

Chapter 1

So You Want to Do Business in China

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China certainly has plenty of prospects for foreign companies. The flip side is that it can be a tough place to do business. Your company's China team will be challenged to deliver results on time and within expectations. Even some of the world's biggest and best companies have stumbled hard in China. Before you consider investing in China, your company needs to figure out whether the opportunities are a good fit.

Finding the right path for your company is key. You need to understand how the market really works and what role the government plays in your business. Be prepared to change course from time to time in response to this fast-changing market. You may face some of the most brutal negotiations you've ever seen. You have to play by their rules on their home turf, doing business the Chinese way.

Consider this chapter your personal guide on your business trek to China. Your guides have successfully been down this path many times. The journey will probably be long and exhausting, but it'll likely be very rewarding in the end. Let the journey begin!

Understanding China's Appeal

The dragon called China has emerged on the world scene as a new economic powerhouse. Since China opened its doors to foreign business in the late 1970s, its transformation has been absolutely remarkable. Over the last 25 years, China has transformed itself from a centrally planned socialist state to a semi-market-driven, semi-command economy. For more than a decade, China's GDP has grown over 9 percent each year.



China recently attracted over US\$70 billion worth of foreign investments in a single year, more than any other country by far! Since China opened her door to overseas companies, approximately US\$700 billion in foreign direct investment (FDI) has landed in China. China now ranks as the fourth-largest economy on the planet after the U.S., Japan, and Germany. Soon, it'll be the second-largest economy in the world. Many economists are saying that China will be the world's largest economy by 2025.

If the booming economy isn't enough, this section can help you understand China's appeal. (For more on potential opportunities for your business, see Chapter 2.)

Cutting costs to meet global demands

Manufacturers based in China have considerable cost advantages over companies producing goods in Europe or North America. Foreign investors in China continue to chase cheaper wages and lower operating costs, which translate into improved margins and greater profits. (However, as we explain in Chapter 13, most companies don't lower their per-unit labor costs by moving manufacturing to China. Instead, the improved margins usually come from lower utility costs, one-stop shopping for suppliers, and using more flexible manufacturing models that don't usually work in the West.)

Strong global demand from consumers for low-priced Chinese-made products is driving much of the foreign investment. You've no doubt heard about the large multinational companies that have poured billions of dollars in investment in China to produce goods for export to the West. For foreign companies operating there, *Made in China* can mean making customers in Europe and North America happy by keeping prices as low as possible.

Looking past the veneer

China's economic miracle can almost take your breath away. As you stroll through a major city, you see signs of progress almost everywhere you look. China's urban centers are teeming with people and activity. Shiny new offices and residential towers are popping up all over. Construction cranes dot the horizon as far as the eye can see. Newly built automobiles are clogging up the city's arteries. Consumer product brands from around the world are all the rage.

Your day is filled up with wall-to-wall meetings with the Chinese. The opportunities seem to hold much promise for your company in China. At the end of a long day as the sun starts setting in Shanghai, you find your lower jaw suddenly begins to drop. You see the city's new skyline unfold in front of you as the sun falls behind the hundreds of gleaming new skyscrapers. You think to yourself, "*This is a land of opportunity.*"

In China's major cities, you'll no doubt be impressed by the posh five-star hotels, high-speed bullet trains, gleaming new airports, and

modern business districts that have risen out of swamps. Some foreigners can easily get a little too carried away with China. But you come to understand that the country has a certain veneer to it. China wants you to believe that everything is A-okay.

As you begin your journey, you realize that China is full of promise. But China is full of challenges, too. Many Western businesspeople tend to underestimate the challenges they'll face. They don't see the trap door ahead of them before they fall through it.

We've heard many horror stories of doing business in China — the Chinese scam artists; companies posing as legitimate businesses; manufacturers producing products from stolen intellectual property; and employee theft and embezzlement. The list goes on and on. China can be a very good market for your business. At the same time, be aware that it can be a very bad place for your business. So keep your business on high alert at all times while working in China.

Accessing a fast-growing local market

Foreign companies aren't going to China just to lower their production costs (see preceding section); they're also looking at getting a piece of the fast-growing domestic market. China's sheer size and growth prospects are a big draw for foreign companies. With the creation of more highly skilled jobs, China's incomes are rising. And rising incomes translate into greater purchasing power for the Chinese in urban centers.

Considering Ways to Get In on the Action

Many people ask themselves, “What’s the best opportunity for my company in China?” Business executives and managers may not be clear about what the opportunities are, never mind how to develop them. You should sit down and search in depth to understand the possibilities for your business.

Despite certain challenges, China is a good place for many companies. Foreign companies have the opportunity to sell into China, manufacture in China, or source products or parts from there. This section can help guide you to make better decisions about your company’s opportunities in China. We begin by looking at several of the most common possibilities.

Selling into China

Exporting your products to China is one way to enter the market, and it may be less risky for your company, too. China has an estimated 200 million middle-class consumers, and it’s adding millions of new consumers who are buying all sorts of consumer products and financial services. A fast-growing middle class, mostly in or near the coastal cities of China, is paving the way for strong selling opportunities. Retailers, financial services companies, and consumer product companies are jumping into the market to aggressively expand their business.

Retailing in China is taking off like a rocket. Soon, sales are expected to reach US\$1 trillion. China has more than 20 million retail outlets now. New hypermarkets, supermarkets, department stores, and electronics, appliance, and home décor shops are popping up everywhere in eastern China (see Chapter 14 for details on retail markets).

With the explosion in retailing, the China market is witnessing more consumer products and brands (prestigious foreign brands are particularly popular). New types of consumers are emerging with different needs and wants. The markets are becoming more segmented as consumer buying behavior differs from place to place.

Financial services firms are also starting to enjoy some good times. Foreign banking institutions are expanding their capabilities and services. Foreign insurance companies are starting to gain local market share by providing much-needed protection for Chinese consumers. And because the Chinese savings rate is a whopping 50 percent, financial services companies in particular are salivating at the opportunity to tap into Chinese household savings!

Selling to businesses in China is another huge opportunity. Just about every Fortune Global 1000 firm is now doing business there. Thousands of small- and medium-sized foreign companies are present, too. Opportunities for sales of business services to foreign companies operating there include management consulting, human resources, accounting, legal services, real estate, and so on.

Manufacturing and sourcing

Foreign investors have made China the world's factory. With a good supply of labor (and other lower costs) and high-quality production capabilities, China continues to attract foreign manufacturers. Because China is highly competitive on making products at a lower cost, many foreign companies look to source parts and components there. Some large foreign multinationals are moving their global procurement centers to China. As China moves up the food chain into higher-value products, more companies are procuring higher-quality products and components from China. Chapter 13 can tell you more about manufacturing.

In the meantime, China has made massive investments in the country's infrastructure. New airports, highways, bridges, tunnels, trains, and ports have sprung up across eastern China. This brand-new infrastructure has the potential to allow transportation companies to develop more sophisticated support services for logistics and express carriers, air cargo, and sea freight. Third-party logistics services in China are seeing explosive growth in supporting manufacturing-driven export services. (However, logistics and distribution are still highly fragmented and inefficient, as we discuss in Chapter 14.)

The sourcing capabilities aren't just for the benefit of large multinational companies. Small- and medium-sized companies are jumping on the bandwagon, too. They can now get access to high-quality products and components to stay internationally competitive. They can also avoid middlemen or buyer's agents to keep their prices even lower. Many small- and medium-sized companies are trying to secure their future by lowering costs while maintaining high quality standards. See Chapter 12 for details on sourcing.

Deciding Whether China Is a Good Fit for Your Business

Many traditional manufacturers face rising business costs. Spiraling wages, higher energy costs, and other cost-drivers have taken their toll. Manufacturers have seen others go under before them. As they look for ways to become more competitive, their eyes turn toward China.

Some companies are better suited than others for doing business in China. This section can help you and your company understand some of the important characteristics of a business that's likely to succeed in China. By taking stock of your company, you can evaluate your company's readiness for China.



Your company shouldn't go to China because everyone else seems to be going there. And going to China as the last resort — because your business is already on its knees — isn't a smart move either. Consider doing business in China for one reason: because it makes good business sense.

Considering your employees

Many companies take pride in the fact that they've been a local manufacturer in their home community. Some companies have been in business for several generations. These companies have created jobs for local people, and the company leaders are part of the fabric in the community where they live. Unfortunately, many of these companies are under extreme pressure to improve margins, lower costs, or boost productivity.

For companies like these and other less-established firms, going to China may be an option to seriously consider. But no company leader really likes to outsource jobs overseas. Restructuring your company while laying off loyal company employees is no picnic, either. And other political, ethical, or financial concerns about China may weigh on businesspeople like yourself.

Consider all your options — both in and out of China. As you begin to get a grip on the trade-offs for your business, you'll be in a better position to understand some of the likely consequences as well — and be prepared to explain your decision. Laid-off workers may find some consolation that they aren't losing their jobs simply because somebody else is willing to do their job for a much lower wage. Maybe doing business in China is a survival issue. Perhaps you need a growth engine for new sales. Whatever the reason, make sure you know why China may be your best bet.

Having international experience

Ideally, your company has some proven skills in successfully developing international business opportunities. This experience can be importing or exporting products to selected overseas markets. It may be managing overseas distributors of your products in Europe. It can be sourcing components from a supplier in Malaysia. Maybe you already manage a production facility in Mexico.



International business skills aren't necessary for doing business in China, but they're highly desirable. You have to be a very fast learner if you're new to the international business game and plan to make your mark starting with China. A company with no international experience can do well, but it needs to be extra prepared for what lies ahead. For more information on business planning, go to Chapter 4.

Getting company leaders on board

Some companies know that China is an option for their business, but the owners don't have the time, energy, or inclination to figure out how to make China work for the company. They don't know where to start. They don't have a roadmap to help them find their way. It seems all too foreign for the owners. And it seems way too hard. If your company leadership has this type of attitude, don't attempt to do business in China.



You need to have strong leadership that's committed to making your China business a success in the long-term. Without your company leadership's full commitment, the chances of failure increase drastically.

Having patient capital

Your China business will likely require a significant amount of financial resources to get started and to keep your business up and running. Most companies find that making a profit in China takes longer than it does in the West. Generally, you can expect getting profitable to take twice as long. In part, this delay is due to China's competitive business landscape. Getting to critical mass takes time, too. If your financials aren't at full strength, stay away from China — your company doesn't need to take on any more risks.

Dealing with the government and laws

To set up in China, your company should be comfortable working with government workers and officials. You'll face a lot of red tape with many permits and approvals required, too. And China's government bureaucracy has a well-deserved reputation for moving at a snail's pace. On top of it all, the government official you deal with today may be gone tomorrow. If your company isn't prepared for dealing with government bureaucracy, China likely isn't the place for you to do business.

China's business laws are quite different from what you're used to. Make sure you do your research and can get some good legal advice. Here's what you have to be ready for:

- ✔ Your company needs to have its various business activities preapproved and then stay within them (unless you want to get more approvals).
- ✔ The currency, the *renminbi* (RMB), has a lot of exchange restrictions, so you want to structure business in a way that optimizes your ability to repatriate money. (See Chapter 10 for details on money.)
- ✔ You're not allowed to own land in China — you may only own rights to use the land for a period of time. And the types of rights vary, so you have to be careful about which ones you're receiving.
- ✔ China has different systems for taxation, labor regulation, and resolving disputes (among other things).
- ✔ Many of China's laws are somewhat business-friendly. Getting to understand how they affect your company is imperative.



One area where China's laws are very weak is intellectual property rights (IPR) protection. Don't sell or manufacture in China if you need to rely on intellectual property laws alone to protect technology or processes. Go somewhere where you'll have more protection. See Chapter 17 for ways to protect your company's IPR.

Appreciating cultural differences

Different cultures do business in different ways. If your company has trouble adapting to new ways of doing things or respecting a culture that's different from your own, your company is probably not well suited for doing business in China.

On the other hand, your company's culture can also be its biggest draw in the labor marketplace — the Chinese are often hungry to work for foreign companies that offer more flexible and creative cultures than Chinese companies do.

Tracing the Path to Success

China is certainly not for the fainthearted. Many businesses over the years have tried and failed. Some foreign investors have failed more than once! The good news is that we know of many success stories in China, too. You can find the path to success — you just need to know where to look for it.

What this book can deliver is a great deal of hands-on experience and know-how about doing business in China. You need nerves of steel, the patience of a saint, and the cunning of a fox. But your company can win in China. We're here to guide you down the right path.

Getting the right knowledge of China under your belt

Before you get started in any new market, you need to get the lay of the land. Finding your way through the maze takes time. China's certainly like no market that you've ever done business in before.

The best way to look at the situation is to consider yourself a really big sponge. Soak up as much as you can find out about the China marketplace. Squeeze as much information out of good sources as possible. With the knowledge of what the business environment is like, how the government gets involved in business, and some of the market challenges you'll likely face, you'll be much better prepared for the journey ahead.



Don't believe just anyone who says he or she is an expert on China. The China market is way too complicated for anybody to be a true expert on business. (And because the market moves so fast, becoming out of date very quickly is easy.) We're here to serve as your guides, not your gurus.

To get a head start figuring out China and how to develop the right business plan for the market, check out Chapters 2, 3, and 4.

Starting your engine



Visit China a few times before you start making any decisions. The best information and advice in China comes from people who've done what you're trying to do — especially if they're only a little further along than you are. Put your feet on the ground just to do some networking. Take people out to lunch and pick their brains. Then start thinking about making some decisions. The more slowly you go and the more patient you are, the more information you'll collect and the better your chances of success. See the following section titled "Taking the first steps: What you can do today."

After you've broadened your knowledge of China, you're ready to get your business started. Some companies plunge right in with a real physical presence in China; others do business from a distance. Still others go halfway by setting up in Hong Kong. You have to figure out the right approach for your situation.

For newcomers to China, organizing a new company can be a real challenge. You'll soon be asking yourself what kind of company structure you need for your company's business in China. You have other considerations, too, such as geography.

And getting the right people in China can be a difficult task. You may encounter a shortage of talented managers with the right mix of skills and abilities. All this startup activity comes at a cost, too. If your company needs to be physically present in China, see Part II.

Getting down to business the Chinese way

When you first start doing business in China, you may think you've landed on another planet! But armed with an understanding of how business really works over there, you'll find it's not as hard as it seems. For information on the how the Chinese go about business, go to Chapter 11.

The hard part comes when your company starts to negotiate with the Chinese. They're tough as nails when bargaining, and they have a reputation for being some of the hardest-hitting negotiators around. *Cunning* is probably the best way to explain their style, which is very well developed but can seem outrageous and unprofessional to foreigners. To find out what you can expect when you sit across the negotiating table from the Chinese, go to Chapter 6.

Organizing your team for China

Putting a good team together in China is a balancing act. Many successful investors do well in part because they make sure their top one or two China managers are long-time company employees from home markets. If you're going to succeed in China, you have to ensure that your company's culture in China is foreign yet respectful of Chinese culture.

One must for attracting and retaining talent in China is to make sure you have a clear idea of how you can help your Chinese employees develop their skills and careers. You may find that Chinese employees are hungrier to learn than any other employees you've had. If you don't feed that desire — even for unskilled laborers — you're going to have problems with retention. To find out more about organizing your team, go to Chapter 9.

Remaining flexible while staying the course

Advising you to keep your eye on the ball with China would be wrong — you have to keep your eyes on a number of balls at the same time. Don't fixate on any one thing (such as minimizing taxes) while ignoring others. Don't marry yourself to any one strategy or plan, either.

You're learning, and you'll make mistakes. Don't be afraid to recognize and correct mistakes. Your operating environment can change at the drop of a hat, too. Be ready to make large and fast changes to keep up. Even though you likely have to change quickly and often, stay committed to China. Don't expect overnight success — you'll get there eventually.

Respecting the country for what it is

China can look modern at first glance — glass skyscrapers, Chinese with Western MBAs toasting fine wine at Jean Georges restaurant, and glitzy neon displays in downtown shopping districts. This setting may be interesting, but it's not China.

China was isolated from the Western world for the better part of three decades. It's an old society with an old culture. Although it's changing, the vast majority of China hasn't been transformed yet. Don't ground your expectations on your experiences in the West. Some things are easier in China, but many aren't.

You should give the Chinese some credit where it's due — dragging millions out of poverty and overhauling a plodding centrally-planned economy. Chinese society today faces many strains and has plenty of growing pains. Don't hold this against the Chinese — they're doing a pretty good job when you look at the challenges they face.

Staying on the lighter side

Keep your sense of humor about you. If you can't laugh at yourself when you're doing business in China, you're going to go crazy! Doing business in China may be the most challenging thing you'll do in your business career — humor helps to keep things in perspective.

Taking the First Steps: What You Can Do Today

Ancient Chinese philosopher Lao Tzu once said, “A journey of a thousand miles begins with a single step.” That's good advice for someone exploring the China market for the first time. This section can give you some valuable ideas on how you can get started now.

The right next steps to get you and your company headed in the correct direction aren't that difficult. Here are three simple steps to assist you in getting started on your journey:

1. Read.

A lot of information on China is in the media and online. You can find some good info from government and official agencies, such as your country's commercial or trade service and the chamber of commerce. Some countries offer specific China-related resources for businesses thinking about doing business in China. Check out what specific China information and services your home country government may provide.

Some of what you read may be of limited value. China is so big and diverse that generalizing about it is almost impossible. Moreover, some writers step off the plane, see modern buildings and new cars, and write about China as though it's as developed as Luxembourg. A lot of sources don't give you a realistic picture. Be wary of any literature that seems overly positive or overly negative on China.



2. Go there.

Take business trips to different parts of China. Consider visits to both large- and medium-sized cities to get a flavor for each. Go to a city in the north and the south. And perhaps visit a city somewhere in between, maybe a place outside of Shanghai.

Attend business networking functions while you're there. Go to some trade shows. Visit factories if you can. Look around, smell the smells, and observe keenly. Most of all, don't be too wide-eyed — try to scratch the surface and find out what's underneath.

3. Reach out.

The best people to meet are people who're doing something similar to what you want to do. Sometimes, the most informative contacts are only a few months ahead of you on the road. Arrange beforehand to see people you think may be helpful. Follow up with contacts you make while networking — even if they don't seem to know much more info that can help you (you never know who they know or may meet). By talking with others who have experience, you can start to piece together your plan. Be careful to get a diversity of viewpoints, though — don't overly rely on a few people for advice.

If we can leave you with just a couple of themes for the rest of this book and successfully doing business in China, they're patience, flexibility, and persistence. The more time you take to plan, or find a business site or partner, the better your chances of success. The better you are at quickly adapting to changes in the operating and regulatory environments, the more likely your success will last.

