



“CHENGDU CAN DU?”

INNOVATION AND START-UP ENVIRONMENT AND OPPORTUNITIES FOR NEW ZEALAND

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Summary

As with other tier 1 and 1.5 cities, Chengdu is investing heavily into innovation and entrepreneurship. The rapidly expanding start-up environment, as a central pillar of innovation, has received a significant boost through new infrastructure, subsidies and policy incentives.

For New Zealand start-ups looking to tap into the Chinese market and raise capital, Chengdu can be a good fit. The lower cost of living and doing business and a large and vibrant market can give a start-up more time to localise and grow. There is growing interest, and early examples of two-way flow of start-ups between Chengdu and New Zealand have been positive.

The Consulate is continuing to build connections between the New Zealand and Chengdu ecosystems through engagement with stakeholders from both sides and seeking opportunities to foster partnerships. Two precedent-setting examples in 2016 demonstrate the potential, but have also highlighted some challenges and provided useful insights into the wider Chinese start-up scene.

Report

China's core focus on 'innovation' to sustain economic growth is by now a well traversed topic. Enshrined in the national 13th Five Year Plan for 2016-20, references cascade down to policy documents at every level of government. As one contact put it, "innovation is no longer an elective course; everyone must do it now".

2 But the state of innovation is difficult to grasp as a distinct topic, given its reach across so many facets of the government and business environment. In Chengdu much of our focus has been on the start-up scene, as one important pillar of Chinese innovation.

3 In this report we focus on the start-up environment and potential in Chengdu. This includes local policies and approaches, existing contact points between New Zealand and Chengdu start-up communities, and the value proposition for expanded collaboration in future. We also report the comments of some experienced local contacts on the current start-up environment across wider China. To prepare this report we have drawn on discussions with NZ and local incubators and business accelerators, NZ and local start-ups, local government officials, foreign entrepreneurs in Chengdu and other contacts.

What's new Chengdu?

4 Chengdu has a long history of technological innovation, jump-started by the relocation of sensitive industries to safe inland regions under the 'Third Front' strategy. The development of innovative industries in turn drove expansion of a local education sector with a strong technology focus. Over the last decade Chengdu has successfully attracted hundreds of foreign multinational technology companies to join local ranks, through a

platform of competitive incentives. The city is now a confident 'Tier 1.5' economic hub in inland China, holding itself out as a "liveable" city characterised by ambitious development, enthusiastic local consumption and healthy work-life balance.

5 This mix of history and modern realities has enabled Chengdu to position itself as a base for small-scale innovation and entrepreneurship alongside other Tier 1 and Tier 1.5 cities in China. In terms of sector size and raw output, the city is aware that there is a gap between itself and larger hubs like Beijing, Shanghai and Shenzhen. But Chengdu is at the forefront of the next wave of upcoming innovation centres in China and already has pole position in central and southwest China across a range of metrics.

6 The first half of 2016 saw 150,000 newly registered start-up companies in Chengdu. More than half of these were in the technology sector. **Infrastructural support** for innovation and start-ups has also grown rapidly. In 2016 there are over 300 incubators, up from over 200 in 2015. Large-scale new economic development initiatives, such as the 1,578m² "Tianfu New Area" in the south of the city, will also include large new sectoral parks and zones containing multiple incubation facilities.

7 Local government provides support for start-ups through numerous **subsidies and grants**. Each level of government (provincial, municipal, city district) has developed comprehensive policies to support innovation, which viewed holistically can be bewildering. Incubators often have to hold a dictionary of subsidies and policy incentives, and part of their services is to assist start-ups to navigate and access the myriad of incentives which can cover the costs of establishing and operating incubators, cost of office space, operating hardware, accommodation, and living expenses of start-ups. Reputable incubators we spoke to noted that local government agencies sometimes approach them to ask what kinds of subsidies have not already been created.

8 **Access to capital** has also received a lot of government attention. Sichuan and Chengdu governments have established and oversee a number of capital pools. The Sichuan Provincial Government funds and manages an "angel investment guidance fund" established in 2014 which is now officially valued at RMB 983 million (NZD 20 million). The Sichuan Government also provides financial aid to start-ups which can be used as pledged deposits for loans. In the past year, over RMB 1 billion (NZD 208 million) of loans have been offered in this way to start-ups in Chengdu.

9 The local government has also established platforms such as **forums, roadshows, and investment conferences** to allow start-ups to connect with private investors. One example is a series of financing conferences in the past year, which has generated pledged investment of around RMB 69 million (NZD 14 million) from 24 events. For start-ups who receive private angel investment, the government also provides additional financial assistance of up to 10% of the investment amount.

10 The lower **cost of living and doing business** is another draw for investors and start-ups alike. Wage costs in Chengdu are around two-thirds to half of those in tier one cities. This has helped Chengdu attract high-tech manufacturers such as Foxconn, which purportedly makes half of the world's iPads in Chengdu. For start-ups, the lower cost of living, human resources, and accommodation can make a big difference to staying in-market. The co-founder of co-working space "Hi-Coffee", which has offices across all tier 1 and 1.5 cities in China, estimated the amount of financing that would support a start-up for three months in a tier one city can support operation for up to a year in Chengdu.

11 But the lower cost of living in Chengdu does not have to be traded off against a **large and vibrant market**. Chengdu's population is around 15 million and has a per capita GDP of RMB 75,000 (NZD 15,625 or around three-quarters that of Shanghai). The retail sector continues to see strong growth, up 10.7% in 2015, characterised by a move away from high-end designer luxuries to high-quality consumer goods. Chengdu consumers are known as freer spenders within China and have a reputation of spending more on high-quality goods and services, recreation and travel – it has been suggested that this is the result of 'live for the day' attitudes which developed after devastating earthquakes in Sichuan in 2008 and 2013. The China Business Network reported this year that Chengdu ranks second-equal in brands index, behind Beijing (156) and equal with Shanghai (150) (The index is based on the number of recognised brands that have established themselves in market, e.g. Starbucks, UNIQLO, Wanda). The city also ranked fourth in air passenger movements, and third for number of first class air tickets purchased (behind Beijing and Shanghai).

12 The **availability and retention of talent** is another key challenge for emerging businesses based in China. The city has a deep talent pool and one of the highest rates of talent retention in the country. As one of Chengdu's key sectors, the Chengdu Software Industry Association estimates most of the 250,000 people employed in the local software industry are attracted to the better lifestyle and lower cost of living in Chengdu. The city also has the greatest concentration of universities in Southwest China, producing about 180,000 graduates a year across all sectors. Chengdu attracts a significant amount of talent from other parts of China, reflected in the diverse make-up of some of the teams in the innovation sector we spoke to.

Foreign interest starts up

13 The 'on paper' potential that exists for foreign start-ups in the Chinese market has drawn a lot of interest, including to Chengdu. The large size of the market, availability of capital and the interest of Chinese consumers in new and innovative products present a theoretical wealth of opportunities.

14 In addition, although the vast number of support policies is framed as supporting local companies, foreign entrepreneurs and start-ups can often in theory access the same kinds of support through registering their company locally.

15 A number of New Zealand based organisations have begun to explore start-up collaboration opportunities in Chengdu. In 2015-16, for example, the Consulate has met with [Creative HQ](#), Wintec ([SODA](#)), [FunderTech](#) and [InnoHub](#) during their visits to Chengdu. The overall vision is broadly the same in each case – to create a new channel that connects New Zealand start-ups to market and investment opportunities in China.

16 Other foreign governments are also awake to these opportunities. One example is the China-South Korea Innovation and Entrepreneurship Park in Chengdu's High Tech Zone, which houses incubators for both local and Korean start-ups. Cooperation at this scale also attracts specific policy support from city-district government. Singapore will also open an innovation park in the same district in 2017. During a recent innovation forum in Chengdu hosted by Austrade and a collection of Australian start-ups, Southwest China was identified as a key pivot destination for start-ups after their 90 day programme at the Australian landing pad in Shanghai.

17 New Zealand also holds a reverse value proposition for emerging businesses in China. The call by the Chinese government for local businesses and entrepreneurs to "go out" to the global market means more Chinese companies will be looking for an international

angle. New Zealand's position as a smaller market with a developed and open economy has its merits as a testing ground for bigger, potentially riskier Western markets. Exposure to business planning and operations in New Zealand can be of great value to Chinese companies. Younger entrepreneurs are often also attracted to New Zealand's healthy and balanced lifestyle proposition.

NZ Case studies: A tale of two start-ups

a) Chicken Run

18 The Consulate assisted in selecting and enabling Chengdu start-up Chicken Run to participate in one of Creative HQ's four-month Lightning Lab business acceleration programmes. The main challenges for the two founders were cost and time away from their business in Chengdu. Financial burdens were eased through some CHQ sponsorship support at the New Zealand end. The relative size of their operations also meant they could cope with the time away.

19 Chicken Run's feedback of their experience has been overwhelmingly positive. It says the programme provided the founders with different levels of thinking and approaches to growing their business. They came away with new approaches to key areas, including rebranding, marketing, and growth strategy. The programme was different in style and substance to many of the local Chinese programmes Chicken Run and other local start-ups have been exposed to. The founders also highlighted the value of gaining new perspectives through living in New Zealand and working with homegrown start-ups.

20 The value goes both ways. Creative HQ noted that participation by a Chinese start-up added to the diversity of the programme and allowed New Zealand start-ups to communicate and learn directly from a Chinese counterpart. It is seen that future participation of this kind would bring about similar benefits. However, financial costs and time away from their core business remain challenges for any future Chengdu-based start-ups to participate in a New Zealand acceleration programme. One way around this would be for the programme to be delivered in China by the New Zealand accelerator or, more likely, in conjunction with a local partner.

b) Company Y

21 Company Y is a food and beverage start-up with product currently manufactured and sold in New Zealand. The start-up met Chicken Run during their time in New Zealand and formed a strong friendship. Company Y's founders then travelled to China in September and made investment pitches in Chengdu.

22 While in Chengdu, Company Y decided to stay on and continue to develop their product to the Chinese market and source investment. In the first two months, their ability to gain support and knowledge from Chicken Run and their local networks was critical. The low cost of living compared to New Zealand and larger Chinese cities also gave Company Y much more time to leverage new connections and opportunities. The founders cited these factors as essential to their ability to stay on in market here in Chengdu.

23 In November, through developing their local network, Company Y found and took up residence in an incubation park in Chengdu. To date, Company Y has received a range of support through the incubator, including free workspaces, recruitment of local interns, visa assistance, subsidised accommodation, connection with Chinese investors, and assistance with local business registration to allow the start-up to bid for local government support.

24 In many ways it has been a challenge. But the founders have described the experience as transformative in the way they are thinking and planning for the Chinese market. When leaving New Zealand, their main emphasis was around investment. Instead, they have learnt from a much broader range of experiences through their time in-market and found channels to become savvier at operating in China and develop their product and marketing for the Chinese consumer. These are vital attributes for sustainable growth in China.

Under the hood: Commentary on the start-up environment in China

25 Against the backdrop of the government-led innovation drive in China are criticisms that the model is inefficient and unsustainable. It's worth noting that the survival rate of SMEs in China is only around 1/16th that of the United States. The most vocal critics are inevitably foreign commentators, however a number of more market-focused Chinese innovators and start-up experts also share similar concerns. Contacts we spoke to with experience across major centres in China offered perspectives on the state of the Chinese start-up environment across the country. While these are perspectives on China's start-up environment as a whole, these challenges are also observable and faced by Chengdu.

26 It is difficult to summarise the state of the start-up ecosystem in China. Much of it is anecdotal and there is **little reliable data**. Many key indicators used in official reports fail to light up commercial outcomes or may be cherry picked. For example, pledged investment is an often quoted marker by officials, however whether the amounts pledged actually translate to actual investment and tangible commercial outcomes for a start-up is generally less visible. Issues like these may help to explain why the 2015 Global Startup Ecosystem Ranking (by Compass) omitted China completely due to insufficient data and analysis.

27 **Incentive-driven bubble:** The abundance of favourable government policies can overcook the sector and lead to a bubble. The numbers of government agencies clamouring to provide incentives to incubators and start-ups has a hugely distorting effect. This creates a condition where some of the start-up service providers (incubators, maker-spaces) rely heavily on subsidies to survive with no strategy to transition into a sustainable market-driven model. In the long-run, many incubators that work directly for the government but can only ever live off the government. This also creates issues with poor quality services and support for start-ups.

28 The bubble can also be observed in start-ups. Tapping into financial incentives offered to start-ups can be an attractive source of income. This is particularly the case with **recent university graduates**, although it also motivates more people to move from existing employment into entrepreneurship. While much of this has been presented in a positive light officially, there are concerns too much of this is happening and for the wrong reasons. Teams of new graduates in particular have been identified as lacking in life and business experience and tend to produce fewer innovations and take fewer of the risks required to come up with truly disruptive products.

29 This bubble comes as both a warning and opportunity for foreign start-ups. Those wanting to work with a Chinese incubator must be careful to select one which is serious about supporting the start-up rather than lapping up more money from government coffers. At the same time the serious, market-driven incubators looking for high quality start-ups are more incentivised to look globally to supplement the mixed quality of start-ups available locally.

30 **Investment environment:** While there is truth behind the vast opportunities for start-ups to raise investment in China, it's also important to note the environment has changed rapidly and identifying the correct channels to connect with investors remain critical. One of the most visible formats has been roadshows and pitch day type events, often organised in conjunction with city or district governments. These continue to happen frequently across the country. However, most lack substance as a direct channel to investment. These are now predominantly an optics exercise for governments and attended by rent-a-crowds (sometimes literally rented). In contrast to a few years ago, genuine investors are now very cautious, especially at these kinds of events. There is still value for start-ups to attend these types of events, mainly for product visibility and general networking with government and investment groups, but they need to go in with the right expectations.

31 The resources and connections required to gain a foothold in the market are just as critical to survival and growth as raising investment. The best channel to hook into an existing market need for the start-up is not always clear for local start-ups, let alone foreign ones. The lack of market freedom in China restricts the number of channels a company has to enter a sector, many of which are tightly controlled by the government and state-owned enterprises.

32 Leveraging connections and networks remains the best way of finding investment. For foreign start-ups, having support and assistance from local partners or landing pads will be a key part of this. Foreign start-ups require hands-on support in a range of areas, such as language, product development resources, marketing, distribution channels, legal guidance, accommodation and mobility. Ideally an investor will also be hands on in helping with these, but a significant proportion of investment companies or clubs have limited resources to do these themselves and are more hands off. In such cases, a foreign start-up would need to rely on other channels (such as local incubators) for these types of assistance.

33 China's **start-up culture** often suffers from distrust of others which reduces the kind of collaborative, risk-taking spirit emblematic of places such as Silicon Valley. There is also a shortage in the number and diversity of mentors, partly driven by the deification of a few successful elite (think Jack Ma) and fewer "usual" experienced entrepreneurs giving back into the scene. There are efforts to change this culture, led by entrepreneurs returning to China and expats, but they have found it hard going. Local incubators and investor groups have also looked to experienced foreign entrepreneurs as a source of mentorship.

34 China's business **laws and regulations** appear murky to foreign start-ups and SMEs. Often, it is the stories of IP theft and crooked commercial disputes that reach their ears first. There are also extra bureaucratic hoops to jump through when compared to most developed countries, including in certain sectors such as education and health. However, the regulatory environment is steadily improving. Visas and business licences have become easier to access. Local companies are more open and willing to partner with foreign companies and there are more resources for foreign businesses to tap into. Local registration of the business also bring access to most of the preferential policies afforded to local companies, which goes a long way to levelling the playing field.

What's next for New Zealand start-ups?

35 The growing trickle of interest by New Zealand incubators and start-ups has reaffirmed a convergence of belief that the theoretical opportunities for start-ups in Chengdu and China can be turned into a reality. The precedent setting examples of Company Y and Chicken Run show this can be done. It has also revealed some vulnerabilities and challenges of start-ups entering the Chinese environment, and a need for a support structure

to help them succeed. The Consulate welcomes opportunities for further engagement with the New Zealand start-up sector, including incubators and accelerators, tertiary institutions, and businesses.

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