

EDITED BY ANURADHA DAYAL-GULATI AND ANGELA Y. LEE

KELLOGG

ON CHINA



STRATEGIES FOR SUCCESS



Kellogg
School of Management

FOREWORD

I have been teaching business strategy for more than twenty years, so very few comments from my students really surprise me anymore. But a few years ago I was shocked by one of my graduate students, a young American executive who had just returned from Asia. This gentleman had earned a master's degree in business administration from one of the most prestigious business schools in the United States. I asked him how well he felt his business education had prepared him for the "real world" of international business. He proceeded, very bluntly, to tell me that everything he had learned in his top-rated M.B.A. program was utterly irrelevant in Asia—and especially, in China.

Perhaps I should not have been so surprised. His professors no doubt did their best to provide their students with the most effective business education grounded in a curriculum based on the most successful system they knew: the western, or American, system. In retrospect, both the school and its faculty can be excused for a bit of cultural and institutional tunnel vision. After all, the system of enterprise they took as their blueprint, that is, the American model, had created by far the most powerful economic engine in history.

We must remember, too, that only a few short years ago every western politician, business executive, and economist believed, quite firmly, that an unleashing of the merciful powers of capitalism would be the salvation of eastern Europe. It was widely held that once the political obstacles were removed, an American-style, market-based, profit-driven system of business and economic growth would simply replace the centrally planned economic systems behind the Iron Curtain. Unfortunately, when these countries did adopt capitalism,

what occurred was not so much an ascent into a paradise of western-style consumerism, but rather a descent into a chaotic, Wild West kleptocracy (to borrow a term from Thomas Friedman) that very nearly brought the former Soviet states to their knees.

The Russian experience has been instructive: it signaled to business interests everywhere that the American model, at least in its purest form, might not be an appropriate socioeconomic model for all areas of the globe. China presents perhaps the most complex dilemma for western business interests, because it has so incredibly little in common with western Europe, the United States, or even Japan. The Chinese ethos—and Chinese business methods—present an entirely new set of challenges for western business managers and investors because the fundamental mismatch between West and East is not economic but cultural. More, the issue of China can no longer be avoided; China is already well on the road to economic superpowerhood. As one western businessman put it: "China is too complex to solve—but too big to ignore."

Indeed, it would be foolhardy to underestimate the potential economic impact of so vast a nation. Currently the world's fifth-largest trading power, China has averaged better than 7 percent real economic growth for each of the last twenty years. The country has become a veritable factory to the world, with a 50 percent share (as producer or consumer) in such industries as steel, textiles, and consumer electronics; it will soon occupy a commanding position in many more. Its 2003 agreement with the Association of Southeast Asian Nations (ASEAN) members creates a new economic entity that could develop into the world's largest free-trade zone, encompassing some two billion consumers and more than a trillion dollars in trade.

It is not surprising, therefore, that China has become a magnet for business interests worldwide. However, these investors and managers—including some of the most sophisticated and forward-thinking multinational corporations in the world—must prepare themselves to modify significantly their current definitions of business success. Indeed, China may be able to avoid many of the bumps and bruises suffered by Russia on the road to the free-market

government at all levels and with customers of all kinds, and working to achieve long-term stability.

Undeniably, the American enterprise system has fueled the global economic engine, but to China (and most of the East), the system is too narrowly confined to economic spheres, with investors and financial interests dominating corporate, cultural, social, and governmental decisions. The effects of such a system are at times bizarre by Chinese standards: How can a company's value increase when it eliminates ten thousand jobs? The Chinese believe that development of their country must strive for economic efficiency—but not at the cost of social-political stability. Instead of overnight reform or immediate liberalization, they prefer patience, gradualism, and conservatism. The Chinese agree with Thomas Jefferson: Delay is preferable to error.

Perhaps the most challenging problem facing expatriate investors in China is not “market socialism” or even the fact that the underlying culture is foreign to their way of thinking. It is that, today, Chinese society and business seem to be in constant flux, a situation that presents tremendous uncertainties for business planners.

China's hybrid industrial system, for instance, is in constant tension, pulled one way by private enterprise, which employs 30 percent of the workforce and produces 70 percent of the goods, and another way by state-owned enterprises, which employ 70 percent of the workers to produce the other 30 percent of goods. As the economy continues its transition toward a market orientation, both enterprise types will undergo major changes as native Chinese managers are forced to focus less on production quotas and guaranteed employment levels and more on industrial efficiency and market development. Meanwhile, overall industrial planning in China (which until a few years ago aimed mainly at encouraging labor-intensive industries to maximize the country's labor cost advantages) has begun to concentrate on developing industries that demand highly skilled and educated workers.

Another challenging issue is China's entrance into the WTO, which western observers hailed as a great victory for the world economy. However, the issue of China's full engagement in the

system. China, unlike Russia, will not adjust *to* western capitalism; rather, it will actually adjust western capitalism.

Consider the many ways in which China has already begun to influence capitalism as we know it. Currently, western investors are not confronted with pure socialism in China, but with a hybrid socialist-capitalist system: "a socialist market economy." This system is one shaped by institutional concerns rooted in thousands of years of Chinese history. It is, for instance, influenced by the country's personal and business connections and by an extensive network of overseas "business families" (which, incidentally, constitute a formidable economic power in their own right).

For the most part, western businesspeople have been raised to believe, almost unquestioningly, in the supremacy of their business culture and its practices. As financiers, investors, and managers, many have never worked outside the system into which they were born. Consequently, westerners tend to view China and the Chinese market not only as an alien system but also as one riddled with wrong-headed inconsistencies and contradictions.

In sharp contrast, the Chinese were raised in one economic system, were revolutionized into another, and watched as yet a third evolved. Their original business system derived from their care for relationship and respect for family, the fundamental social and economic unit. With the advent of socialism, the basic hierarchic structure remained intact, but patriarchal authority was ceded to the government. Some twenty-five years ago, China began its economic liberalization campaign, and modern western-style business ideas began to take root in the form of market socialism, a form of government-sanctioned entrepreneurialism. Now, having gained entry to the World Trade Organization (WTO), China seems to be gingerly approaching the adoption of a western-style economic system.

From the West, we see a fundamental contradiction in the Chinese "socialist market economy." For the Chinese, however, there is no contradiction. The traditional Chinese business yardstick (reinforced by more than fifty years of socialism) fully embraces multiple "bottom lines"—creating jobs, contributing to community well-being, maintaining good relationships with

world economy brings with it a host of complex consequences, far beyond the merely economic. It must not be forgotten, either, that while China has become a formidable economic power in a short time, it is still hampered by inadequate infrastructure and vast differences in regional economic development. In addition, at this stage of its development, it remains heavily dependent on foreign investment.

As an example, this volume invites us to consider the special economic incentive zones developed throughout the country by the Chinese government. These zones, designed to attract investors, offer subsidies and special tax treatments for multinational corporations that choose to locate in the designated areas. But these zones had the effect of creating a dual tax system. As tariffs decline with WTO membership, this presents the government—and foreign investors—with a dilemma. Should the playing field be leveled and the incentives eliminated (thereby endangering future investment), or should all taxes be lowered to the rates in the incentive zones?

Furthermore, as more multinational corporations choose to locate in China, the overall competitive pressure will intensify, and the effectiveness of existing regulations and commercial laws will increasingly be called into question. In one example cited in this volume, a multinational corporation now complains that it is allowed to keep its young workers for only a few years, since Chinese law requires them to return to their native towns in the interior of the country. Such cross-currents present new and complex challenges to any company interested in participating in the Chinese economy.

Fortunately, there are encouraging signs that the Chinese system is incorporating new initiatives to make things easier for expatriate investment. As pointed out in the following chapters, Pudong, in response to the burgeoning software industry in the city, has become the first Chinese city to create an intellectual property division in its court system. In addition, the Chinese government is training provincial-level officials in WTO rules and regulations as they relate to foreign investment—a clear sign that we can expect increased transparency in bureaucratic decision making. Another signal to note is that China is opening wider its import doors, with

its reduction of tariffs on Hong Kong imports and its ASEAN agreements. And there is a strong movement at the management level to meet the future needs of the country. As expatriate managers learn to work within the Chinese business culture, Chinese professionals, in record numbers, have begun to enroll in western-style and western university-affiliated M.B.A. programs.

Finally, one of the more encouraging signs is the publication of this volume—a clear demonstration that U.S. business schools not only recognize but celebrate the global opportunities and challenges China presents. (China is now among the leading countries hosting international study tours for many western M.B.A. programs.)

In what most people recognize as the typical “American” style, this book identifies the problems—but emphasizes solutions. This book is not an academic treatise but a close examination of the economy and a guide to its business practices. It is, in effect, “a how-to” manual based on practical, effective procedures of some of the multinational corporations that have proven successful in their Chinese business ventures. The material presented in these chapters includes strategic approaches to start-up situations as well as lists of simple but experience-proven “dos” and “don’ts” across a variety of industries. It should be noted that the book’s survey of expatriate investors is designed to be useful not only for other foreign investment sources but also for Chinese officials who wish to find out what attracts and sustains western investment.

Without doubt, this book will be helpful to both sides of the cross-cultural business exchange. China’s entrance into the WTO has exposed the gaps between eastern and western business practices and has demonstrated the need for a new, refined enterprise system to bridge the gulf and enable both Chinese and U.S. interests to conduct business on a truly global basis.

The Chinese way of doing business and China’s “socialist market” economy will continue to challenge—and frustrate—many western businesspeople. It may also provide an opportunity for the development of a new sort of business model, one that could make “globalization” a reality instead of a bumper-sticker slogan. U.S. businesses can be justifiably proud of the accomplishments of capitalism. The system has worked wonders for two hundred years.

However, it must not be forgotten that Chinese business enterprises have also worked rather well—for almost five thousand years. Therefore, when we talk about China's emergence as an economic power, we should remember that from their point of view, the Chinese are thinking about their *re*-emergence.

To achieve genuine globalization, as well as strong relationships and an enduring presence in China and other emerging economies, business enterprises will need, ultimately, to develop programs able to balance the needs of a diverse array of interests and parties. As in diplomacy, so in business: While the two ways of doing business come into closer contact, the United States and China can accommodate and learn from each other and perhaps develop a common platform at the enterprise level—a platform that fully recognizes western and eastern institutions and differences and draws on their respective strengths.

As we view the world economy, it is clear that the two giants, China and the United States, must either become strategic partners or strategic competitors—or perhaps a combination of both. When will we know the outcome? As we remind ourselves that that the Chinese economic system is five thousand years old, going on twenty-five, we must give the same answer the Chinese ambassador gave to the French ambassador. At a state dinner, the Frenchman asked his Chinese guest, "What do you think about the impact of the French revolution?" The Chinese ambassador replied: "It's too early to tell."

Ming-Jer Chen

E. Thayer Bigelow Research
Professor of Business Administration

The Darden School,
University of Virginia