

Institutional Environment, Entrepreneurial Confidence, and Corporate Investment Choices

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Abstract: A lack of confidence is one of the typical issues in China's current economic development. Understanding the factors that influence entrepreneurial confidence can help address related challenges in a targeted manner, thereby contributing to economic growth. By reviewing the literature on institutional environment and entrepreneurial confidence, and analyzing classic cases such as United Family Healthcare and Credit Hangzhou, this paper elucidates the relationship between institutional environment, entrepreneurial confidence, and corporate investment choices. The study finds that the credit system and the legal institutional environment play a significant role in influencing entrepreneurial confidence. Specifically, the development of the credit system, strengthening of property rights protection, and optimization of the business environment can enhance entrepreneurial confidence, which in turn affects corporate investment. Looking ahead, the paper suggests promoting the construction of trustworthy and untrustworthy credit systems and establishing a safe and reliable legal society to overcome the issue of insufficient entrepreneurial confidence, thereby fostering investment and healthy economic development.

Keywords: Institutional environment, Entrepreneurial confidence, Corporate investment, United Family Healthcare, Credit Hangzhou.

1. Introduction

A lack of confidence is a typical issue in China's current economic development. Due to the impact of the COVID-19 pandemic and the transition of China's economic growth from high-speed development to medium-to-high-speed, high-quality growth, corporate investment activity and financing amounts have declined, weakening growth momentum and slowing economic growth. Entrepreneurial confidence has notably decreased compared to previous periods. Zhang Junkuo, former Deputy Director of the Development Research Center of the State Council, pointed out that one of the prominent issues constraining steady economic growth is weak domestic demand. Boosting entrepreneurial confidence to promote investment is a crucial entry point for addressing China's domestic demand problem. The transmission of market confidence can also assist in the development of China's socialist market economy. In current literature, an important measure of market confidence is investment. Numerous studies have indicated that investment is a core indicator for observing regional economic performance and confidence. Investment decisions not only affect a company's short-term financial performance but also its long-term development and market competitiveness. Furthermore, these decisions are closely tied to the high-quality and healthy development of China's

economy. Understanding what factors influence entrepreneurs' confidence in making investment decisions and how these factors affect the recovery and sustainable growth of the national economy has become a key area of emerging interest for many economists and is the primary focus of this paper.

Most existing research concentrates on the impact of confidence on companies and the economy, often utilizing empirical analysis to simulate and explore this relationship. For instance, studies have shown that entrepreneurial confidence has a significant positive effect on fixed asset investment. Empirical results from scholars such as Jia Pengfei and Zheng Shikun suggest that entrepreneurial confidence notably promotes fixed asset investment [1]. However, there is less focus on the factors influencing confidence. This paper aims to expand the discussion by examining factors that impact entrepreneurial confidence, which have yet to be deeply explored in current research, and providing additional perspectives on confidence boosting and promoting investment growth.

The paper is organized as follows: the second section introduces the institutional environment and the representation of confidence, the third section analyzes the impact of institutions on entrepreneurial confidence, the fourth section discusses potential pathways to overcome the lack of confidence, and the final section summarizes the paper and offers future outlooks.

2. Institutional Environment and Entrepreneurial Confidence

2.1. Representation of the Institutional Environment

The institutional environment referred to in this paper encompasses two main aspects: the credit system and the legal system.

Credit system. Firstly, the development and improvement of mechanisms such as public credit information sharing and commercial credit systems have made significant contributions to China's economic development. In recent years, China has placed great emphasis on promoting the construction of the social credit system and a new regulatory system. This includes not only improving long-term regulatory mechanisms for corporate-related fees and clearing arrears owed to enterprises, but also accelerating the establishment of a comprehensive evaluation system for the credit status of private enterprises and improving the credit enhancement system for small and medium-sized private enterprises to promote business through trust. Secondly, as enterprises are the core microeconomic entities, the construction of the social credit system primarily impacts them by increasing rewards for creditworthy behavior and the costs of dishonest actions. On one hand, the social credit system has shown positive effects, reducing the risk of corporate violations, which is beneficial for enhancing long-term corporate value, stabilizing capital markets, and promoting the specialization of enterprises [2]. Furthermore, clear rewards and penalties for trustworthy and untrustworthy behavior should be implemented to form effective incentives and regulatory mechanisms, maximizing the microeconomic value of credit. On the other hand, curbing corporate violation risks is the baseline for protecting the interests of small and medium investors and is a prerequisite for preventing systemic financial risks in the capital market [3].

Legal system. Firstly, laws such as tax law and labor law, which promote social fairness, contribute to the equitable distribution of social resources, increasing entrepreneurial confidence and promoting investment. Secondly, by optimizing the business environment, the legal system directly influences market entities' decisions and investment behavior, while also impacting industrial restructuring and macroeconomic growth [4]. Thirdly, by affirming property rights and intellectual property rights, laws protect the economic interests of microeconomic entities, enhance the business environment, and promote economic development. A favorable economic environment boosts entrepreneurial confidence, thereby influencing corporate investment decisions.

2.2. Entrepreneurial Confidence

Entrepreneurial confidence reflects entrepreneurs' subjective perception of the external market economic environment and macroeconomic conditions. Modern macroeconomics suggests that confidence plays a crucial role in economic growth and the stability of financial systems. Studies based on micro-level data have shown that entrepreneurial confidence significantly influences corporate decision-making. Heaton's 2002 study demonstrated that optimistic managers tend to increase project investment when free cash flow is available [5]. Financing decisions are also affected by managerial confidence, with confident managers typically opting for debt financing rather than equity financing [6]. Hayward found a positive correlation between entrepreneurial confidence and corporate investment, noting that positive entrepreneurial sentiment and financial resilience help boost both entrepreneurial confidence and corporate investment [7]. Angeletos and La'O, through theoretical modeling, confirmed that entrepreneurial confidence has a promoting effect on fixed asset investment [8]. In a study using U.S. entrepreneurial confidence survey data, scholars Khan and Upadhyaya discovered that entrepreneurial confidence serves as a predictor for short-term future investments [9]. Therefore, many scholars and studies have pointed out the inseparable relationship between entrepreneurial confidence and investment, with investment being a key manifestation of entrepreneurial confidence.

3. The Impact of Institutions on Entrepreneurial Confidence

3.1. The Credit System Increases Entrepreneurial Confidence Through Resource Allocation

In recent years, China has introduced a series of institutional reforms, with the construction of the social credit system being a key component. In 2014, the State Council issued the "Outline for the Construction of the Social Credit System (2014-2020)," followed by policy pilot cities in 2015 and 2016. On March 25, 2022, the "Opinions of the Central Committee of the Communist Party of China and the State Council on Accelerating the Construction of a National Unified Market" emphasized the need to "improve a unified social role system" as part of efforts to strengthen market institutional rules and boost the construction of the social credit system, thus increasing entrepreneurial confidence and driving economic growth.

The credit system enhances rewards for trustworthy behavior, converting creditworthiness into resources, thereby boosting entrepreneurial confidence. Establishing credit record websites that document the credit information of enterprises, individuals, and organizations creates a reward mechanism linking credit with credit financing. This system provides financing support for trustworthy enterprises, reduces information asymmetry between banks and enterprises, effectively alleviates financing difficulties, and enhances confidence in investment and financing. "Credit Hangzhou," jointly established by the Tax Bureau, Market Supervision Bureau, and City Leasing Association, has had a profound impact on the construction of Hangzhou's credit system. Hangzhou became the first city to implement "zero material submission" and "zero government approval," helping to build a new government-business relationship based on "credit + government services." This approach greatly alleviated the issues of slow and difficult financing for enterprises, supporting their development and boosting confidence.

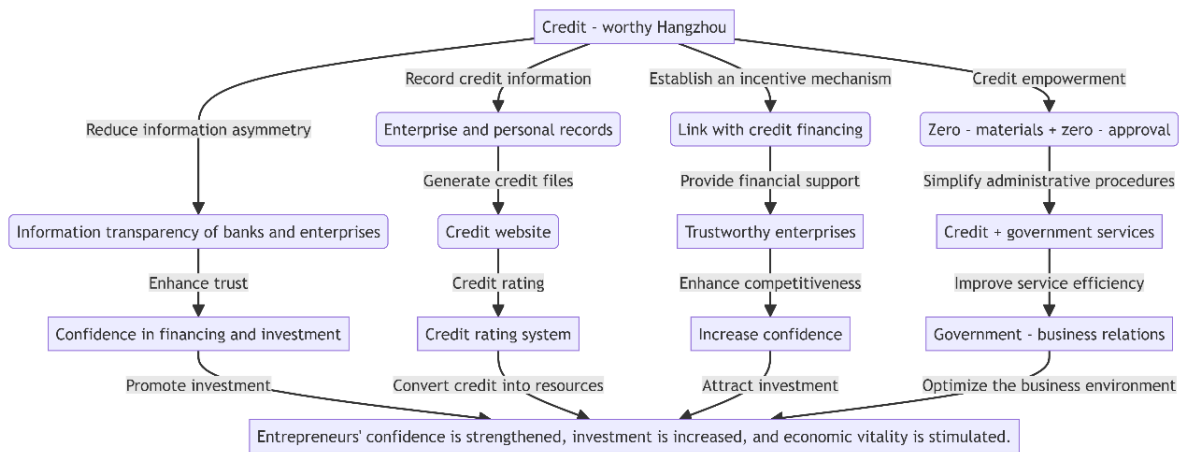


Figure 1 : Flowchart of How “Credit Hangzhou” Impacts Entrepreneurial Confidence and Investment.

Additionally, the credit system promotes the disclosure of environmental credit information, which is an effective way to encourage enterprises to fulfill their environmental protection responsibilities. The government promotes the implementation of environmental credit reward policies, granting certain policy benefits to companies that meet environmental credit standards. For instance, companies with high environmental credit ratings may receive more favorable credit terms, and green projects and energy-saving products that meet environmental protection requirements can enjoy tax reduction and exemption benefits. These policies incentivize green innovation investment, improve the quality of environmental information disclosure, promote corporate R&D, green innovation, and ESG (Environmental, Social, and Governance) performance, and drive supply chain companies to adopt green product transformations, further enhancing confidence in investment [10].

Second, the credit system promotes fair resource allocation by increasing the costs of dishonest behavior. The “Red-Black List” system, which raises the costs of dishonesty, regulates market resource allocation. When a company experiences a serious credit default event, the local government promptly publishes the list of dishonest entities to the public, adding them to the “blacklist” on the local credit website, identifying them as “dishonest executors.” Cities such as Hefei, Wenzhou, Weihai, and Weifang have established this system, which greatly enhances corporate transparency, increases the cost of violations, and reduces dishonest corporate behavior [11]. Specifically, dishonest entities face strict penalties in nine areas, including loan financing, registration, and market access, which raises the costs of violations and effectively reduces corporate misconduct. Through dynamic effect analysis and other models, scholars such as Huang Zhuo have concluded that the credit system reduces corporate violations, stabilizes the business environment and market order, promotes the fair allocation of market resources, boosts entrepreneurial confidence, and increases corporate investment enthusiasm [3].

3.2. The Legal System Increases Entrepreneurial Confidence Through Property Protection, Stability, and Fairness

First, the legal system enhances the stability and fairness of the business environment through relevant laws and regulations, thereby increasing entrepreneurial confidence. The better the business environment, the more confident entrepreneurs are, attracting more business investment. Ba Trung used principal component analysis (PCA) to conclude that the environment plays a crucial role in promoting corporate investment and improving productivity [12]. One focus of China’s legal services is the rule of law in the business environment. In October 2019, the State Council passed the “Regulations on Optimizing the Business Environment,” followed by the issuance of the “Opinions

on Creating a Better Development Environment to Support the Reform and Development of Private Enterprises” in December of the same year. In recent years, China has made significant progress toward building a business environment governed by the rule of law. For instance, the “Civil Code” provides a fundamental legal basis for optimizing the legal business environment, adjusting civil relations between equal subjects, and promoting fairness in the business environment, supporting and ensuring the construction of a law-based business environment. Additionally, tax governance is an important factor in optimizing the business environment and has a significant and forward-looking impact on corporate investment decisions [13]. Under the “delegating powers, improving regulation, and optimizing services” reform, China’s tax governance model has rapidly transformed, promoting the rule of law in value-added tax (VAT) administration to optimize the tax business environment. This shift has created governance effectiveness in VAT systems. Within the context of an optimized business environment, VAT administration has aligned itself with the theme of the rule of law, transitioning from policy-driven to law-driven governance, forming a VAT governance system based on legal rules. This governance model, led by law in legislation, enforcement, judicial processes, and compliance, stabilizes the business environment [14]. Regarding fairness, China has established a legal aid mechanism for VAT, with government-organized legal aid lawyers providing free legal services to taxpayers facing economic difficulties or special cases. This enables taxpayers to better defend their rights, ensuring greater investment security and enhancing entrepreneurial confidence.

Second, the legal system, through laws such as the “Intellectual Property Protection Law,” the “Patent Law of the People’s Republic of China,” and the “Implementation Regulations of the Trademark Law of the People’s Republic of China,” protects corporate property rights and contracts, thereby increasing entrepreneurial confidence. Innovation is the primary driver of development, and property rights protection ensures that businesses can receive a fair return on their investment in research and innovation, giving them confidence to engage in more R&D and innovation. For example, intellectual property-related laws protect corporate innovation rights, and the Yanta Technology New Area has established a comprehensive intellectual property protection system that stimulates innovation, consistently ranking among the top in the province in various intellectual property indicators. Additionally, by protecting corporate property and patents and raising the statutory upper limit for infringement compensation, the legal system optimizes the property rights environment. Companies can prevent competitors from illegally copying their products or services, thereby maintaining their market competitiveness and boosting entrepreneurial confidence. In the stable commercial environment provided by property rights protection, entrepreneurs and investors are more willing to invest in enterprises because they know their investments are legally protected, fostering a social environment that supports and values property rights protection.

4. Case Study

There are numerous examples of how improving the institutional environment can enhance entrepreneurial confidence. In the third batch of typical cases released by the Supreme Court regarding the protection of property rights and the legitimate rights and interests of entrepreneurs, the Hemu Family Company registered two trademarks on November 7, 2007. Before the establishment of Hemu Family in a certain city, seven medical institutions using the “Hemu Family” name had already been established in Beijing, Shanghai, and other locations, and the “Hemu Family” name and trademark had long been used in medical services. The “Hemu Family” series of medical institutions carried out extensive publicity, and the annual revenue of these related medical institutions reached a certain scale. National and local newspapers and periodicals had also published numerous reports on the above-mentioned “Hemu Family” medical institutions. In April and June 2011, the Hemu Jia Company and Hemu Jia Hospital were established in a certain city, with business operations including preventive healthcare, obstetrics, and neonatal specialties. They prominently used the “Hemu Jia”

name and also employed a logo strikingly similar to the “Hemu Family” logo. In the trademark infringement and unfair competition dispute case between Hemu Family and Hemu Jia, Hemu Family requested that Hemu Jia cease infringing on its “Hemu Family” word and logo trademarks, stop using the “Hemu Jia” name, change its business name, and compensate 3 million yuan. After being dissatisfied with the rulings from the first and second trials, Hemu Family applied for a retrial. The Supreme People’s Court ruled in favor of all of Hemu Family’s claims, ordering Hemu Jia to stop infringing on the exclusive rights to the registered trademarks and change its business name. Considering factors such as Hemu Jia’s intent, the impact of its actions, the infringement situation, and the reasonable costs incurred by Hemu Family to stop the infringement, the court ruled that Hemu Jia must pay 3 million yuan in compensation, based on the statutory maximum limit.

After receiving a fair judgment, Hemu Family increased its investment, introduced advanced medical equipment, transitioned into a general hospital, partnered with New Frontier Group, and successfully went public through a reverse merger. Following the end of the pandemic, Hemu Family’s performance quickly rebounded, with 2023 revenues reaching approximately 3.7 billion RMB, and EBITDA growing by about three times. This case demonstrates that by strengthening the legal institutional environment, enhancing judicial protection of trademark and property rights, and maintaining market competition order, Hemu Family boosted its confidence, increased its investment, and saw an improvement in its financial performance.

5. Conclusion

A lack of confidence is a typical issue in China’s current economic development. This paper finds that the institutional system is a crucial factor influencing entrepreneurial confidence, with the credit system and legal framework being particularly impactful. Through the examples of “Credit Hangzhou” and Hemu Family, it is evident that the credit system and legal framework play an important role in establishing a favorable business environment, boosting confidence, and promoting investment. Based on this research, we propose the following outlook:

First, promote the construction of a credit system that rewards trustworthiness and penalizes dishonesty. The construction of a social credit system has a clear “incentive effect,” which can increase the value of trustworthiness and the cost of dishonesty, thus maintaining a stable business environment. However, the development of China’s credit system is unbalanced, with coastal economically developed regions progressing faster than inland areas, resulting in varying levels of impact on confidence and investment promotion. It is essential to spread successful credit systems from model regions to underdeveloped and imbalanced areas to aid in their development. Simultaneously, efforts should be made to advance the construction of credit cities, providing supporting policies and financial backing to improve the social credit environment and business landscape, thereby addressing the issue of confidence deficiency.

Second, build a secure and reliable legal society that protects the rights of investment entities. Whether the investment and business environment is safe and stable is the primary concern for market participants. First, regular efforts should be made to combat organized crime. In response to prominent issues raised by entrepreneurs, particularly those directly affecting their personal safety and property security, courts should strictly punish illegal activities that harm the legitimate rights of entrepreneurs, such as forced transactions and extortion. Moreover, it is essential to address the root causes, thoroughly investigate the “protective umbrellas” of organized crime, and eliminate the breeding ground for such forces, thereby fostering a harmonious and secure social environment. Second, implement the principle of property rights protection. Fully protect the property rights, creditor’s rights, shareholder’s rights, and other intangible property rights of all types of entities to boost market confidence in investments. Third, establish a full-chain intellectual property protection mechanism through coordinated efforts among public security, courts, market regulators, and

copyright authorities. By strengthening administrative enforcement and judicial protection of intellectual property rights, the protection system will be improved, enabling judicial and administrative departments to maximize their roles. This collaborative mechanism will connect administrative law enforcement with judicial processes, creating a powerful synergy to build a comprehensive protection framework that fosters innovation, utilization, protection, management, and service. These multi-faceted efforts will precisely target the root causes of insufficient confidence and create fertile ground for innovative investment entities.

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