimed that self-efficacy is not only significantly positively associated with work-related performance, but also the consequence of work-related performance. Sadri & Robertson (1993) conducted a field study and found its significant correlation with actual work-related performance, and behavioral choice and intention. Stajkovic & Luthans (1998) quantitatively synthesized, tested, and compared the variations in the self-efficacy – work-related performance patterns of results as a function of moderating effects of various studies' characteristics across the population of all available studies. They found, by means of a meta-analysis, that there is a significant weighted average correlation between self-efficacy and work-related performance and a significant within-group heterogeneity of individual correlations. Studies with self-efficacy has provided practical guidelines for more effective management of human resources in today's organizations as well as suggestions for new directions for future theory development and research (Stajkovic & Luthans, 1998).

Bandura (1977b, 1986) distinguishes his social learning theory from many traditional psychological theories by emphasizing reciprocal causation among cognition-behavior and environment. Whereas traditional unidirectional theories depict human behavior as caused either by environmental events or internal dispositions, social learning theories explain human behavior in terms of triadic reciprocal causation among behavior, cognition and other personal factors, and environmental event. Each of the three factors affects and is affected by the other two. Bandura (1977b, 1982, 1986) found that self-efficacy is the most effective predictor of performance. People with high self-efficacy have more intrinsic interest

in the tasks, are more willing to expend their effort, and show more persistence in the face of obstacles and setbacks (Chen, et al., 1998).

Entrepreneurial self-efficacy is defined as the strength of a person's belief that he or she is capable of successfully performing the various roles and tasks of entrepreneurship (Boyd and Vozikis, 1994; Scherer, et al., 1989). Chen, et al. (1998) claim that entrepreneurial self-efficacy affects entrepreneurship behavior through influencing entrepreneurial decisions.

The changing political, economic, legal, financial, criminal, and cultural environments facing entrepreneurs in China are fairly visible and relatively easy to recognize. It still takes time for a fully supportive entrepreneurial environment to develop. Very often, entrepreneurs have to surmount the obstacles in a non-supportive environment. However, this environment could be assessed as replete with opportunities by those with high entrepreneurial self-efficacy but fraught with cost and risks by people with low entrepreneurial self-efficacy. Even if people perceive an identical reality consisting of uncertainties, risks, and hardships pertaining to an unfavorable entrepreneurial environment, those with high entrepreneurial self-efficacy would feel more competent to deal with that reality than those with low entrepreneurial self-efficacy. People with a high entrepreneurial self-efficacy anticipate different outcomes than people with low entrepreneurial self-efficacy.

Brockhaus (1980) contended that because entrepreneurs have a very high belief in their ability to influence the achievement of business goals, they perceive a very low possibility of failure. People with high entrepreneurial self-efficacy are likely to associate challenging situations with proportional rewards. They believe that their perseverance and resilience will offset the disadvantages embedded in the inferior environment. Therefore, individuals who consider themselves efficacious in performing entrepreneurial roles and tasks are more likely to enter the entrepreneurial environment than those who do not. Instead of lamenting challenges imposed by the environment, high self-efficacy entrepreneurs start to determine and analyze how to deal psychologically with this unsupportive environment and turn threats into opportunities (Luthans, et al., 2000). Luthans, et al. (2000) also suggest that the emergence of potential entrepreneurs in transitional economies depends on the entrepreneurial potential of the society, which is, in turn, largely a function of systematic effort on developing entrepreneurial self-efficacy, suggesting that:

Hypothesis 7. The frequency of new business start-ups in China is related to the entrepreneurial self-efficacy.

Methodology Used

Study Site. Data collection was conducted in Tangying County, Henan Province, mainland China, about 500 kilometers southwest of Beijing. The population in this county is 439,000 and total area about 645 square kilometers. Its industries include traditional areas such as mechanical engineering and high technology industries such as computer and mobile phones. This county is considered as a representative of Chinese middle/small communities.

Sample. There are approximately 3800 registered companies and enterprises in this country. Seventy company owners were asked to fill out the questionnaires and 61 respondents answered all or most questions. The local commercial registration office provided the data of the number of new companies or enterprises registered in each year from 1995 to 2000. The demographic information obtained from the questionnaires indicated that 59.6% of the participants are private owners and that 67% are male, 33% female. Service industry accounts for 77% and manufacturing industry for 23%. 38% of participants previously worked in state companies and 13% of participants started their own businesses because of lay-off from state companies.

Re-Translation Method. A major concern with cross-cultural research is the accurate translation of US-based measurements to other cultures and languages. A cultural gap occasionally triggers affective or conceptual responses (Ibrayeva, 1999). Earley (1989) suggests that the use of re-translation method may avoid or narrow the cultural difference. This study involved two languages: English and Chinese. A management major doctoral student (native Chinese) studying in the US translated the English version of the questionnaires in Chinese language. Before the questionnaires were distributed to the participants, the Chinese version of questionnaires was re-translated in English by an English majoring student in Beijing (Native Chinese). The original and the re-translated version of the questionnaires were carefully compared and discrepancies in terminology or intent were discussed and reconciled. This re-translation method was used in this study for all the measures.

Variables. The number of registered companies in each year between 1995 and 2000 is the dependent variable. There are seven independent variables: the strength of political influence on venture creation (strength), business freedom (freedom), overseas training leaders (training), personal discretion (discretion), financial infrastructure and illegal business (financial), and public support (support), and entrepreneurial self-efficacy (efficacy).

Analysis. The method used in this study is regression analysis. This analysis provides the correlations between each of independent variable and the number of yearly new ventures (dependent variable). Significant level of each correlation is also revealed in the analysis.

Discussion of the Statistical Results

Descriptive analysis indicated that the level of the environmental and psychological variables among 61 entrepreneurs in China is, on a 5 point scale, 3.425 strength, 3.8667 freedom, 3.8667 training, 3.5067 discretion, 3.0233 financial, 3.2867 support, and 4.0717 efficacy. The relatively low scores on financial infrastructure and illegal business may reflect current financial policies supporting private businesses and the serious strikes on illegal businesses.

The statistical findings were that all the variables are correlated with the number of new venture creation. However, significance levels indicate that strength ($p=.000$), freedom ($p=.027$), training ($p=.003$), discretion ($p=.020$), and efficacy ($p=.036$) are significantly correlated with the number of ventures started. Strength has a negative relationship with venture creation. Financial infrastructure/illegal business and public support do not have significant relationships with venture creation (financial $p=.293$, support $p=.221$). Therefore, Hypotheses 1, 2, 3, 4, and 7 are supported and Hypotheses 5 and 6 are not supported.

One reason why financial infrastructure and illegal business were not significantly related with venture creation could be the recent improvement of the banking policies. Due to large size unemployment, the Chinese government is seriously challenged to address the social consequences of those who lose jobs. Because of governmental involvement in banking system, bankers have been forced to lift their policies of not providing funds to private businesses, reflecting the government's hope that new businesses can create new jobs. The relative low evaluation score from the entrepreneurs indicates that private businesses may already have sufficient access to bank loans at the current time.

Public support from government agencies is also found to not be significantly related with entrepreneurship perhaps because people have started to tune out the governmental daily verbal promotion and encouragement for being entrepreneurs in the recent years. Entrepreneurial self-efficacy is significantly associated with people's entrepreneurial decision. Clearly, a major concern for people who are struggling to start their own businesses is their entrepreneurial self-efficacy, that is, whether or not they believe that their businesses can survive and make money. This finding is consistent with Bandura's (1986) social cognitive theory that self-efficacy plays a pivotal role in people's decision behavior.

Conclusion

Theories of entrepreneurship offered in the growing literature have mainly focused on one-side determinism, where either environmental or personality variables have been specified as unique predictors of entrepreneurial action (Luthans, et al., 1998). Taken separately, both approaches have generally failed to capture the complexity of human action that encompasses the interaction of environmental, cognitive, and behavioral variables. (Bandura, 1986, 1997; Stajkovic & Luthans, 1998a, 1998b). Given an improving political, economic, legal, and cultural environment in the People's Republic of China, this paper presented a discussion how these environmental changes tend to provide a more supportive climate, facilitating the birth of new entrepreneurs. Political influence, business freedom, open-minded leadership and personal discretion are found to foster new venture creation.

Key to the findings of this study is the important role that entrepreneurial self-efficacy plays in process of entrepreneurial outcomes. Entrepreneurial self-efficacy cannot only lead to better explanation to entrepreneurship, but also effectively strengthen new venture start-ups in the continuously improving environment of the People's Republic of China.

Despite this impact of the environment, it is suggested that entrepreneurial self-efficacy may better predict which individual entrepreneurs may be able to overcome environmental threats and turn them into opportunities. Unlike personality traits, self-efficacy can be developed through training and modeling (Gist, 1989; Gist, Schwoerer, & Rosen, 1989). Instead of hoping for dramatic improvement in the general environment, Chinese authorities may be well advised to implement formal

entrepreneurship self-efficacy training programs to foster individual initiative for entrepreneurial outcomes.

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