Remastering the Art of Doing Business in China

BY ROBERT LAWRENCE KUHN

For foreign companies in China, the game has changed.

Five years ago, I wrote an article called "Mastering the Art of Doing Business in China." It was my first for *Chief Executive* and it dealt with the tactical details of doing deals in China, especially the subtleties of relationships. Since then the world has changed. China's rise has been astounding. As 2006 began, China's foreign reserves were just over $800 billion. Today they are approaching $3 trillion. At the same time, the financial crisis undermined the economies of developed countries, boosting China's relative strength.

China's senior leaders, especially the new generation, who—coming to power in 2012-2013—have a grand vision of China as an emerging superpower, particularly in economics and trade, and this requires industrial transformation. China's leaders must also grapple with China's biggest, most intractable problem—economic and social imbalances between rich and poor (urban vs. rural, coastal vs. inland).

China's leaders recognize that for China to complete its historic modernization, its domestic market must expand dramatically. Two factors drive this. First, the Chinese people, ever more vocal (especially on the Internet), demand more of the fruits of their country's success. Second, China must never again be held hostage to economic crises in other countries by being permanently dependent on exports.

What this all means is that for foreign companies in China, the game has changed. Simply bringing capital is no longer sufficient. China has capital, including, recently, many private equity firms and diversifying sources of funding. What also no longer works are low-end manufacturers leveraging lowest-cost labor, especially if their processes are energy intensive or in any way polluting. Sure, deals can be done, but not as in the past.

Today, many companies want to enter China, but the landscape has a new shape. Some companies should not even try—running uphill is not good strategy. For others, the converse is true: the time is propitious because they have what China needs—and now China can and will pay for it. (It is not always obvious which companies fit today's China. Surprises are common.)

Hence, in advising international clients on doing business in today's China, I use the following guiding principles for optimizing success.

ROY SCOTT

Alignment with Senior Leaders

My watchword can be encapsulated in a single word: Alignment. Foreign companies will succeed in China to the extent that their China strategies are consistent with the principles and policies of China's senior leaders, particularly China's new leaders. (Note that this can mean modifying one's corporate strategy or simply presenting the unmodified strategy in a congruous, inside manner—either or both.)

China claims that a prime benefit of its one-party system is that principles and policies can be set long-term with minimal risk of reversal (It is hard to lose an election when there are no elections). Thus, when business executives set China strategies, they can be confident that current principles will prevail (even if policies that express these principles continue to evolve).

Following are principles of China's leaders with which foreign companies should align: increase domestic consumption; increase social services for the masses (particularly healthcare, including pharmaceuticals and medical services); increase high technology capabilities; attract and develop world-class talent (particularly in science, technology and management); favor inland and rural areas; build world-class Chinese companies in every industry of importance; and develop strong Chinese brands. (High-tech priority fields include IT, biotech and agritech, advanced materials, advanced manufacturing and automation technology, energy, water resources, oil and gas, environment technology, alternative energy, and disaster prevention and mitigation.)

Sometimes, problems are slippery. One multinational, a world leader in its industry, had obtained all the approvals and endorsements needed; all the company did not have was business and they could not figure out why. The answer was that China was determined, long term, to build its own world-class companies in this industry and it would not have a foreign company thwart this overarching mission by dominating China's domestic market. Alignment here meant discerning how the success of the foreign company could increase, not decrease, the likelihood of building strong Chinese companies.

On the surface, this would seem a contradiction, a zero-sum game. The key was to invert conventional wisdom and have the foreign company help its domestic competitors—an anathema in normal markets. But because of China's unique growth, and its appreciation in world capital markets, a counterintuitive solution made financial sense.

Strategic Principles

Following are strategic principles that are now working in today's China:

Assess every strategic move by testing it against the policies, and expected policies, of China's leaders.

1. Alignment. This heads the list. Assess every strategic move by testing it against the policies, and expected policies, of China's leaders. Emphasize competitive strengths that support alignment. I stress alignment and I enjoy figuring out how to achieve it in diverse industrial settings (sometimes with out-of-the-box thinking).

2. Complementary Interests: Seek Chinese partners or business allies that can use your company, its resources and products, to bolster their own competitive positions in the market. Many Chinese companies, having grown large and confident, worry about domestic competitors, not foreign competitors. This means that if your company can help a Chinese company in its bruising domestic battles, you can cut a good deal. (Be warned: it will not be the deals of old, as valuations and sophistication of Chinese enterprises have skyrocketed.) At some point, however, Chinese partners or allies will likely have interests that diverge from your own. This presents strategic challenges, but recognizing them upfront enables subtle structural adjustments.

3. Target Provinces and Municipalities. Local governments in China, in fierce competition with one another, compete to attract foreign investment and can offer very attractive support (in one form or another).

When I'm representing multinational companies, I like to arrange a kind of informal auction among local governments, exploring with three or four. (Foreign business executives may be dumbfounded to find that the local boss, usually the Communist Party secretary, is more like a deal-doing investment banker than a Mao-suited ideological watchdog.)

4. Be Important. When working with local entities, whether governments or companies, target managers at the proper level so that what you bring to the table is meaningful to them. Balance their capabilities in your market with their perception of your relevance. A powerful partner to whom you are not important might look good in board presentations but will not work in the real world.

5. Recognize Relationships. Individuals remain key to doing business in China. I generally start with governmental officials who, in one way or another, are central to a client company's success. This is high-maintenance work. Usually only the foreign CEO can meet the number one person on the China side—China respecting hierarchies and protocol—and thus to do serious business in China, the CEO must visit China on a regular basis. When Hank Paulson was running Goldman Sachs, he came to China more than 70 times.

6. Be Vigilant. China is dynamic; uncertainties and high variances are the rule, not the exception, so that ongoing monitoring is essential. Scan regularly for early warnings of potential disruptions. Just because your business is running well today does not mean that it will do so tomorrow.

All foreign companies have a China strategy—whether they know it or not—and many should be active there. But doing business in China is only for the committed, not for the casual. If that's you, remember my watchword: Alignment. ▲

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