Designing a China Business Framework

Looking to succeed in China? Align your strategy with the agenda of China's leaders.

by Robert Lawrence Kuhn

My work involves frequent and extensive interaction with senior executives of diverse companies doing or seeking to do business in China. During those candid and confidential discussions, I am struck by the common assumption that China's transformation into a market economy should translate into China's adoption of a Westernized style of doing business. Consequently, executives become viscerally annoyed, some even apoplectic, when they find doing business in China is troublesome, irksome and risky. When executives are slow to sense how business and government are intertwined in China with multiple layers of nuance, simplistic thinking can become a self-fulfilling prescription for frustration and failure.

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In some cases, these executives are from companies entrenched in China. Others are deciding how (not whether) to enter this vast, burgeoning market. All believe that an increasing percentage of their global revenues will come from China. While all are committed, none are satisfied.

This article offers an explanation of China's unique structure, culture and characteristics, both political and economic, which can be used to build a framework for generating meaningful revenues and profits in China.

A Politico-Strategic Framework

I call my framework for doing business in China "politico-strategic" because I seek the intersection between the corporate strategy of the firm and the political agenda of China's leaders, which in China has singular significance. Many large companies have "government relations" offices, but in China the term is misconceived and counterproductive because a "government-relations" mindset underrates the pervasive power of Chinese officials who are far more than regulators. A better way to think about the Chinese government is as a large corporation—"China Inc."

The "Office of the Chairman" of "China Inc." is the Politburo Standing Committee (PSC), comprised of nine senior leaders. Everything in China reports to one of these nine leaders. But the PSC is not like the U.S. Cabinet, whose members the U.S. president can replace for any reason at any time. The president of China—who is more meaningfully the general secretary of the ruling Communist Party—cannot replace PSC members, who are more or less equal, each with his own portfolio. This means that the philosophies and policies of these leaders exert great influence in China. This is why the watchword for doing business in China is "alignment"—and why "politico-strategic" defines this framework.

Foreign companies prosper in China to the extent that their strategies and operations facilitate or enhance the agenda of China's senior leaders. China's 12th Five-Year Plan (2011-2015) favors businesses that enhance standards of living (i.e. healthcare and education), encourage domestic consumption (i.e. consumer product companies), boost science and technology, serve rural markets, facilitate sustainable development and strengthen environmental protection.

It may seem odd that aligning with the objectives of China's senior leaders can make much difference to companies fighting in the myriad trenches of market competition. After all, when doing business in the U.S. it usually makes no matter if a firm's strategy is aligned with President Obama's agenda.

China is different. Because the Chinese government operates like "China Inc.," it oversees the activities of state-owned enterprises and even modulates private companies (which must always conform with policy) as well as maintains regulatory functions. All high-level officials, at central and local levels, and all senior executives of major state-owned enterprises are selected by the Party's Organization Department—and they are judged by their track record in achieving the objectives of the country's leaders. (For example, since leaders want a sustainable economy, governors are judged by how well they increase their province's ratio of GDP per unit of energy.) As such, to the degree that your company can advance the careers of senior officials or executives, your company can be favored.

Expect curves in the road: leaders change; agendas change.

Change of leadership almost always triggers a reset, major or modest, in overarching principles and policies. This means that assessing, finding and maintaining alignment is a subtle, continuous and dynamic process, and it must always skew to the number one person. This is particularly true for China's senior leaders, who in 2012 will undergo a complete change (likely led by China's current vice president, Xi Jinping). But leadership change also impacts ministries and state-owned enterprises. To the extent that your business is tied to a specific ministry or agency (or company), when the person at the top changes, one must reassess strategy to align with that new person.

Personally, I enjoy the creative challenge of figuring out how to align a multinational company's China strategy with the agenda of China's leaders. This can be done in two phases. First, seek new profit-seeking strategies, stressing core competencies and achieving long-term corporate goals. Second, seek novel ways to reposition current strategies so that they are more aligned with policies.

Expect curves in the road: leaders change; agendas change. Even companies who have been in country for 20 years or more are still only partially equipped to compete and win in China, says Sam Fouad, Ernst & Young America's emerging markets leader. "The China market requires long-term commitment and continuous adaptation to the priorities of the Chinese government." Doing business in China is ever dynamic.

Demystifying China

An understanding of the complexity, dynamism and subtleties of China is critical to building robust businesses there. At a minimum, companies that truly hope to thrive in China should seek to gain a grounding in the following seven areas:

- China's Future: Economic Prospects and Political Landscape. (China in 10 to 20 years. Can China sustain its remarkable growth? How fragile is China's system?)

- How China's Leaders Think. (Why senior leaders affect business, and how they do it.)

- China's New Generation of Leaders. (Who will take power in 2012-2013? How will new leaders deal with foreign companies? Which industries, geographies, structures will be favored?)

- Working with the Central Government. (Principles for aligning corporate strategies with China's leaders' objectives.)

- Working with Local Government. (Appreciating provincial politics and leadership. Seeking beneficial competition among local governments.)

- Chinese Media. (Media's surprising importance. Opportunities and pitfalls.)

- Special Issues for High-Visibility Companies.

These are not magic bullets. The goal is to shift the probability curve of likely success somewhat in your favor.

Perceived Risks

A survey of major companies doing business in China, conducted by Ernst & Young, generated the following risks (listed in order of concern): theft of intellectual property; difficulties in integration (acquisitions) or in collaboration (joint ventures); violations of Foreign Corrupt Practices Act; industrial espionage; government regulation after the deal is done; enforceability of contracts; reliability of information about counterparties; difficulties in performing valuations; government involvement in negotiations; lack of internal consensus within the counterparty's organization; renegotiation of the deal after it closed; repatriation of cash; export controls; scarcity of quality talent.

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Perhaps my favorite executive comment came from the head of business development at a medium-tech company. He complained vociferously about how tortuous it was to do business in China, but then cheerily reported that of his firm's last three acquisitions, all were in China.

A common question among companies entering China is whether to establish joint ventures with Chinese partners or to develop wholly owned subsidiaries. There are always trade-offs and reliable generalizations do not work. Each situation needs to be assessed on its own merits, using commercial due diligence and a politico-strategic framework. ■

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