

## The Development of Entrepreneurship in Macao and Hong Kong: A Comparative Study

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### ABSTRACT

This article reflects an almost controlled experiment in economic development. Two economies, with similar natural endowments have experienced different public policies under their respective colonial governance. Macao, a Portuguese colony, was a center of entrepreneurial activity well before the blossoming of its close neighbor, the British colony of Hong Kong, forty nautical miles to the east. Whereas market forces were permitted to shape economic activities in Hong Kong, business development in Macao became relatively constrained by colonial bureaucracy. This article presents a comparative overview of entrepreneurship in these neighboring economic entities.

### INTRODUCTION

Cantillon (1755) was the first to use the term entrepreneur. Say (1803; 1815) linked the growth of England's economy to the skills of her entrepreneurs. A century later, Knight confirmed, "It is unquestionable that the entrepreneur's activities affect an enormous saving to society, vastly increasing the efficiency of economic production (1921, p.278)." Still today, entrepreneurship is valuable to society.

Entrepreneurship involves the creation of new ventures and the operation of business enterprises by risk-bearing, and often creative, individuals. In economics, entrepreneurship has been defined as the act of creating new, innovative combinations, thereby causing an economic disequilibrium, such as to profit therefrom (Schumpeter, 1911; 1928; 1942; 1947; 1949). In anthropology, entrepreneurs have been equaled to agents of social change (Barth, 1963; 1967). Such activities contribute significantly to economic growth, as entrepreneurs have precipitated technological progress while creating more jobs than have large corporations (Mulhern, 1995). Acs and Audretsch (1988) showed that small firms are more innovative than larger ones. Thus, entrepreneurship has a positive effect on society, creating economic expansion, enlarging the tax base and improving consumer well-being. As such, entrepreneurship is very relevant to public policy.

Policy plays a strategic role in the economic development of its people. Given that entrepreneurship has shown to be important in the creation of employment and the economic advancement of a nation, many governments have introduced policies attempting to encourage this phenomenon (Scase and Goffee, 1987). However, there is no consensus as to what the optimal public policy on entrepreneurship should be (Peterson, 1988; Peterson and Ainslie, 1988). Thus, different policy-makers have adopted various approaches. At the extremes are the following, with a long continuum in between:

- **Policy Style A, The Laissez-Faire Approach:** Since entrepreneurship occurs naturally, it should be left to the spontaneous processes of entrepreneurs and market forces, with minimal, if any, interference or assistance from the state. Therefore, state intervention is considered to be an impediment to entrepreneurship.

- **Policy Style B, Visible Intervention:** This view holds that the state should guide entrepreneurship and market forces, monitoring economic activity for the national interest.

Some research has found that entrepreneurship policy is often shaped by colonial experience.<sup>1</sup> In this article, two neighboring city-economies are compared; they are similar in terms of latitude, access to markets and natural resources. Yet, the colonial experience has been different, with unlike public policies on entrepreneurship. In this study, Macao serves as the treatment group, to which a colonial administration has applied much public policy governing entrepreneurs. Hong Kong serves as the control group.

Thus, the setting of this essay is the Pearl River Delta, where Hong Kong and Macao are situated. Hong Kong consists of 1067 square kilometers, namely Hong Kong Island, Kowloon, the New Territories and 235 outlying islands, at the southern tip of China's Canton (Guang Dong) province, where the Pearl River flows into the South China Sea. Macao - spelled *Macao* in Portuguese - is composed of the peninsula of Macao, and two islands, Coloane and Taipa, covering 18 square kilometers.

It can be said that Hong Kong policy has tended to be of the Style A variety, while Macao received Style B treatment. Until 1997, Macao and Hong Kong were the last two European outposts in China. On July 1, 1997 Britain relinquished Hong Kong to China, and Portugal will return Macao to China on December 20, 1999. While Hong Kong's handover to China has made headline news around the world, the future handover of Macao has received much less attention. One reason is that Hong Kong is more important from an economic perspective.

The objective of this article is to compare entrepreneurship under Portuguese colonial rule in Macao, with the situation arising in neighbouring Hong Kong. Both colonies were established as trading centers for entrepreneurs. Although Macao had a head start, Hong Kong surpassed its neighbour in importance. A causal variable appears to be public policy on entrepreneurship. Hong Kong policy has tended to be of the Style A variety, while Macao practiced a Style B intervention, unduly constraining entrepreneurship.

This study involved several data-collection techniques, including preliminary research involving secondary sources, an information search by telephone, and most importantly, interviews conducted in Hong Kong and in Macao. An open-ended interview guide was used to ensure that identical questions were asked of respondents, without leading them into answers. The study would not have been possible without the cooperation of governmental and para-statal bodies, as well as, entrepreneurs and corporate entities. All interviews were conducted in English; this was a limitation, however, as several interviewees in Macao would have been more comfortable (and perhaps more expressive) in Portuguese.

### **HISTORICAL OVERVIEW**

In 1513, Captain Jorge Alvares was the first Westerner to sail the waters of the Pearl River - the waterway leading to Guangzhou (Canton), which was already a great city of trade. Soon after, the Portuguese arrived in Japan, where they found the people willing to buy Chinese silk. Given that the Celestial Empire prohibited Chinese and Japanese merchants from dealing directly with one another, Portuguese entrepreneurs prospered as middlemen.

In 1553, local government officials in Guang Dong gladly accepted bribes from the Portuguese, providing the latter permission to dock in Macao for the purpose of trade. In 1557, China allowed the Portuguese to establish warehouses and homes in Macao. Here, the Chinese would bring porcelain, seed pearls and silks for sale, while Portuguese entrepreneurs supplied cannons, clocks and mirrors from Europe. Also, the Portuguese brought cotton from Goa (India) and ivory from Africa.

The Portuguese found that exporting Chinese silk from Macao to Japan was highly profitable, as the demand for Macanese silk was high, and the Japanese were ready to pay in silver. The silver was then used to pay the Chinese for luxury goods that would be sold in Europe. Portugal's clergy, and even the king, invested in the Macao-Japan trade, and eventually Portuguese entrepreneurs prospered in Macao.

Macao also thrived from the Chinese regulation of the economic sphere. When China introduced a new policy denying foreign entrepreneurs residence (on the mainland) beyond the official trading season, numerous entrepreneurs (known as *taipans* - meaning big traders) acquired mansions in Macao, in order to spend their summers in the Portuguese haven. During the mid-17th century, however, Japan expelled the Portuguese, which decreased Macanese exports.

During the late 17th century, the English developed a liking for silk and tea, but there was no demand for English merchandise in China. The Chinese demanded to be paid in silver. The problem was resolved when some Chinese entrepreneurs agreed to give English traders silver in exchange for Indian opium; this silver was then used to buy silk and tea from other Chinese businessmen.

Following the Opium War of 1840, Portugal enlarged its colony by seizing two islands, Coloane and Taipa, both south of the Macao Peninsula. During 1841, England's navy occupied Hong Kong Island. Queen Victoria also wished to enlarge her empire, and this was made possible in 1842 with the Treaty of Nanking, which ceded Hong Kong to Britain, in perpetuity. The opening of a deep-water port in Hong Kong presented strong competition for Macao, a short sail away. In 1860, Britain acquired the Kowloon Peninsula; in 1898, Britain leased the New Territories for 99 years.

Meanwhile, in 1887, Portugal forced the Qing dynasty to sign the Draft Agreement of the "Sino-Portuguese Meeting" and later the "Sino-Portuguese Treaty of Peking." This stated that Portugal should administer Macao in perpetuity.

As the Chinese Empire began to disintegrate, wealthy Chinese entrepreneurs coveted Hong Kong, which, thanks to British rule, was perceived as a haven. The population of Hong Kong increased from about 30,000 during the middle of the 19th century, to almost a million during the Great Depression.

However, when the Japanese occupied Hong Kong during World War II, many Hong Kongers fled to China.

Macao's neutrality during World War II made it a safe haven. After the war, however, interest shifted to Hong Kong's pro-entrepreneurship environment, and Macao became dependent on its neighbour for its television channels as well as for its airport. Civil war in China prompted many more entrepreneurs to escape communism by settling in Hong Kong, so that by 1950, Hong Kong's population exceeded two million. The Hong Kong dollar came to circulate freely in Macao, while the British colony prospered with a per capita GDP considerably higher than that in the Portuguese colony.

In 1984, the British signed the Sino-British Agreement, the principal document of which was the Joint Declaration, pronouncing the reversion of Hong Kong to China in 1997; it was agreed that upon the termination of its lease, Kowloon would be given back to China, and Hong Kong as well. The uncertainty resulting from this prompted many entrepreneurs to leave Hong Kong, at least temporarily. These "boomerang entrepreneurs" are the subject of Dana (1996a). In April 1987, Portugal agreed to the Joint Sino-Portuguese Declaration and Basic Law, transferring Macao to China effective December 20, 1999.

As scheduled, the Union Jack was lowered from Hong Kong flagpoles, on July 1, 1997. Thus, Hong Kong became a Special Administrative Region of China, in the context of "one county, two systems." This was to ensure the survival of capitalism in Hong Kong, up to 2047.

### **DEMOGRAPHICS**

A striking difference between Hong Kong and Macao is that Hong Kongers have long been considering themselves as ethnic Chinese, while the people in Macao tend to consider themselves of Macanese ethnicity. The Macanese are of mixed Chinese and Portuguese ancestry, sometimes crossed with Japanese refugees from the sixteenth century persecution of Christians in Japan. Macao's population was about 440,000 in 1998, of which 5 percent were Europeans. In 1999, the population of Hong Kong was estimated at 6 million, with 4 percent of the population consisting of ethnic minorities, including Britishers, Indians and Japanese.

Britain gave Hong Kongers a British National Overseas Passport, which does *not* entitle the bearer to reside in Britain. It did not offer British citizenship to Hong Kongers. In contrast, Portugal has given Portuguese citizenship to the Macanese. In fact, while China regards Macao as a Chinese territory under Portuguese administration, Portugal considers Macao as an integral part of Portugal, with the Portuguese president as Macao's head of state. Until 1999, the governor of Macao is appointed in Lisbon, by the Portuguese president. At any time, any Macanese can immigrate to Portugal; this may subdue concerns about the colony's future. In both Hong Kong and Macao, Cantonese is the day-to-day language, but Mandarin is widely understood. Under British colonial rule, English became an official language in Hong Kong. Portuguese is Macao's second official language. It may be said that the adoption of English in Hong Kong became an asset in the world of business.

### **INDUSTRIAL STRUCTURE**

Both Hong Kong and Macao were built on entrepreneurship, but their industrial sectors evolved differently. During the 1950s, Hong Kong became an important manufacturing centre, as entrepreneurs benefited from inexpensive labour and the government's laissez-faire policy. The colony grew into an industrial center as its favourable tax policies attracted considerable foreign investment.

The small business sector gradually became over-shadowed by the hundreds of multinationals attracted to Hong Kong. For years, clothes, electronics, plastic goods, textiles, toys, watches, and other low-priced products were made in this colony, but as large firms made Hong Kong their regional base, Hong Kong's financial services sector surpassed manufacturing. Macao, in contrast, served as home to fewer multinationals. Furthermore, as Hong Kong wages and rents rose, while technology evolved, the heart of Hong Kong's industry shifted away from manufacturing, and toward international banking, communications and management.

Thus, an important difference between Hong Kong and Macao is that in Hong Kong, the principal source of employment is the service sector. The Trade Development Council has been promoting Hong Kong as a regional service center, providing communications, transportation and other services. In Macao, an increasingly interventionist approach was adopted in 1981; this has directed the economy, attempting to promote economic diversification and foreign investment.

Today, in Macao, numerous local, small-scale industries are paramount, and they are engaged in the manufacturing of artificial flowers, ceramics, clothing, electrical goods, electronics, fireworks, footwear, furniture, machinery, optical products, plastic products, textiles, and toys. Clothing provides two-thirds of export earnings. In 1997, wages in Macao were half of those in Hong Kong. In contrast, high rents and wages in Hong Kong have caused manufacturing to be shifted away from Hong Kong, often to the People's Republic of China.

Gold has long been an especially important field of activity for small-scale entrepreneurs in Macao. After World War II, the Bretton Woods Pact regulated much of the world's international exchange of gold. Portugal, however, did not sign it, and so Macao never adhered to it. Thus, Macao became a distribution center for gold. Entrepreneurs began importing bricks of gold, legally, from Hong Kong. Some of the gold would be used in jewelry, but most was re-exported unofficially, to individuals using gold as a security. Macao also has a thriving gambling industry, franchised to the *Sociedade de Turismo e Diversões de Macau*, controlled by entrepreneur Stanley Ho. Since 1962, he has held the gambling monopoly, which is scheduled to expire in 2001. A very important by-product of the gambling industry in Macao is a thriving sector of *casa de penhores* (pawnshops) that are open 24 hours daily.

### **INFRASTRUCTURE**

Both Hong Kong and Macao benefit from an elaborate infrastructure, although Hong Kong's is said to be more modern and efficient. As noted in Dana (1995), Hong Kong has one of the world's most comprehensive and unsubsidized public transportation systems. The underground Mass Transit Railway (MTR) carries

over two million people daily, while about 3.5 million people use at least one of Hong Kong's franchised bus services. Hong Kong also has 163 electric trams, comprising the world's only all-double-decker tram fleet. Hong Kong's Kwai Chung container port is the busiest in the world, and the new airport at Chek Lap Kok, opened in June 1998, is the largest civil engineering project in the world - four times the size of the old Kai Tai airport. In 1998, sixty airlines linked Hong Kong to over one hundred cities. Macao built its own airport only in 1995; air service agreements have been signed with Australia, Austria, Belgium, Brazil, Germany and Portugal. While Hong Kong's Chek Lap Kok is estimated to handle 35 million people a year, Macao's airport is projected to serve six million.

### **TOURISM**

While Hong Kong enjoys a diversified economy, Macao relies on eight million tourists a year, to contribute 25 percent of the GDP. A positive consequence of Macao's relatively slower economy is that modernization has not encroached on many of Macao's historic buildings. Thus, Macao boasts architectural treasures, some of which are five centuries old. In Hong Kong, skyscrapers have replaced most of the pre-World War II construction. The European atmosphere in Macao thus contributes to Macao's attractions.

Tourists are also drawn to Macao's gambling facilities, which represent 50 percent of the colony's GDP. Hong Kongers enjoy visiting Macao for its diversity of cuisine, including Macanese and Portuguese. Vintage wines from Europe, which are expensive elsewhere in Asia, are quite affordable in Macao.

### **TAXATION**

Taxation has a definite impact on entrepreneurship, and high rates of taxation may lead to tax-avoidance. It may also unduly restrain entrepreneurship. In contrast, a simple taxation system may encourage compliance, as well as entrepreneurship.

Hong Kong was established as a duty-free port, with no import tariffs. Its simple taxation system simplified reporting for small-scale entrepreneurs. Under colonial rule, Hong Kong levied three taxes:

- (i) a 16.5 percent profit tax for corporations, reduced to 15 percent for unincorporated firms;
- (ii) a salaries tax; and
- (iii) a property tax.

It should be mentioned that in Hong Kong, the government sold land through auctions. The proceeds were used to subsidize the budget, thereby eliminating the need to increase the tax burden on entrepreneurs.

Taxation in Macao presents quite a different picture. Firms are subject to a variety of taxes:

- (i) *imposto complementar*, which is a tax of up to 28% of profits and capital gains;
- (ii) a stamp duty surcharge equal to 5% of *imposto complementar* payable;
- (iii) *contribucao industrial*, a flat business tax, payable annually, regardless of profitability;
- (iv) a stamp duty surcharge of 5% of the amount of *contribucao industrial*

- payable;
- (v) social welfare contributions, paid quarterly and based on 20 patacas per employee, per month;
- (vi) inheritance and gift tax levied at rates of up to 33%;
- (vii) a stamp duty surcharge of 5% of the amount of inheritance and gift tax payable;
- (viii) real estate transfer tax equal to 6% of the sales price of a property;
- (ix) a stamp duty surcharge of 5% of the amount of real estate transfer tax payable;
- (x) *contribucao predial urbana*, a property tax of 10 or 16 percent of gross annual rental value;
- (xi) a stamp duty surcharge of 5% of the amount of *contribucao predial urbana* payable;
- (xii) land tax;
- (xiii) *imposto do selo*, levied at a rate of up to 10% of the value of a contract;
- (xiv) consumption taxes; and
- (xv) export duties imposed if and when a certificate of origin is required.

As can be seen, entrepreneurial activity is somewhat restrained in Macao, where there is a multitude of taxes, and no credit for foreign tax paid. In addition, legally exported gold is subject to a 0.5 percent export tax.

### ***THE IMPACT OF POLICY ON ENTERPRISE***

Public policy in Hong Kong has traditionally been one of laissez-faire -- a Style A type of policy. The state encouraged the operation of market forces, and business start-ups were made easily and rapidly due to several factors including the absence of tariffs and sales tax. Furthermore, income taxes have been low -- only 15 percent under British rule. A 1996 survey carried out by the Fraser Institute ranked Hong Kong as the world's freest economy.

The results of Hong Kong's public policy have been outstanding. Minimal government intervention combined with low taxation helped Hong Kong develop from a free port into an important manufacturing and financial center, the eleventh trading entity in the world.

When Hong Kong was reunited with China at the end of the 99-year lease, China allowed Hong Kong to retain its special status. The 1997 *Index of Economic Freedom*, published by the Heritage Foundation, rated Hong Kong as having the highest amount of economic freedom in the world. In 1998, *The Economist* described Hong Kong as the best environment in which to conduct business.

Hong Kong's supportive government policy has attracted countless entrepreneurs - individuals with a culture attaching a high social value to entrepreneurship. In 1998, nine out of ten enterprises in the former colony were small firms.

As is the case of Hong Kong, Macao was established as a trading center, and the colony's history has been closely linked to entrepreneurship, a quality ingrained in the local culture. As well, most enterprises in Macao are small.

However, Macao has had considerably more government intervention than has its neighbour under British rule.

As illustrated above, Macao has a complex tax system. Also, since 1981, the government has intervened in the economy to promote economic diversification and foreign investment. Until the 1990s, the infrastructure was relatively poor here. The banking sector was only opened up in 1995, as was the airport. To avoid antagonizing its trading partners, Macao has been discouraging entrepreneurs from expanding in the textile production sector.

Baumol (1990) and Murphy, Shleifer and Vishny (1993) have argued that excessive state intervention prompts innovators to concentrate on finding ways to beat the system. This should be of concern to policy-makers of Macao. In addition to imposing more taxes than does Hong Kong, Macao levies a stamp fee and requires substantial administrative paperwork. Considerable bureaucracy is involved when launching and while operating a retail business in Macao.

Under British rule, Hong Kong's *laissez-faire* policy had minimal requirements. A wholly-owned subsidiary of a US company in Hong Kong was altogether exempted from filing financial statements in the British colony. It is still relatively easy to create a new business venture in Hong Kong. Even foreigners have no obstacles setting up an enterprise. A firm may be incorporated within 72 hours of application.

Macanese law, in contrast, limits entrepreneurial activity. For example, a non-resident of Macao may not conduct an import-export trade, unless delegated by an authorized representative who resides in Macao.

In contrast to Hong Kong, Macao charges a 3 percent stamp fee on all shipments. Documentation requirements are stringent, and all imports are subject to licenses issued by the *Servicos de Economia*. A license is valid only three months from the date of issue, and extensions are not usually allowed. In addition to a bill of lading, a commercial invoice is required in duplicate, in Portuguese or in English. Furthermore, a certificate of origin may be requested in duplicate, and a sanitary certificate is sometimes required, particularly when importing seeds. Special government approval is required of certain imports, such as telephone and telegraph equipment, motor vehicles, fuels, electrical equipment, medicine, livestock, certain chemicals, arms and ammunition. Also important is a 5 percent *ad valorem* duty on the importation of electrical appliances and equipment. Indeed, Macao never pursued a *laissez-faire* approach as espoused by Hong Kong.

Although Macao has been somewhat protectionist when it comes to imports, its products can enter Portugal duty-free. Therefore, many products from China are temporarily imported, "in order to be finished," and then sold in Europe as Portuguese goods.

Nevertheless, during the early 1990s, Macao became a party of the General Agreement on Tariffs and Trade (GATT), and an associate member of the Economic and Social Commission for Asia and the Pacific (ESCAP). In June 1992, Macao signed a trade and economic cooperation agreement with the EU. In addition, Macao has become an associate member of the World Trade Organization (WTO). The Macao Trade and Investment Promotions Institute is currently promoting Macanese fans, sewing machines, showers, televisions, textiles and

video equipment. The Macao World Trade Center provides exhibition facilities, a library, meeting facilities, office space, secretarial services, trade information and translating services.

Hong Kong also took steps to encourage trade. For example, the government launched the "Helping Business Programme" to assist foreign entrepreneurs in doing business in Hong Kong. Furthermore, in July 1996, the Small and Medium Enterprises Committee was formed, as a forum for entrepreneurs and representatives from government and trade organizations. Meanwhile, the Hong Kong Trade Development Council has posted profits, by selling industry guide books listing manufacturers and products.

Although both Hong Kong and Macao have encouraged entrepreneurship, entrepreneurial behaviour was less restrained in the former British colony. This, coupled with the fluidity of capital across members of extended families, resulted in substantial investment outflows from Macao. A sophisticated network of entrepreneurs and their families facilitated this. In order to attract entrepreneurs, a Macanese law in 1995 offered the right of abode in Macao, to entrepreneurs with a capital of \$250,000.

It may be concluded that in the case of the Pearl River Delta, findings suggest that per capita GDP is inversely related to government intervention, economic regulation and redistribution policies. This is consistent with previous research findings, elsewhere. Pioneering the field, Peterson and Peterson (1981) found that paperwork requirements could be a burden on owner-managers. Levi and Dexter (1983) found that government intervention is an obstacle to entrepreneurship, in several ways. More recently, Acs and Preston (1997) suggested that public policy should aim to reduce barriers. Perhaps this information can be of use to policy-makers in the future.

### ***TOWARD THE FUTURE***

This article has shown that Macao favoured entrepreneurship even before the establishment of Hong Kong, but the influence of the Portuguese colony dwindled with that of the mother country. During the twentieth century, Macao was governed in line with standard Portuguese policy, not as entrepreneurship-oriented as that of Hong Kong. Meanwhile, entrepreneurs in Hong Kong have benefited from the absence of heavy regulation, tariffs and sales taxes.

On July 1, 1997, the Union Jack was lowered from the flagpoles of Hong Kong for the last time. Macao is next. Soon, both economies will be governed as Special Administrative Regions of China, with public policies independent of England or Portugal. Liberalization in China, and its growing market, will provide more and more opportunities for entrepreneurs in Hong Kong and Macao.

Findings of this study suggest that the means to a higher per capita GDP is a policy of minimal intervention with market forces. In essence, Style A Policy appears to yield more favourable results than does a Style B approach. Policy-makers should keep this in mind when formulating new policies for the economies of the Pearl River Delta. Further comparative research into public policies may help us design optimal policies for the future.

**NOTE**

1. This was illustrated in Dana (1993a). As discussed in Dana (1993b), entrepreneurs in Kenya have tended to be wealthy Englishmen. In contrast, Dana (1996b) explained that Portuguese settlers in Mozambique were usually illiterate and often poor. Dana (1992) compared (formerly British) Ghana with its (formerly French) neighbour, Togo. Dana (1990) compared entrepreneurship on two sides of one island, each with a different colonial influence.

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