



The ten principles for doing business in China

Everyone is opening shop in China because “it’s the place to be.” Before you sign the lease, read this...

Since the 1840s, Western companies have dreamed of the riches a country as large and - since 1978 - as dynamic as China would generate for them. Some have succeeded: General Motors would have found it much harder to re-emerge from bankruptcy without its profits from China. Many, though, have found the going to be tough and the rules of the game, difficult to comprehend. The following are ten insights intended to help your business be successful in its China operations.

1. Do your homework.

When China operations get into trouble, a lack of preparation is a common theme. It is surprising how many businesses decide to enter China because everyone else in their industry is going or because a key decision-maker was impressed with Shanghai. Entire generations of management consultants have lived off sorting out the resultant messes. What you need is hard-nosed, agnostic, data-driven analysis of your business potential in China, just as you would do it for any other country.

Get your top management team to take a week off to go to experience China. In China, take them outside the usual experience of Audi limousines and luxury hotels and arrange for exposure to experiences relevant to your business - for example, do store checks or visit private homes of average citizens.

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Take the team to a fourth-tier city and to the countryside for a more holistic picture.

2. Beware of industrial dynamics.

A common cause of losses in China is that foreign firms are so focused on market growth rates that they neglect the basics of competitive analysis. In the beer industry, for instance, more than 20 foreign brewers entered in the mid-1990s, each of them planning to capture on average 15 percent of their market segment. In a market lacking clear differentiation, they also found themselves competing with around 600 local brewers, many of them subsidised by local governments. Some expected these issues to disappear over time, but almost twenty years later, the fundamental situation has changed little. Many industries in China resemble the beer industry, with overcapacity, high levels of fragmentation, subsidised local competition, and foreigners willing to absorb losses from their “strategic” investments.

3. Take your time.

Many companies want to get on the ground quickly. In one case, the CEO told his head of strategy to get China operations going within six months. Time pressure of this sort can create problems later on. It tends to result in sloppy planning and analysis. It

shifts the attention from finding the right partner to finding any partner, regardless of partner fit. Moreover, it weakens your hand in negotiations. Your Chinese counterpart will know how to use your time constraints against you, and you will walk away with a worse deal.

4. Chinese society is collectivist.

Conventional wisdom and cross-cultural management studies, such as Geert Hofstede's seminal work, emphasise the collectivist nature of Chinese society. However, visitors to China often remark how individualist they find behaviour to be. This seeming contradiction is the result of a conflation of collectivism with widespread cooperation. Chinese society is collectivist in that individuals identify with an "in-group" consisting of family, clan, and friends. Within this, cooperation is the norm. Outside it, zero-sum competition is common.

As a result, self-organised, as opposed to hierarchically imposed, cooperation can be difficult to achieve—an issue epitomised in Sun Yat-sen's famous observation that China is a "tray of loose sand." In addition, zero-sum competition means that your Chinese counterpart may not believe in win-win solutions. One can observe this, for instance, in the tendency to re-open negotiations just as everything seems settled, especially if one seemed too ready to agree with the negotiated terms; one's counterpart may interpret this as an indication that s/he has not bargained hard enough.

5. Mistrust and opportunism are endemic.

There are two opposite ways of extending trust. One is to trust until given reason not to; the other is not to trust until there is enough evidence of trustworthiness. China takes the latter approach. The zero-sum competition already noted creates an incentive to take advantage of people outside the in-group. China still lacks reliable and impartial mechanisms to check such behavior, such as a well-functioning legal system. This opens the door for opportunistic behaviour.

As a consequence, the Chinese tend not to trust people outside their in-group. Take your cue from them. The absence of a reliable system to ensure fair outcomes means that you can encounter difficulty in enforcing contracts to the letter, and you should take suitable countermeasures, such as cash on delivery.

6. Trust is interpersonal and takes time to build.

A common safeguard against opportunism is to build relationships of trust with persons who matter for your business. Unlike in the West, the creation of

personal friendship is a prerequisite of doing business. Building friendship takes time, which is another reason to avoid rushing into things. Besides numerous invitations to sports and other events, one key element in building trust is long dinners during which everything but business is discussed. In these, alcohol plays an important role. Learn to drink intelligently. Seasoned negotiators dispose of the alcohol into their water glasses or into the wet towels most good restaurants make available.

7. Notions of "out-of-bounds" behaviour do not necessarily match.

Chinese negotiators occasionally push beyond what their Western counterparts consider appropriate bounds. For example, the representatives of a large Western firm were negotiating the distribution rights for one of their products. Their Chinese counterparts closed their initial pitch by threatening to use their political connections to prevent distribution of their products if they did not receive the rights. In another case, the Chinese party got their Western guests drunk to prevent them from being effective in negotiations the following morning (which, on the Chinese side, involved a completely different set of people).

Be alert and prepare suitable countermeasures. For instance, negotiation teams should learn how to drink without getting drunk, include women (as they are not expected to get drunk), and know that the heavy drinking can be delegated to one of the team members.

8. Chinese society is hierarchical.

Company decisions are typically reached in a top-down manner, with only the very top of the pyramid involved in decision-making. Mistrust puts limits on delegation, and supervisory control at each level is high. Mid-level managers typically have little power to make decisions of consequence, and their main role is to pass on orders from the top and ensure execution.

Be aware in negotiations that the decision is ultimately made at the very top. If your counterpart is not part of that group, s/he is typically not authorised to make major decisions but must report back to the top for instructions. Also make sure your representative matches the status of his or her counterpart. Important dimensions of status are formal position, age, and education. Once you run your business in China, be mindful of the limitations to delegation.

9. Government in China is decentralised and in important respects, bottom-up.

Conventional wisdom holds that China's

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governmental structure is highly centralised, with all key decisions made in Beijing. In reality, Beijing directs little of what happens throughout the country, especially in far-flung regions. To be sure, if Beijing truly wants something to happen, it will. At the same time, Beijing recognises that decentralisation of power plays an important role in taking economic reforms forward. By running things in a slightly different way, the thousands of localities throughout China constitute a large population of local experiments collecting information about what works. From these experiments, the central government can select suitable future policies.

Expect conditions to vary by location. In addition, to the extent you need to negotiate with government, it is crucial to involve the local government. Even if you have agreement from Beijing, if the local government wants to thwart you, it will.

10. Be conscious of the large picture.

Most of the growth in China since 1978 has come from private small and medium-sized enterprises. Today, they make up about 65 percent of Chinese GDP. Moving forward, policy-makers are keen for China to produce its own large multi-national enterprises, and government is re-asserting its role as the key orchestrator of these initiatives. A group of about 100 state-owned enterprises - those under the tutelage of the State-owned Assets Supervision and Administration Commission - is being groomed toward that end. Government ownership - or at least partial control - and support also appear in many of the new industries being put together under apparently local and private initiative.

You should know whether any of these targeted firms are active in your industry. If so, fierce competitive battles seem likely for the future, and easy access to state money for these firms means the playing field will not be level. Government may be on your side as long as your technology is needed. Keep this in mind when selecting a partner for cooperation or considering market entry.



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