

Chief Executive

What's China Really Thinking?

Robert Kuhn, a reformed investment banker with personal relationships at the highest levels of China's leadership, shares his thoughts on what CEOs need to know now.

By **Dan Bigman**

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No global issue has had more impact on U.S. CEOs in the past few years than America's evolving relationship with China. At a recent gathering of big-company CEOs in Washington hosted by Yale's Chief Executive Leadership Institute, 64 percent said that Trump's tough U.S. stance on China was justified, with 65 percent saying U.S. business has suffered from unfair Chinese competition. Yet, 58 percent did not think the President would achieve a trade deal with China this year, and 80 percent said they thought business confidence was suffering as a result of U.S. trade policy.

So how does China see it? And what does the increasingly authoritarian rise of President Xi Jinping mean for China's relations with American companies—especially over the long haul? For insights, we turned to Robert Kuhn, a reformed investment banker with personal relationships at the highest levels

of China's leadership, as well as decades of experience coaching American companies on dealmaking in the country.

How close is Kuhn to China's top leaders? Critics say he's too close. Put it this way: When President Xi recently celebrated the 70th anniversary of communist party rule with a massive military parade, Kuhn was invited to be the English-language commentator for Chinese television. *Chief Executive* caught up with Kuhn shortly before he travelled to China for the big occasion to ask him for his take on the situation—and what it means for American business over the next few decades. What follows is edited for length and clarity.

So how does China see the trade fight?

I guess the phrase that they use is fighting and talking, fighting and talking or sometimes talking and fighting, talking and fighting. It has sort of a friendly sound, but it means that there's a feeling that there's no resolution that will solve the problem and it'll go away and be back where things were about seven years ago or so, where everybody recognized both sides, but that's impossible. Secondly, there has been an intensive campaign in the Chinese media that says that China will never succumb to external pressure, U.S. pressure. China is too dignified, too proud and will continue to be strong and resist all U.S. pressure, and that's been a very continuous theme.

Some were quietly concerned that while that may have a salutary effect on reduced economic growth—which is already slowing—and therefore, prepare the people as if it's a nationalistic struggle. Human beings have shown that, in every country and every culture that we know of, people will put up with physical uncertainties or even hardships if their pride as a family, country, nation, race or whatever is affected. China is no exception. And because of its so-called century of humiliation—where it was invaded, oppressed and humiliated by Western powers and then, ultimately, Japan—in light of that, the nationalistic spark perhaps is brighter in China than in other places.

How seriously does China take the U.S. worries about IP theft?

That's a very important question, and that's what makes a trade deal doable because from China's point of view, they really do want to do it. It's not a subterfuge; it's not delaying tactics. If you go back, I don't know, 15 years or 20 years, China said they want to do it but really put no energy behind it because it wasn't on the high list of the things that they needed to do for their country.

But now it is a serious problem. China knows that in order to have foreign companies do business there and in order for China to be a center [for global business] it has to be a world-class center for IP protection, especially in science or technology. It doesn't mean they're able to do it as perfectly as they like. The problem is how is it enforceable? And what will the U.S. insist upon in terms of new laws or open books or some sort of an approach or snapback—if they find an exception—and who will be the judge?

China will not allow enforcement that makes it look like it's a schoolchild and the U.S. is the 40-year-old schoolmarm who's watching whether or not the eight-year-old child misbehaves. China can't have that kind of optics, but they can come to a deal where China is fully committed to IP protection in ways that will be publicly known.

But philosophically, a lot of this IP theft took place when they were a developing nation. Now, they're a developed nation. Do they have an understanding why people feel this needs to change now?

First of all, China is both a developed and a developing country. There are hundreds of millions of Chinese who are really poor and tens of millions of people in extreme poverty. So they actually say they're still a developing nation. In a sense, that's true. If you look at GDP per capita, it's under \$10,000. But on a selective basis, you have this bi-model where you have urban and rural populations in China, and the rural population is very substantially a developing country.

China is putting a lot of energy into that and wants to change that but the target dates are 2035 and 2050 for when their rural areas will be approximately in the same categories as the urban areas and China could be a developed country. In fact, China's own self-description would be that they will be a developed country—my words, not theirs—basically by 2035 and fully by 2050.

Nonetheless, your point about IP is absolutely right, and I think there is recognition of that. I've pointed out that a way to harmonize the U.S. position and the Chinese position—which seem gravely at odds—is by recognizing that they wanted to change over time. I use the WTO entry in December of 2001 as sort of the benchmark day they opened. At that point, China was a developing country, its GDP was \$1 trillion, a trillion and a half or something, and now it's 10, 15 times more than that. Over this time, there's been a dramatic change in China's position in the world economically. It's gone from just a couple percentage points of the world's GDP to, what is it now, 15? That accounts for

the discrepancy because in China, they said, “Why did the U.S. suddenly start a trade war or start to fight with us?” The U.S. point of view is, “Why did it take us so long to fight back?”

What don't most people in America understand about China and its long-term ambitions, and what should we understand? How does China see itself in the future?

I think you have to look at China's vision, particularly as it's articulated by Xi Jinping. From a domestic perspective, they have three targets, 2020, 2035 and 2050. 2020 is defined as the so-called moderately prosperous society, which has a rough GDP per capita of about \$10,000—it changes because of the currency rate—and it was technically double the GDP per capita of 2010.

Then, Xi Jinping added another feature that is very important in China today—it has motivated the country substantially over the last several years. He said that China cannot claim to be a moderately prosperous society, no matter how much the GDP per capita is if there is a single person in China who is living below the line of what they call absolute, or extreme, poverty. That's maybe an arbitrary line, and people who are living just above that we would consider still very poor. But that target has motivated an enormous output of resources and people's time, particularly at the local party level in making sure that every person in China is somehow brought above that level from 2010 to 2020, and they're pretty much on target to do that.

A critical component there would be what they call rural vitalization, which will bring up rural areas to roughly the equivalent of urban areas today, that is a huge difference, there is a three times difference in standards of living and they want to rectify that by mid-century. A second test would be they see themselves domestically by mid-century as having survived and jumped over the middle-income trap, so average GDP per person won't be at the level of Western Europe and U.S. even then, but it will be in the ballpark. Nobody quite defines what that is, but, certainly, the major urban areas will be at roughly the same level of standard of living of major Western countries, which puts a lot of pressure on the environment and other kinds of issues, so it sets up all these complicating questions.

[Under these plans] they stay an integrated country in terms of economic integration and efficiency—it's not a planned economy but it's a coordinated economy by the government—and you see that with Beijing, Tianjin and this new city of Xiaogan, which is just out of farmland. They're building a super-modern, 5-million-person, most-advanced-city-in-the-world kind of thing in terms of A.I. and social services and everything, literally from the ground up,

from zero several years ago. And then, similarly around Shanghai and the Yangtze River Economic Belt, and then in Guangdong with Guangdong-Hong Kong-Macau Greater Bay Area, they see those three as really three dragon heads that will lead the Chinese economy in this vision.

Then, they would like to see that China has a very high cultural level in terms of civic behavior and all of that. They would see, certainly, the party continuing monopolistic or perpetual rule and enforcing political stability, and they want to want to do all these other wonderful things. And I would say in science and technology, which is very important, China will—it's a little vague in the exact words—be a leader, if not the leader, in every field of scientific importance by that time.

What do you counsel CEOs about how this will impact doing business there over the next 10, 15, 20 years there?

I think you need to look at that timeframe to really understand where China wants to be. Because it is absolutely the case that China sees itself as not moving an inch politically in terms of the party giving up power, but really being creative and dynamic in becoming what they would like to be as the best place to do business in the world, or certainly among the best places, for sure.

In 2018, at the annual political meetings, they had a massive restructuring of the government and did some things that put the party more in control of everything, but one of the new institutions that they created de novo was the National Immigration Administration. They never had that before. One of the purposes of that immigration administration is to attract the best and brightest foreigners—which has made the U.S. so great. China has massive challenges for that, starting with language and cultural issues and the Internet censorship, those would be the top of the list of difficulties. But nonetheless, they want to make that attraction, and they certainly have been attracting handfuls of world-class scientists by giving them fairly massive research capabilities. Most of them have been overseas Chinese from China who became very distinguished scientists in the West for 20 years or more... and a few non-Chinese as well, but not many.

But that's how China would like to see itself. It's not just talk to diminish the sort of propaganda trade war thing—it's really part of China's strategy. They realized they have to do that in order to reach world-class capabilities as the center of business and culture and economics in the future. So, how can they do that? They are trying to figure out all different ways how to do it.

At the same time, they don't want foreign companies to blow over the Chinese companies, and they certainly want—at the same time, in every industry of importance—major Chinese players. But attracting foreign companies to China is absolutely a part of their plan, and so the opportunity for companies is to understand China's strategies.

The way the system works in China is that because the party is in absolute control and under President Xi in the last few years, it's even more so in every aspect of the country. What's called the CPC, Communist Party of China Central Committee, this organization appoints all the political appointees in the country below the politburo—all the ministers, governors, party secretary, heads of provinces, heads of cities and senior executives of all the major state-owned enterprises and within the provinces of the local state-owned enterprises. Virtually everybody in the country other than the private entrepreneurs are directly controlled by the organization department of the party. Their careers are judged entirely by how well they are fulfilling the current strategy, which is now Xi Jinping's.

So if you're a company, you can structure what you do—and that's what I spend a lot of time doing—to be consistent with that plan. You know, we're not talking about spending different kinds of money, just positioning and structuring and sometimes making subtle changes, so that the people that you work with will see your success as beneficial to their career because your success will be part of this overarching plan.

It's different today than it was 10 years ago, which was different from 10 years before that. So, some companies today, they can spend their lifetimes doing everything terrific and still they won't make any progress, and others will find themselves being better able to do business today than ever before because they have something that's really needed and are part of the strategic plan, even on a small level.

The translation of how your particular product or expertise translates into that, that's a case-by-case situation and some won't work today. If you want to produce computer keyboards or toys or socks at the lowest cost level, you shouldn't be coming to China today. You should go to Bangladesh or Indonesia or Vietnam or other places.

You've also said it's important to have the right expectations about market share and how to do these kinds of partnerships.

Five years ago, the emphasis was in joint ventures, so the advice I was giving then had to do with when you're in a joint venture because you had to be in a joint venture. The difference today is not on the political [side]—you always need to do the political [side]—the difference today is you don't necessarily need a joint venture. China will go out of its way to help you if you make sense in their plans.

You need to understand that if you're going to do business in China seriously, whatever size you are, you must put on your agenda having political relations on a formal basis. That's critical, no matter what, in China, and that's the uniqueness about China, but the exact structure today is actually more flexible, encouraged by the government, which wants to see expansion and greatly expand the economy in the future.

How does China see the emerging great-power competition between the U.S. and China?

I have asked that of a lot of people I know in China who are really smart about it and really see less of the severe competition than others, and feel that the way that both sides are positioning is counterproductive. I guess in terms of misunderstanding, I would use a single term, which is self-fulfilling prophecy. The danger is that—from the U.S. perspective—what we perceive China has done in the past will cause us to create certain kinds of rules or regulations or activities, which will in China reinforce the people who say that the U.S. is trying to contain China and to keep it down.

So you have a positive feedback circle that creates self-fulfilling prophecies and negative results on both sides, so it's a race to the extremes in terms of antagonism. That's the great danger, and it's equal on both sides, that each side, as we can see, makes decisions in reaction to what it thinks the other side is doing, which confirms in the other side their worst fears, which makes them do things, which re-confirms your worst fears—and it spirals downward. That's the danger.

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