



“Is the next Mark Zuckerberg going to live in China—despite the negatives?”

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ERIC SCHMIDT, 33, moved to Beijing in 2002 after graduating from Rensselaer Polytechnic Institute in Troy, N.Y. Schmidt didn't speak Chinese and knew little about business. His first entrepreneurial ventures included a basketball camp that had middling success: “I made a lot of mistakes,” he says.

But as China's market grew, Schmidt noticed that a little entrepreneurship club he had established in 2003 was getting standing-room-only crowds. In 2009 he turned the club into a business that focused on corporate networking and training. While such companies abound in the U.S. and Canada, the field was wide open in Beijing. Today, Schmidt's Cebex Group holds 100 conferences, forums and training sessions a year with companies like Microsoft, Citibank, KPMG and Lenovo. As for China? “Once you get in, you don't want to leave,” Schmidt says.

Is the next Mark Zuckerberg going to be living in China? Seems that way, despite the negatives. In China, many rules for business are unclear or ill-defined, companies must operate under the whim of an authoritarian government, and founders can even go to jail for illegally borrowing money.

But on a recent trip to Beijing and Shanghai, we met with entrepreneurs who were adamant they wouldn't be anywhere else.

Take Chinese-born Eric Wang, 26. Though he was brought up in Seattle and earned degrees in the States, when it came to starting an Internet car-sharing business, he didn't even consider the U.S. One reason had to do



with scale: Recall the infamous highway snarl-up in 2010 that caused a 62-mile, nine-day traffic jam outside Beijing. His master's thesis was on solving transportation problems, and “that traffic jam was just stuck in my head,” says Wang. In 2011 he bought a one-way ticket to Beijing.

Wang's parents, university professors in Seattle, were furious. “They called me stupid,” he says. One

reason his parents left China was wide-open opportunity for their son in the U.S. But times change. “You only have a few times in your career where you can shape an industry,” says Wang.

The brain drain that has brought so many well-educated Chinese to the U.S. over the years is still alive and well—but it's losing momentum. As of 2009 (the most recent year tracked), 89 percent of Chinese recipients of U.S. doctorates stayed in the U.S. at least five years after graduating—down from 98 percent in 2001, according to Oak Ridge Institute for Science and Education. And in a 2011 Kauffman Foundation survey of American-educated Chinese entrepreneurs who returned to China, 81 percent said that superior opportunity was their chief reason.

China clearly wants to encourage that thinking. The government understands the drawbacks of state-controlled enterprise and is loosening its grip on small business, notes Colin Wu, a Chinese national who is vice chairman of the U.S. China Business Association. “It realizes it has been too nosy,” says Wu. One sign of progress: Several years ago, getting a business license could take more than six months and was so

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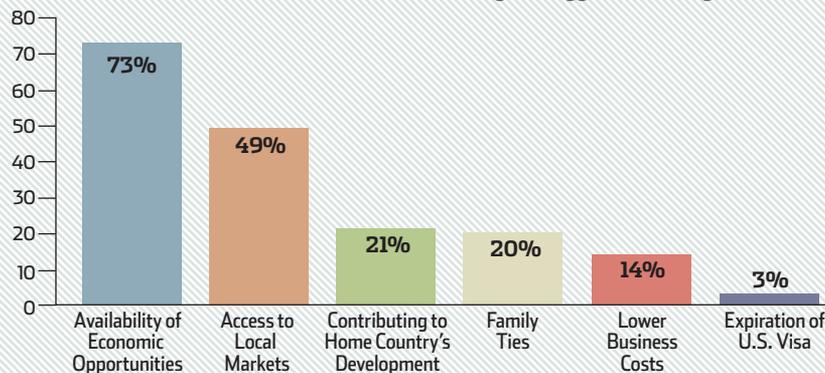


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Why They're Going Home

In a recent survey of Chinese-born professionals who returned from the U.S. to China to start businesses, these were among the bigger motivating factors:



Note: Share of respondents citing factor as "extremely important."

SOURCE: THE KAUFFMAN FOUNDATION

complicated that Schmidt's Cebex Group held seminars on the process. Now it's simpler and takes less than two months, Schmidt says.

Raising capital is another notorious problem under China's state-run capitalism. The government-run banks generally loan only to the low-risk state businesses—and the below-inflation interest rates they pay to depositors discourage savers who yearn for higher returns. Angel investors and venture capital funds are allowed, but don't come close to meeting the burgeoning demand for loans. What's more, many business founders are reluctant to give up ownership.

As a result, many entrepreneurs have only a few financing options: Their own savings, borrowing from immediate family or turning to the country's huge (and illegal) shadow banking system. Emblematic of the issue is the widely publicized case of Wu Ying, a 32-year-old entrepreneur who was sentenced to death for fraud after raising money from investors and failing to pay them back. Following a public outcry, the courts reduced her sentence to life in prison.

The government is wrestling with bank reform to give cash-starved companies access to loans, according to Colin Wu. At a news conference this spring, Premier Wen Jiabao called for allowing private capital into the financial sector and breaking up the

"monopoly" of big banks, and he endorsed bringing private finance into the open. In a pilot program in one city, investors have been permitted to set up private banks.

Turning on the capital spigot couldn't come too soon for Huiling Cheng, 48. Cheng borrowed from every member of her family to start CitiKing Trading, a Shanghai company that makes window-surfacing and wood products; within three years, she paid them back. Cheng says her 11-year-old firm, which has 300 employees, could be double its size if she had access to capital, but banks won't lend to her. "It's very frustrating," says Cheng. "We give our life to this business."

Yifeng Hu, 35, started his mobile Internet company, iEdge, several months ago with his and his partner's savings, and may seek angel investors once the business gets some traction. In a Shanghai coffee shop populated mostly by students, Hu speaks French-accented English, a by-product of years working in the Paris office of Boston Consulting Group. He's drawn to a market where smartphone-application use is soaring. But he's also aware that the government can make rule changes overnight that could wreak havoc on his business plan. Even so, the opportunity outweighs the risk. "Every company in the world is restricted in some way," Hu says, "but still you can do something." ☺