

From Start-Up to Sustainable Success: The Crucial Role of Compliance in Chinese Entrepreneurial Companies

Shen Xin^{1, 2}, Roshazlizawati Mohd Nor³, and Siti Suraya Abd Razak⁴

^{1, 3, 4}Faculty of Management, Universiti Teknologi Malaysia, 81310 Johor Bahru, Johor, Malaysia, ²Faculty of Law, Shanxi Jinzhong Institute of Technology, Shanxi, China
Corresponding Author Email: shenxin@graduate.utm.my

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Abstract

This paper discusses the importance of compliance management for Chinese entrepreneurial firms. In order to achieve this goal, this study used qualitative research, utilizing semi-structured interviews with a number of people related to compliance work in entrepreneurial firms. The results of this study suggest that compliance management can help companies reduce legal risks, avoid penalties, enhance reputation, and attract investment and talent. Respondents emphasized the critical importance of employee buy-in to compliance systems and the need for increased employee engagement. Compliance systems should be developed by listening to the real needs and challenges of frontline employees to help solve problems and gain employee buy-in. In addition, companies should focus on operating and competing in a compliant manner to ensure that compliance measures are actually implemented, thus adapting to trends in the rule of law regulatory environment. The ultimate goal is the survival and success of the startup company after its inception.

Keywords: Entrepreneurial Companies, Compliance, Startup Success, Compliance Talent

Introduction

Over the past ten years, entrepreneurial spirit has been a significant driver of economic growth in China (Gerrit et al., 2005). With China transitioning from an investment and export-driven model to an innovation and domestic consumption-driven model (Yaxin et al., 2020), the roles of private enterprises and startups have become increasingly important. Startups are emerging every day, with each company aspiring to disrupt industries and achieve sustainable success. Despite the proliferation of entrepreneurial companies, many struggle to survive in their first year of operation (Arild et al., 2005). Startups face numerous risks, leading to many companies facing challenges within the first five years, and some ultimately fail (Guoqing, L., 2003). Entrepreneurial companies need new risk management methods, tools, and approaches, and should more effectively utilize and manage risks (Fauzi et al., 2023).

However, the process from a startup to a thriving enterprise is full of challenges (Laura Giurcă Vasilescu, 2014). While innovation and market acumen are crucial for entrepreneurial companies, a key factor that is often overlooked but has long-term implications is compliance. This is because China's complex regulatory environment poses significant challenges for entrepreneurs (Li Jiangyu, 2020), especially in the early stages of entrepreneurship. So, startups need the support of compliance in order to grow into full-fledged businesses.

Compliance includes adhering to relevant laws, regulations, and industry standards (Breux, 2008) and is a key factor determining the development trajectory of startup companies (Chatra, A., 2023). Non-compliance with regulatory requirements can lead to serious consequences, including hefty fines, operational disruptions, and even company closure. Conversely, proactive compliance management not only reduces risks (Didla et al., 2009) but also fosters trust among stakeholders, facilitates resource acquisition, and paves the way for sustainable growth. Despite the importance of adopting compliance efforts for companies in their entrepreneurial endeavors to garner necessary support, it often receives little attention. Therefore, entrepreneurial entities must be perceived as compliance by stakeholders (Nieto Martín, A., 2022). Failure to win or lose stakeholder support will ultimately result in the withdrawal of funding and may even lead to project failure (Clark et al., 2019). Thus, compliance plays an important role in resource allocation. We apply the concept of compliance to structure resource allocation in corporate entrepreneurship to improve our understanding of the survival or success of startups.

This article aims to explore the critical role of compliance in Chinese startup companies, with a particular focus on the challenges and opportunities faced by startups. The subsequent sections of this article will delve into literature review, research methodology, data collection, analysis, and recommendations to provide a comprehensive perspective on compliance for Chinese startup companies.

Literature Review

Company Compliance

In recent years, corporate compliance has become a focal point of attention, with increasing emphasis on implementing internal compliance systems within companies (Parker, 2000). Corporate compliance refers to the implementation of plans within an organization aimed at preventing and detecting violations of laws and regulations (Cantone, 1999). These plans typically include codes of conduct, written policies, internal monitoring, employee training, and feedback mechanisms (Fowler, 1999). Effective corporate compliance programs are designed to reduce criminal behavior, subject senior personnel to oversight, effectively communicate standards, consistently enforce standards, and modify standards based on reported issues (Angelucci et al., 2010; Haugh, T., 2018). Research indicates that compliance with company policies may be influenced by economic motives (Simpson et al., 2011). The findings of Bajra et al. (2019) suggest a positive relationship between compliance levels and the quality of corporate governance. However, compliance failures may not follow a predictable distribution and are more likely to result in extreme outcomes due to individual decision-making and complex corporate networks (Schiff, 1995), but developing compliance plans is considered a sound corporate policy to avoid severe legal consequences.

Company Success

Company success is a multidimensional concept that extends beyond financial performance (Issor, 2017). It involves factors such as knowledge management, communication strategies, organizational structure, and employee performance (Higgins, 2011; Dular, 2007; Babelova, 2014). Literature on company success covers various viewpoints and factors that contribute to the overall performance and longevity of a company. Houghton et al. (1987) discussed using financial ratios to predict company success and failure, emphasizing the importance of financial indicators in assessing the health of a company. Miller (1990) introduced the concept of the Icarus paradox, suggesting that outstanding companies may bring about their downfall through their own actions, highlighting the dynamic nature of company success, decline, and renewal. Kay (1995) delved into the foundations of company success, exploring key elements that support a company's thriving in competitive environments. Fritz (1996) presented results of a study in Germany, emphasizing the importance of market orientation for company success while also cautioning about potential negative impacts of implementing market-oriented measures. Page et al. (2005) discussed consumer perceptions of company reputation, emphasizing the importance of fair treatment of consumers and how company success and leadership influence consumers' attitudes toward the company.

Compliance and Entrepreneurial Companies

Compliance, as a tool for preventing and managing risks, plays a crucial role in entrepreneurial companies (Mello, et al., 2022). There is an increasing societal demand for it, representing an investment in intangible value and providing a competitive advantage in the global market (Hermoso-de-Mendoza, 2022). The implementation of compliance plans not only enhances a company's public image and reputation but also helps prevent commercial crime, aligning with global strategic priorities such as human safety and sustainable development (Ballesteros Sánchez, 2020). Compliance plays a vital role in promoting the success of entrepreneurial ventures. Hermoso-de-Mendoza (2022) argues that compliance not only ensures compliance with legal and contractual obligations, especially safeguarding the lives and health of workers, but also contributes to improving the company's image and reputation (Barbosa, 2023). Additionally, implementing compliance plans helps prevent commercial crime and mitigate risks (including criminal risks), creating a favorable environment for sustainable and effective business development (Manafe et al., 2023).

Research Methodology

This study adopts a qualitative approach to determine the impact of compliance on Chinese startup companies. Qualitative research enables researchers to understand how individuals interpret their experiences, how they construct their world, and what meanings they attribute to their experiences (Merriam, 2009). This qualitative technique examines in-depth data collected through empirical research techniques, such as semi-structured interviews (Abdul Ghani et al., 2023). In qualitative research, relatively small and purposefully selected samples can be used to increase the depth of understanding (rather than breadth) (Palinkas et al., 2015). Purposeful sampling strategies move away from any form of random sampling and instead ensure that specific types of cases that may be relevant are part of the final sample in the study (Campbell, S., 2020). With purposeful sampling, semi-structured interviews were conducted with 8 individuals involved in compliance management within companies to gain in-depth insights. Respondents in this study include founders, CEOs, compliance officers, legal professionals, investors, and company employees from Chinese entrepreneurial companies.

According to Rabiee (2004), six to eight Respondents are sufficient to obtain diverse perspectives, while eight or more Respondents are considered the ideal number for interview participation to demonstrate a stronger ability to address specific questions (Krueger, 2014). Prior to the interviews, researchers contacted the interviewees and provided them with information on the topics to be covered via email, facilitating Respondents to consider answers to more in-depth questions in advance. Additionally, the email mentioned the approximate duration of the interview and a brief explanation of anonymity assurance to reassure Respondents and encourage them to provide relevant information. During the interviews, Respondents were made aware of what information the researchers expected from them, and they knew they had the right to withdraw from the interview at any time without providing a reason. This was done to minimize Respondent discomfort, as interviews are often seen as confidential encounters (Orb et al., 2000). Furthermore, researchers engaged in social conversation with Respondents before the formal interview commenced to create a relaxed and polite atmosphere, gradually transitioning into the formal interview to foster a friendly environment for the smooth progression of the interview.

The interviews were conducted in either Chinese or English, depending on the Respondents' preferences, to ensure that interviewees could openly share their views with researchers in the most comfortable manner. The interviews lasted 40 to 45 minutes, and with the interviewees' consent, researchers recorded the interviews using phone or computer software to ensure all responses were captured during the transcription process. This process enhances the effectiveness of data collection to some extent, rather than solely relying on notes (Fielding & Thomas, 2008). Verbatim quotes were used in this study to reflect the Respondents' genuine feelings, thoughts, experiences, and basic cognition (Neale et al., 2005), even if there were grammatical inaccuracies. Subsequently, researchers transcribed the audio files into text and uploaded these files into qualitative data software like NVivo. This software allows for the identification of consistent themes. If the software is not available, inductive analysis can be utilized to read and re-read summarized responses to detect themes within the data. The quality of Respondent interaction is particularly crucial in data analysis (Kitzinger, 2005).

Findings and Discussions



Figure 1. The Model of Compliance for Startup Success

Theme 1: Challenges facing Chinese startups to succeed today

Category 1: Strict Regulatory Requirements

Regulatory agencies are increasing their compliance requirements for companies, as mentioned by Li Jiangyu (2020). Respondent 7 stated: "I work in the healthcare service industry where there is a rich array of laws, regulations, and standards to comply with. Due to the recent adjustments in China's healthcare policies, management has become stricter, and many business practices that were previously permissible are now subject to strict supervision." Respondent 2 also expressed a similar view: "Regulatory agencies have been intensifying their oversight of personal information data protection, requesting us to submit relevant reports multiple times." Respondent 5 remarked: "Regulatory agencies are enforcing stricter measures against corruption and commercial bribery, with a wide range of regulatory tools. In terms of tax law enforcement and audits, previously we would engage tax planning firms for legitimate tax avoidance, but now such actions could potentially lead to hefty fines for the company." Respondent 8 also noted: "Market supervision on illegal advertising is very stringent. When promoting our restaurant online, carefully crafted ad content may not be posted due to restricted terms." From the statements of the Respondents, it is evident that legal compliance requirements are reflected in various aspects. With the increasing intensity of supervision, compliance oversight has increasingly become a red line that startup companies may inadvertently cross, and the complexity of regulatory rules exceeds what startup companies themselves can manage in terms of risk control.

Category 2: Outstanding Legal Issues

The intense market competition and rapidly changing legal environment have made legal issues more prominent (Van Waarden, 2001). Respondent 8 stated: "In an increasingly competitive environment, startup companies are facing a 'blitz' of legal tactics from more and more competitors. Our limited understanding of laws and regulations has put us in a very passive position." Respondent 3 also mentioned hearing about some startup companies being reported for violations during the bidding process and getting involved in lawsuits for breaching trade secrets. Respondent 6 noted that their company is preparing for intellectual property litigation, requiring them to collaborate with lawyers and review numerous legal provisions they were previously unfamiliar with to prepare the necessary documentation for the lawsuit. It is evident from the interviews that in the face of fierce market competition and a complex and ever-changing legal environment, entrepreneurial companies are more prone to encountering unforeseen legal issues. Most entrepreneurial companies lack a comprehensive understanding of intricate laws and regulations, making them apprehensive and struggling to navigate the competitive landscape."

Category 3: Financing is Difficult

The difficulty in external financing for entrepreneurial companies has increased, and the pace of fundraising has slowed down (Saleem & Atiq, 2023). Respondent 4 stated: "As a founder of a startup company, I face more pressure from investors and shareholders, especially since founders typically bear the buy-back responsibility if the company's IPO is unsuccessful. It is challenging to manage both the personal liability risks of the founders and the exit demands of shareholders." Respondent 1 also raised a similar point: "Investors are more sensitive to risk management of their investments, requiring entrepreneurial companies to enhance their self-generating capabilities and operational performance." From the Respondents' statements, it is evident that due to the impact of the global economic environment, the slower pace of fundraising necessitates adjustments in business strategies for entrepreneurial companies. They must improve the efficiency of capital utilization, enhance cash flow management, and boost productivity to meet the demands, which are more refined compared to the previous reliance on capital expansion for operations.

Category 4: Lack of Talent

Respondent 6 mentioned that the startup company they are part of is preparing for intellectual property litigation, stating, "Due to limited resources, our startup company cannot fully understand how to protect its intellectual property, leading to the risk of intellectual property being stolen by others. However, the company lacks internal compliance professionals, forcing them to hire external lawyers to assist in organizing compliance materials." On the other hand, Respondent 8 also noted: "As an entrepreneur in the restaurant industry, my understanding of the law mostly comes from the internet because there is a lack of legal compliance professionals in the industry. I have to engage a lawyer as our consultant to prevent any illegal activities." Respondent 4 also mentioned: "Entrepreneurial companies often face disadvantages in personnel recruitment. "From the Respondents' narratives, researchers discovered that entrepreneurial companies struggle to identify compliance risks promptly due to the absence of suitable compliance professionals. Even though they can seek assistance from third parties or hire experienced legal compliance personnel to address these issues, the lack of internal staff cooperation can hinder the proactive handling of legal matters."

Theme 2: Evaluating the Effectiveness of Compliance as an Important Tool for Improving the Success of Entrepreneurial Companies

Category 1: Reduce the Risk of being Fined

Respondent 8 mentioned: "At the beginning of the opening of my restaurant business, we printed 2000 promotional flyers... which were deemed as false advertising by the market supervision bureau, leading to a fine of 20,000 RMB. However, following the advice of legal counsel, we made compliance adjustments and voluntarily destroyed the remaining 558 flyers, eventually being fined only 5,000 RMB." Respondent 5 also shared a similar statement: "Due to the establishment of a compliance system, our company identified a tax underpayment during a self-audit. Prompt payment helped us avoid a tax penalty." These accounts highlight that compliance management is a crucial way to reduce the likelihood of companies facing penalties. Compliance allows companies to regularly assess potential administrative penalty risks related to their operations. A compliance system keeps pace with regulatory changes, market trends, and industry developments, assisting companies in anticipating potential fines and taking proactive measures to mitigate risks.

Category 2: Reduce Legal Risks and Enhancing reputation

Respondent 6 mentioned that the startup company they are part of is preparing for intellectual property litigation, stating, "Our startup company cannot fully understand how to protect its intellectual property, leading to the risk of intellectual property theft. However, the company lacks professional compliance personnel... If we had a complete compliance system, this incident might not have occurred." Respondent 5 mentioned: "Because of our strict adherence to the protection of customer privacy in data collection, we have always had a good reputation in the marketplace Since the start of our company, not a single client has gone to the regulatory authorities to complain about our company." Respondent 2 noted: "In a recent litigation I handled, the company was absolved of legal liability due to having a comprehensive compliance system." Respondent 8 said: "I was unaware of the numerous laws and regulations governing the establishment of a company until my legal advisor listed all regulations and guidelines for me and my employees to learn." Compliance management can help companies fully understand and monitor their compliance status, promptly identify and address potential violations, and prevent legal risks resulting from negligence. Compliance management aids in establishing robust compliance systems and processes within a company, enhancing internal compliance awareness and risk management capabilities to reduce instances of non-compliance, enhancing company's reputation. Additionally, compliance management reports or charters can serve as evidence and basis for a company's compliance efforts, providing support during legal lawsuits or reviews and reducing the likelihood of legal sanctions.

Category 3: Improve Profitability and Attract Investment

Respondent 4 stated, "New investors are very concerned about whether investment risks are effectively controlled. To attract new investors, my company provides compliance reports showcasing detailed risk assessments conducted through legal, financial, and business due diligence. The company has implemented measures to address risks, and the new financing terms provide robust protection of investors' rights." In this context, Respondent 1 mentioned, "I believe compliance is a great tool for ensuring proper implementation of the company's accounting and operational policies. After running a compliance system, I have seen a

significant improvement in the overall image of the company." On the other hand, according to Respondent 5's response, it was corroborated that, "I believe compliance sets us apart from other companies in the market because we strictly adhere to customer privacy protection in data collection. Our reputation in the market has been excellent, resulting in good profit margins and increased customer willingness to cooperate with us. "By studying these aspects, it can be observed that compliance management enables companies to demonstrate strong governance structures and risk management capabilities, enhancing their reputation and sustainability while reducing legal and operational risks and strengthening stability to attract more investors. Furthermore, compliance operations can enhance a company's credibility and image, build trust with customers, increase customer loyalty, and attract more clients to choose the company's products or services, thus expanding its market share. Conversely, if a company faces significant compliance risks and lacks social responsibility, it can greatly damage investor and customer confidence, leading to capital outflows and customer losses. Therefore, establishing a comprehensive compliance management system is essential for attracting financing and investment.

Category 4: Attract and Retain Top Talent

Respondent 4 mentioned, "The most important aspect for a startup company is its 'people.' The internal acceptance of the compliance system by employees is a prerequisite for the compliance system to be implemented and to drive business effectively. "Respondent 5 stated, "The implementation of many aspects of the compliance system relies on employee execution, such as the enforcement of anti-commercial bribery policies. The rules involved in these aspects must be internally accepted by employees to reduce internal conflicts during execution and truly achieve implementation. "Respondent 7 believed, "For pharmaceutical companies that are just beginning to establish standardized marketing systems, referencing the marketing systems of multinational companies or top pharmaceutical enterprises is definitely inappropriate. However, our company's founder feels this approach is more prudent, which I find difficult to accept."

From the interviews with Respondents, researchers found that increasing employee involvement in the development and implementation of the compliance system is crucial. Employee deep involvement is not only a necessary step to align the compliance system with business reality but also an essential element in enhancing employee ownership awareness. On one hand, in the process of developing specific rules for the compliance system, it is important to listen to employees' opinions. Employees are at the forefront of business operations and are the ones experiencing challenges firsthand. To truly leverage the business-driving potential of the compliance system, it is essential to listen to frontline employees and address their practical issues in business execution. This approach can help solve problems for employees and gain their acceptance of the specific rules within the compliance system. On the other hand, employees in startup companies have multi-level needs, and having their opinions valued and being able to contribute more value themselves is one of their requirements. The more extensively employees participate in the development and implementation of the compliance system, the stronger their sense of belonging to the company will be. They are more likely to endorse the compliance system, embrace the company's culture and values, and be willing to work for the company in the long term.

Implications for Future Research

This paper has mainly studied the impact of external factors on startups' compliance, but less research has been done on internal factors. Future research can focus on the internal factors of startups, for example, to study the possible relationship between some important individual factors such as age, gender, and education of entrepreneurs and startup compliance, and future research needs to shed more light on this possible relationship. To study the impact of internal corporate culture on startup compliance.

Conclusions

The practical contribution of this paper is to provide practical compliance advice to entrepreneurs to help them avoid legal and regulatory risks during the start-up and growth stages of their businesses. Based on the above thematic analysis, the conclusion drawn is that startup companies should prioritize compliance development. In an era of increasingly stringent legal supervision and growing transparency, compliance not only helps companies reduce or avoid penalties from external regulatory authorities and minimize legal risks but also facilitates innovation financing, attraction of top talent, and boosts the company's willingness and level of innovation. Therefore, startup companies should focus on operating in a compliant manner and engaging in compliance competition, ensuring that compliance is truly implemented.

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