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From the Practitioner's Corner Entrepreneurial Hunger—Shall We Try Chinese?

Joseph E. Levangie

Many entrepreneurs are able to manage their businesses within relatively contained and familiar geographical and cultural circles. With a world economy shrinking every day amid a flood of digital information, today's entrepreneur is increasingly confronted with opportunities to consider new ways to secure vendors and recruit customers. Many unfamiliar possibilities emerge. Should the entrepreneur venture beyond "comfortable" surroundings to consider international connections? Specifically, what about China? How practical is this fetching business temptation of larger markets and lower-cost subcontractors? What are the social, trade, financial, and political issues? Should a "China strategy" be a true entrepreneurial offensive, or rather a defensive response to competition? Is this "China strategy" the promise of yet another entrepreneurial nirvana? Or is it perhaps again a case of "Be careful of what you wish for; it may really come true?" Read on...

Entrepreneurial veterans in New England have generally fed their new-business-venturing appetites over the years by exploiting those major business opportunities available locally. Termed "paradigm shifts" by academics who know such things, these industry upheavals emerged in New England in the 1960s and 1970s in concentrated subregions such as the Boston area's Route 128 ("America's Technology Highway") and later Route 495. Defense contractors (Raytheon, AVCO) and universities (Harvard, MIT, BU) were the source of spin-offs in a variety of technologies needing commercialization; markets were emerging for computers, medical devices, biotech and information technology; and there was sufficient capital to feed the resultant entrepreneurial hunger.

By the 1980s, the entrepreneurial infrastructure in the New England region was fully in place. To illustrate the intensity and localization of entrepreneurial activity, at one time I was simultaneously involved in five early-stage ventures that were all within 5 miles of my office. With such geographical concentration, it was not too difficult to become self-deceived into believing that Boston (and environs) was the "Hub of the Universe." When the London capital markets became highly attractive in 1984-1985, for example, I became involved in taking Boston companies public "across the pond." Those exhilarating experiences caused me to acknowledge that there were arguably some smart people and high-quality entrepreneurial deal-making activities out-

side of our own little neighborhood. The lesson learned: We shouldn't always breathe our own vapors!

The Internet has served to make the world smaller and more accessible. International trade statistics reach new record levels every quarter. Entrepreneurs are reacting to these trends in a typically aggressive manner. What's an increasing stimulus to entrepreneurial taste buds? China! Chinese trade issues pervade our daily consciousness. China is a nation with a GDP nearly equal to America's, with four times the population! Its literacy rate is 83 percent, compared to India, for example, with its 52 percent literacy rate (Thomas 2003). What does China mean to the New England entrepreneur? While I don't pretend to be a "China expert," I have been bombarded by a continuous stream of facts, figures, and case studies on China—providing entrepreneurial food for thought. Let us examine the following business concerns about China in the same (metaphorical) way that we might check out a Chinese restaurant:

- How appetizing does China rate in terms of trade activity, vendor quality, and business climate? ("Zagat overview")
- What is the range of available markets, industries, companies, and products? ("Menu options")
- Who from "our little world" has partaken of the Chinese experience? ("Local patrons")
- What negatives lurk behind the scenes? ("Problems in the kitchen")
- What unexpected positive trends in the China story remain unpublicized? ("Chef's surprises")
- How does one buy into the Chinese business opportunity? ("Franchising opportunities")
- What lessons can be learned? ("Doggy bag thoughts")

The Zagat Overview

What's the Big Attraction to an Entrepreneur Investigating China?

All discussions about China start with the obligatory reference to its 1.3 billion population. The Chinese economic landscape is really much more than that. Unless you've been cloistered in a monastery since the Reagan administration, you have increasingly been bumping into a myriad of sophisticated products from China. China is no longer a poor foreign country with mostly uneducated peasants. As Zakaria reports (2005), in the last 25 years China has been able to transition some 300 million people out of poverty and has

quadrupled the average person's income. While latent xenophobia might make some people envision Chinese huddled in little cottages still eating with chopsticks, we should also acknowledge that their booming professional class is building a high-tech infrastructure and is creating an information society tailor-made for American entrepreneurs. Old perceptions must now give way to new realities. Most of the DVD players, microwave ovens, shoes, and toys manufactured in the world today are made in China. In 2002, China joined the World Trade Organization. Now it seems as if the entire world economy is gravitating toward this highly populous, low-cost country.

The surge in China trade has been nothing short of astonishing. Zakaria reports that China's exports to the United States have grown by 1,600 percent over the past 15 years and U.S. exports to China have grown by 415 percent. Fifteen years ago, Pudong, in east Shanghai, was undeveloped countryside. This area is now Shanghai's (and China's) financial district—eight times the size of London's new financial district. Shanghai has 4,000 high-rise buildings, nearly twice that of New York City.

The economic implications of China are significant. Consider just one U.S. retailer—Wal-Mart. In 2004 (Zakaria 2005), Wal-Mart imported \$18 billion worth of goods from China. Of Wal-Mart's 6,000 suppliers, more than 80 percent (5,000) are from China. For the American entrepreneur, a small subset of this type of Chinese trade activity can be quite alluring and may merit consideration.

What Are the Statistical and Regional Dimensions of this Chinese Economic Buffet?

The Chinese trade option has become increasingly popular and statistically significant (Fang 2005):

- China's gross domestic product (GDP) increased from \$1.1 trillion in 2000 to \$1.6 trillion in 2005 (6th largest in the world).
- Its Foreign Direct Investment (FDI) increased from \$38 billion in 2000 to \$55 billion in 2004.
- Communications between China and the rest of the world are improving. Chinese Internet users have grown from 22.5 million in 2000 to 94 million in 2005.

Throughout China, a variety of its major cities and 31 provinces underscore the diversity of its consumers, products, and workers. The country is certainly not monolithic. As reported by Caufield and Shi (2005), these are several hot spots for the entrepreneur to consider, as follows (traveling north to south along China's east coast):

- *Liaoning* is attracting high-tech to a province once known for heavy industry
 - Population = 42.4 million
 - Per capita GDP = \$1,570

- Foreign investment = \$4.3 billion
- Investors: Accenture, Canon, Ford, GE, GM, Mitsubishi, Omron, Toshiba
- *Beijing* as the capital it is also China's largest software production center
 - Population = 13.8 million
 - Per capita GDP = \$3,351
 - Foreign investment = \$5.1 billion
 - Investors: AT&T, Bayer, Hitachi, IBM, Microsoft, NEC, Oracle, Xerox
- *Tianjin* is China's cell-phone-manufacturing hub and fastest-growing regional economy
 - Population = 10 million
 - Per capita GDP = \$2,665
 - Foreign investment = \$3.8 billion
 - Investors: Honeywell, Hyundai, LG, Motorola, Samsung, Yamaha
- *Shandong* is a booming province with growth in consumer appliances and oil
 - Population = 90.8 million
 - Per capita GDP = \$1,406
 - Foreign investment = \$6.5 billion
 - Investors: Daewoo, LG, Lucent, Samsung, Toyota
- *Jiangsu* produces one quarter of the world's laptops and major parts for the digital camera and auto parts markets
 - Population = 74.4 million
 - Per capita GDP = \$1,739
 - Foreign investment = \$10.8 billion
 - Investors: BASF, Fujitsu, Motorola, Sony
- *Chongqing* is China's automotive center, as well as a source of chemicals and pharmaceuticals
 - Population = 30.9 million
 - Per capita GDP = \$767
 - Foreign investment = \$450 million
 - Investors: BP, Ericsson, Ford, Honda, Philips, Suzuki
- *Shanghai* is China's commercial and financial center and a hub for steel, semiconductors, and autos
 - Population = 16.7 million
 - Per capita GDP = \$4,913
 - Foreign investment = \$5 billion
 - Investors: Alcatel, Ericsson, Exxon, Mobil, GE, GM, Intel, Siemens, Volkswagen
- *Zhejiang* is the chief silk-producing province and hosts light industries like textiles and electronics manufacturing
 - Population = 46.8 million
 - Per capita GDP = \$2,001
 - Foreign investment = \$4.7 billion
 - Investors: Hankook Tire, Motorola, Nokia
- *Guangdong* produces shoes, toys, appliances, and electronics for export

- Population = 86.4 million
- Per capita GDP = \$1,815
- Foreign investment = \$13.1 billion
- Investors: BP, Coca-Cola, Honda, Nestle, Procter & Gamble, Shell, Wal-Mart

What's the Nature of Conducting Business in China?

China's business environment is eccentric, if not chaotic. Entrepreneurs who have experienced the China business climate, when asked to describe the best plan of attack for other aspiring New England deal-makers, smile knowingly much as if to enjoy a private joke. There's no simple answer to the Chinese puzzle. Ahmad (2004) suggests that when it comes to doing business in China, the first rule is to throw away the rulebook, along with all the B-School cases and texts and basically all Western MBA theory. To quote Chairman Mao, "There is great disorder under heaven. The situation is excellent." This aphorism underscores the lesson all foreign businesspeople should understand. The Chinese smell profit in chaos!

Many of the challenges an American entrepreneur might encounter in China emanate from the irrational nature of the Chinese business environment. Three factors are at play:

1. **Bureaucratic.** When the Communists took over the imperial civil service, they overlaid the complexities of party organization on existing governmental inefficiency.
2. **Legal.** China abides by the "rule of man" instead of the "rule of law." Rather than statute-based boundaries, in China certain rights to act and conduct business derive from political influence and the power of the individual. Conflict of interest, rather than being an ethical dilemma, is viewed as a competitive edge. Personal connections ("*guanxi*") are critical in pursuing commerce in China.
3. **Cultural.** The China business landscape presents many speed bumps: a difficult and imprecise range of languages and dialects; choking pollution; inadequate transportation, lodging and other accommodations; vast geography to navigate; and often gruesome working conditions. The major cultural challenge, however, is interpreting the sometimes-puzzling attitude of Chinese businesspeople. Notions of profits and "cracking the best deal" seem to take a back seat to psychological "game-playing" where game points are seemingly scored in a series of face-saving maneuvers and negotiating ploys. Deception is part of the process. For example, in an important decision-making meeting that an entrepreneur-friend of mine attended, the unnamed (and un-introduced) note-taker in a golf shirt sitting in the back of

the room actually turned out to be the Chinese company's CEO! Emotions and deceit can often overshadow typical (Western) business logic in deal making.

What's the Role of State-Owned Enterprises?

While the mostly inefficient, state-owned enterprises (SOEs) are still a substantial part of the Chinese economy. SOEs tend to be large basic-industry entities. In China's northeastern "rust belt," for example, SOEs still represent 70 percent of the region's GDP, as reported by Ahmad (2004, p.105). In March 1998, the then-new Chinese prime minister Zhu Rongji enunciated the doctrine of *zhuada fangxiao* ("grasp the big, let go the small") to restructure state-owned enterprises. Simply put, the government wanted to control the biggest and most significant companies and let the smaller ones go it alone. As a result, the ensuing period witnessed turbulent restructuring. Many of China's SOEs have been incorporated and listed on stock markets. Mergers, restructuring, and shutdowns have reduced the number of SOEs from 262,000 in 1997 to 174,000 in 2001.

A majority of China's SOEs were losing money in 2001. Moreover, for a typical SOE, average current assets had risen to 319 days of annual sales, suggesting that working capital was most likely plagued by uncollectible trades receivable and unsaleable inventory. Government control of these SOEs has obviously been more important than profitability. It is more an issue of power and prestige: promote the good SOEs; ignore the rest. Specifically, the government now hopes that the elite SOEs can be championed on the world economic stage to help China become an industrial superpower. Among the so-called SOE "stars" are

- PetroChina—oil/gas
- China Mobile—mobile telecoms
- Sinopec—oil/gas
- CNOOC—oil/gas
- Baosteel—steel
- China Aluminum—aluminum
- Shanghai Auto (SAIC)—cars
- Legend—PCs
- TCL—TVs/electronics
- Qingdao Haier—White/brown goods

The Menu Options

Where Does the Entrepreneur Start in Making Choices Concerning China?

Where to go? What to order? The range of business possibilities in China, like the counterpart menu in a Chinese restaurant, has limitless options. And like a Chinese menu, it is more than a little overwhelming just to get started. The entrepreneur must develop a plan of attack and determine functional areas of interest. An entrepreneurial American company

investigating China trade might consider manufacturing, engineering, or selling opportunities.

- *Manufacturing.* Basing a plant in China involves careful consideration of local area development plans. Each major city and province has identified the industries it wants to emphasize and nurture. (The U.S.-China Business Council summarizes much of this at www.uschina.org.) Since communications and transportation support are less than reliable, operations should be sited close to vendors (and clients, if they are located in China). Business-friendly coastal regions (see “hot spots” above) are the best places for the entrepreneur to consider to site a plant. An alternative to siting a plant is outsourcing, in which the entrepreneur uses local Chinese contactors to make products (or parts), perhaps cheaper and quicker than is possible by building a plant. In any case, it is important to work closely with local officials, who typically earn “bonus points” for dealing with foreign investors.
- *Engineering.* For high-tech entrepreneurs, it is important to acknowledge the undeniable surge in talented engineering students being educated in China’s universities. Recent graduates are trained in a wide range of hardware disciplines, from semiconductor engineering to product design. Software design capability is still constrained by language issues, but increasingly Chinese students are learning English and thereby improving their software design value.
- *Selling.* For a small American company to establish a market presence, China is simply too big, too patchy in infrastructure and too bureaucratic to be tackled on a national basis. Only a focused strategy to garner bite-size pieces of domestic Chinese sales can succeed. For every American entrepreneur with a clever business plan to sell consumer products in China, there might well be 1,000 Chinese entrepreneurs ready to knock-off a duplicate product at lower prices and margins. Attention to branding, partnering, and niche marketing can forestall and nullify such competitive threats. American industrial products—such as specialized capital equipment to help support the growth of Chinese manufacturing and high-tech process capacity—should have a better chance of success than “me too” products.

What Is the Status of China’s Major Markets and Industries?

What menu options might be appetizing to the American entrepreneur? Major markets of economic activity in China include energy, textiles, automotive, high-tech, and countless “other” segments. My various readings on Chinese markets and my discussions with successful American entrepreneurs already established in China only serve to emphasize how

complex these entrepreneurial challenges are. To whet one’s venturing appetite, however, I offer the following thumbnail sketches as illustrations of what might be on the menu:

- *Energy.* The United States faces increasingly stiff competition from China in the pursuit of energy resources. Fang (2005) reports that China’s energy mix comprises coal (66%), oil (23%), hydroelectric (8%), and natural gas (3%). Our national media have chronicled the China National Offshore Oil Corporation (CNOOC) and its off-and-on quest for American oil company Unocal. This kind of Chinese M&A activity is somewhat off-script. Rather than the more typical Chinese bid for American technology or brand names—as has been the case with Lenova’s takeover of IBM’s laptop computer line or Haier’s bid for Maytag—the CNOOC-Unocal pursuit has been steeped in geopolitical and national security policy considerations. From the entrepreneur’s vantage point, however, “smaller is better.” Energy as a basic natural resource is predominantly Big Company business. For smaller entrepreneurial firms, however, excellent targets of opportunity include: alternate energy (photovoltaics, wind, fuel cells); the infrastructure that supports energy distribution; and electric utility grids. For example, a Boston company that I know outsources to a Chinese manufacturing partner \$2 million of annual work for component parts to supply the U.S. electrical utility sector. Three people in Massachusetts manage the Chinese partner’s 57 people (including 3 electrical engineers) in Guangdong province. A net annual savings of \$800,000 is being achieved.
- *Textiles.* In 2005, the WTO brought to an end a 40-year-old global textile-quota system regulating China’s textile and clothing exports. All the antecedent conditions are present for China to lead the world in textiles. Chinese labor rates are 90 percent lower than those in the United States and Italy, and the Chinese workers can process piecework faster. China imported (Fong 2005) \$3.5 billion of textile-related capital equipment in 2004, a 275 percent increase over the 1998 total. Despite on-going debates on tariff and import quota issues, the sheer scale of Chinese factories make it quite possibly “very attractive” to the American entrepreneur engaged in high-volume garment sales. Even “High Fashion” is exploiting the Chinese cost advantage. Many high-end European fashion labels are outsourcing to China: Celine’s Macadam collection of handbags, Francesco Blasia’s line of handbags, and Hugo Boss’s \$500 suits.
- *Autos.* McKinsey (2005) predicts that China—already the fourth largest car market with domestic sales of 2.3 million cars in 2004—will overtake Germany in 2005 and Japan by 2010. America with 17 million cars per

year, it is also suggested, could also be caught soon after! The Shanghai Auto Show in April 2005 unveiled problems for foreign car firms looking to penetrate the Chinese market. VW has seen its 40 percent Chinese market share in 2001 fall to 20 percent in 2004. GM saw its sales drop 35 percent and profits drop 80 percent in 2005 (first quarter). The shifting competitive dynamic stems from new realities: previously, Roberts (2005a) reports VW and GM sold mostly to SOEs, where price was not a paramount issue. More recently, buyers in China have been individuals seeking value. Further, a rumor persists that Beijing is contemplating a big-engine car tax. The real areas in which foreign firms have been underperforming are: (1) implementing much-needed cost cutting and (2) establishing market distribution networks. For the American entrepreneur, most of this Big Company auto agony is good theater, but irrelevant. Auto *parts* are much more of interest. China's ongoing auto part supply activity can feed all types of American companies. For example, low-cost subassembly auto parts examples ranges from Delphi parking-brake components to Johnson Controls seat covers. Given the October 2005 Chapter 11 filing by Delphi, the auto parts market in China has become that much more interesting. A small Massachusetts firm that I know is considering a major play in the hybrid electric vehicle (HEV) component market. As appropriate, sub-assemblies of the components will be fabricated in China.

- *High-Tech*. How many of us had an IBM PC as a first home computer? The fact that Legend (of China) subsidiary—Lenovo Group—purchased IBM's PC division, with the help of McKinsey consultants and Goldman Sachs investment bankers, speaks volumes about our changing international economy. American entrepreneurs might consider the menu of other China high-tech activities.
 - *Laptops*. Dean and Tam (2005) report that China assembled 68 percent of laptops worldwide in 2005, including providing parts like hard disk drives, power supplies, magnesium casings, and liquid crystal displays.
 - *Internet*. Chinese firms are active in web-related ventures (Einhorn 2005). In 2004 Shanda Interactive Entertainment, a Shanghai gaming innovator, raised \$100 million in an IPO (whose post-IPO share price rose 2.5 times); Ctrip.com (on-line travel reservations) placed a \$40 million IPO in 2003 (its shares then doubled in price); and Tencent (Instant-messaging service) completed a June 2005 IPO for \$200 million. Responding to this in-country entrepreneurial activity, American firms like MSN, Google, Yahoo, Expedia, and

eBay have been joint-venturing with their Chinese counterparts to stake out a piece of the market growth.

- *Mobile Phones*. Shi (2005) reports on a clever entrepreneurial pursuit by Chaliyuan, a three-year-old Beijing-based manufacturer of cell phone recharge kiosks. Chaliyuan has installed 75 percent of China's 65,000 kiosks which recharge cell phones for 12 cents in 10 minutes, and last 8 hours. The current installed base of cell phones in China is 340 million, nearly twice that of the United States. The venture economics appear attractive. The "juice bars" cost around \$1,700 to install and generate an average return of \$2,000 annually.
- *Contract Manufacturing*. Dean and Tan (2005) report that large segments of the American high-tech world are outsourcing portions of production to China. Hundreds of thousands of Chinese workers support these contract manufacturing activities. In 2004, 8 of China's 10 biggest exporters (by value) were foreign ventures making PCs or other high-tech devices.
- *Other Segments*. What else is interesting on the Chinese menu? Here's a small, eclectic sampling of how American and Chinese markets are interacting.
 - *Diamond Polishing*. China has carved out a growing role in diamond polishing, as reported by Bradsher (2005a) With a skilled, organized labor force and automated process steps, China has advanced to third place in world ranking (after India and Israel) in diamond polishing. China imports \$800 million of diamonds, and the process of polishing adds value to \$1.1 billion.
 - *Shrimp Exports*. China ranks behind only Thailand as a shrimp exporter to the United States, as reported by Kerber (2005) This market is complicated by U.S. agricultural biotech firms which want FDA guidelines to govern their use of protein-based feed additives.
 - *Theme Parks*. The September 2005 opening of Hong Kong Disneyland represents, according to Fowler and Marr (2005), a \$3.2 billion investment to address China's 290 million consumers under the age of 14. Disney's decision to charge adults a \$45 entry fee will, of course, limit access for many. With regard to the park's food menu, the controversial plan to serve shark's fin soup—a Chinese favorite for two centuries—has outraged environmentalists, who believe the world's shark population will be decimated. This clamor yet again underscores the clash between Western sensitivities and Chinese tradition.
 - *Advertising*. Since the 1979 lifting of government bans on advertising, the ad industry in China has grown to \$16 billion in 2004, as reported by Balfour (2005). Still, cultural peculiarities abound. For example, KFC's

Colonel Sanders does not resonate as a meaningful image with the Chinese, and Nike's slogan "Just Do It" conflicts with the Confucian admonition against youthful individualism. These cultural differences must be considered in establishing brand image in China. The top brands (in \$ millions of advertising) are listed in Table 1.

<i>Brand</i>	<i>Product</i>	<i>\$ in Millions of Advertising</i>
Oil of Olay	skin cream	698
Gai Zhong Gai	calcium tablets	441
Rejoice	shampoo	419
Crest	toothpaste	281
Sanjing Pharmaceuticals	drugs	266
China Mobile	cellular	259
Aoqili	soap	256
Head & Shoulders	shampoo	249
Huangjindadang	vitamins	237
Colgate	toothpaste	230

Experiences of Local Patrons

Much of the meaningful due diligence we conduct in life tends to be more anecdotal than analytical. To check out a new restaurant (metaphorically), we may look at the Zagat's review, but we also ask our friends and neighbors what their experiences may have been with the new establishment. Similarly, to assess the China trade opportunity, we can, of course, delve into tomes of trade statistics. To relate more personally to this "foreign opportunity," we also can examine the "hands-on" experiences of companies we either know firsthand or "know of" because they are in our backyard. A sampling of companies (local to my office) shows China activity in a variety of categories, as follows:

• Manufacturing

- *Morgan Construction* (Worcester, MA) makes equipment (Stein 2005) used to produce steel and has a plant in China where Morgan has reduced its average labor rate from \$20 to \$2.
- *SatCon* (Boston, MA), a \$40 million a year technology company, outsources hundreds of motors per month to a manufacturing partner in China, substantially improving product margins.
- *Midnight Pass* (Marshfield, MA) is a \$2 million a year, eight-year-old gift and recreational product retailer. Midnight Pass has outsourced to a Chinese contract manufacturer to avoid investing in capital equipment. The company has experienced recent problems main-

taining the contract manufacturer's attention, which is being diverted to a larger client.

- *Circor* (Burlington, MA), a valve and fluid-control maker, recently acquired the 40 percent share of its former Chinese joint venture partner for \$6.75 million to gain control over management policy, financial controls, and investment decisions (Qualters 2005).
- *Watts* (North Andover, MA), a water valve maker, made a similar move to Circor's, needing to gain control of its joint venture to permit additional investment to fuel growth.
- *Consulting and Software*
 - *Eleven Technology* (Cambridge, MA) develops software for hand-held devices to assist sales reps and distributors manage sales and inventory. The company has expanded to China (Suzhou region) to save 75 percent on development costs and to open up the China market (Heires 2005).
 - *EastBridge Partners* (Boston, MA) has offices in Suzhou and advises smaller companies on how to navigate entry to China. It sees the American outsourcing to China for manufacturing and electronic components as expanding to encompass all markets;
 - *LEK Consulting* (Boston, MA) has a China practice, with an emphasis on medical devices.
 - *Bain* (Boston, MA) views China as its most important growth market. In mid-2005, the company held a meeting for 200 Bain partners in Shanghai. It plans to double the size of its China presence in 2005 (Ellis 2005).
- *Medical Devices*
 - *AgaMatrix* (Cambridge, MA) makes glucose-monitoring devices. It has its product prototyping done in China, reducing the time to market by 60 percent, with a cost savings of 75 percent (Heires 2005).
 - *Dialectrics* (Chicopee, MA) produces plastic components for other medical devices firms' products and just set up a plant in China with a joint venture partner from Taiwan.
 - *Nypro* (Clinton, MA) also makes plastic products for medical devices, but has been in China for 30 years where it employs more than 7,000 in 14 plants.
 - *Smith & Nephew Endoscopy* (Andover, MA) is growing its China market, but has refrained from any manufacturing in China.
- *Electronics and High-Tech*
 - *Implant Sciences* (Wakefield, MA) has sold 101 explosive detection devices to the Chinese Railway Administration through its Beijing distributor (Light 2005).
 - *3Com* (Marlborough, MA) made a \$160 million investment (Soule 2005) in a Chinese joint venture with a

Chinese competitor to Cisco Systems (network equipment).

- *Other Markets*

- *Trash.* Municipalities in Massachusetts (and other states) are doing a booming business in selling their corrugated cardboard and scrap metal to China, which has a huge appetite for trash.
- *Transportation.* In 2004, 36,000 passengers from New England flew to Beijing and another 28,000 flew to Shanghai, generally through New York City or Chicago. Massachusetts (Massport) is trying to work a deal with Hainan Airlines to provide direct service. Massport resumed its direct China containership business in 2002 (Bailey 2005).
- *Sports.* The New England Patriots (Talcott 2005) football team is venturing with Sina.com, one of China's most popular websites, to provide football news and football tutorials in Mandarin (provided by a Chinese student at MIT). Former Boston Red Sox pitcher Bruce Hurst has been an adviser to the Chinese national baseball team. Reebok launched NBA-branded basketball shoes in 2002.

Possible Problems “In the Kitchen”

Due diligence is the lifeblood of any good entrepreneur. This concern for background facts is particularly key when approaching a very large potential partner. Entrepreneurs are often required, for example, to approach mega-corporations to initiate potential strategic contracts, technology licensing, marketing agreements, equity investments, or joint ventures. Always surprising to me is the entrepreneur who simply barges into the Big vs. Small fray without doing appropriate homework on the current climate and touch and feel of the larger company (an entrepreneur-friend of mine calls this the case of the mouse crawling up the leg of the elephant with intent to rape!). My personal experience with such endeavors constantly reaffirms the efficacy of knowing what's going on behind the published earnings reports of the Big Company.

- What are the Wall Street analysts saying about the Big Company and what are their expectations for the Big Company regarding new products and new markets?
- Who are the key first-level and second-level managers? Who is the heir-apparent to the CEO, and what new (entrepreneurial?) projects might be appealing to the inside “go-getters?”
- What Big Company soap-opera developments might actually be germane for the entrepreneur to know about—say, imminent reorganizations, plant openings/closings, or key-person distractions (illness, divorce, family feuding, etc.)?

These background issues—or “Problems in the Kitchen”—

suggest an analogous due diligence construct that the entrepreneur might employ before approaching a Giant Dragon like China. Before an entrepreneur decides to have a widget made in China, he or she should consider the governmental, social, geopolitical, and economic context of doing business in China. Some cynics contend that the Chinese miracle is not “real” until adequate social and political reforms are implemented. Before bullying in to China, the entrepreneur should investigate the sociopolitical climate. As the fortune cookie suggests, “A peek is worth a thousand finesses.”

Does the Chinese Government Still have Considerable Control over Non-SOE Business Activities?

Of course. Unlike countries such as Germany, Great Britain or Australia, where there is an obvious separation of government and business, China presents to the American entrepreneur a continuing black cloud of “Big Brother” in the background, pushing many of the key buttons and levers that regulate business. Consider, for example, the media industry, as reported by Fabrikant (2005). Big companies like Viacom reach 10 million Chinese homes with its MTV network; and Nickelodeon programming on the government CCTV network is available to 120 million homes. Nevertheless China's Propaganda Department, the Ministry of Culture, and a host of other agencies present obstacles to small independent foreign film makers and animation companies. Some of this bureaucracy is political, and some is blatant economic protectionism to help nurture Chinese companies. Examples like this abound for most other industries as well. Ironically, the flip side of the regulatory-intervention coin is governmental inaction, as China turns a blind eye to the continuing violation of intellectual property rights and refuses to constrain widespread pirating and counterfeiting—practices that cost American industry more than \$200 billion a year, according to Becker (2005).

What Social Issues Represent the “Hot Buttons” to Which the Entrepreneur Should be Sensitized?

Entrepreneurs would be well-advised to be sensitized to the current cultural climate in China. The short list of key social issues in China includes:

- *Energy and the Environment.* As reported by Bremmer (2005a), China spends three times the world average on energy to produce \$1 of GDP because of its reliance on coal for 70 percent of its energy needs. Outdated coal-burning technology produces only 40 percent efficiency. China lacks natural gas, with only a 3 percent contribution to its energy mix. Regulatory codes and emission standards are largely ignored. Reports abound concerning industrial waste from

chemical factories polluting air and water. Lynch (2005a) reports that the environmental/geo-social cycle becomes self-defeating: people relocate from affected regions and crowd into already crowded urban areas; a lack of clean water shuts down factories, costing what the World Bank estimates to be \$14 billion in lost output; and environmental injury costs China 8 to 15 percent of its annual GDP. The government would like to reverse this migration, away from the urban coastal regions and back into the countryside. Regional economic agency incentives reinforce this objective. American ventures in the area of energy and environment must certainly confront these social dynamics. Any American venture wishing to locate in China must be aware of existing natural and financial resources, and environmental concerns.

- *Population and Sexual Concerns.* China's transition into the 21st century has been accompanied with its full share of social problems. As one amusing example, university regulations against one-night stands in the dorms with escort girls or gigolos have backfired into a growing incidence of public sex which has become a raging fad in some urban areas. Krovatin (2005) reports that surveys show that the Chinese are the most likely to agree to unprotected sex with a new partner; 30 percent of Chinese who contract HIV do so through unsafe sex according to UNAIDS. According to French (2005a), some of the estimated 48 million Chinese gays and lesbians are coming out of the closet. Until recently, homosexuals were treated as dissidents who were either criminals or mentally ill. Still, the ruling Communist government remains "in the bedroom" with its one child population control policy and its intolerance of those activists who campaign against the state's forced sterilization and abortion programs. The American entrepreneur would be well advised to avoid any casual reference to sexual or population issues.
- *Lingering Religious Intolerance.* The Communist Party does not abide by the ancient proverb: Man's schemes are inferior to those made by heaven. As reported by Clayton (2005), the broadcast of the funeral of Pope John Paul II over CNN went blank for 35 seconds when the anchor started to discuss the status of Roman Catholics in China. (As a personal note, I find this particularly noteworthy, since an Irish cousin of my mother's, Bishop Edward Galvin, founder of the missionary Columban Fathers, was evicted from China in 1952 by the Communists after 40 years of heroic missionary service there, including enduring several years of incarceration "as a criminal of the state.") In any case, the American entrepreneur in

China should focus on deal-making, not missionary work.

- *Linguistic Confusion.* China has 55 ethnic minorities, as reported by French (2005b). China's Han, the ethnic group that comprises 90 percent of the population, speak as many as 1,500 dialects. While the national language is Mandarin, only half the population can speak it. The linguistic differences among Chinese dialects are much higher, for example, than the differences among European languages. In the Fujian Province, south of Shanghai, the constant migration of ethnic groups over the years has resulted in the expression, "If you drive 5 miles, the culture changes, and if you drive 10 miles, the language changes." American entrepreneurs visiting China generally need a friendly, "connected" escort to help in linguistic "pot hole" avoidance.
- *A Workforce in Flux.* According to Hutzler (2005a) the number of worker protests in China has been growing at 17 percent per year, reaching an estimated 60,000 in 2003. These labor disputes have been in response to state factories being privatized and the loss of job security and benefits. Pensions are limited; only 20 percent of Chinese workers are covered, as reported by Roberts (2005b). The national pension system had a shortfall of \$6.2 billion in 2005, which could reach \$53.3 billion by 2033. As a result, China is likely to extend the current retirement age from 55 for women and 60 for men, to 65 by 2030. The worker skill mix is also of concern. In particular, the management talent pool is undersized. The number of world-class executives to meet industry growth must increase from an estimated 3,000 to 5,000 in 2005 to 75,000 over the next 10 to 15 years, according to Lynch (2005b). This shortage of capable management can be expensive to entrepreneurs looking to hire top-notch bicultural talent. The compensation package for Western-educated Chinese nationals is now in the same stratosphere as New York City investment bankers!
- *Growing Social Inequities.* For many Chinese, Communism has been the only governing force in their life. The state has been their "security blanket." Sweeping market reforms have started to alter that security, broadening the gap between rich and poor. Unbalanced economic growth has generated extensive dissatisfaction among farmers and laid-off workers who resent the rise of the "private sector." As reported by Lynch (2005c), during 2004, 3.8 million Chinese participated in 74,000 demonstrations over issues such as unpaid pensions, official corruption, and environmental concerns.

Does China's Growing Presence in the Geopolitical Arena Represent Potentially Ominous Overtones for the American Entrepreneur?

Many cynical China observers suggest that China wants “to eat America’s lunch, if not its dinner!” The China “military threat” frequently referenced these days by political experts is possibly the precursor of a new U.S.–China Cold War based on mistrust, misinformation, and misjudgments. Washington’s hot and cold relationship with Beijing warmed with Nixon’s visit to China in the 1970s, and suffered through the shock of the post-Tiananmen Square period. Now there are growing economic and political tensions. Chinese warships display their might in the East China Sea near the gas fields in dispute between Japan and China. Recent Pentagon reports (King 2005) suggest that the Chinese military harbors ambitions beyond defending its historic claim to Taiwan, and that China’s military planners are guided, if not inspired, by China’s “Warring States Period,” an era of preunification strife about 2,300 years ago. China’s tradition is to amass its strength while attracting a minimum of attention.

In terms of present-day reality, China’s military spending was up 12.6 percent in 2005 (Cohen 2005)—undoubtedly one third to one half the true figure, since R&D and overseas purchases are not included in the total. The issue of North Korea is doubly confounding. It should go without saying that New England entrepreneurs engaged in military R&D for the U.S. government, holding a top-secret clearance classification, should tread carefully when entering China.

Importantly, all visitors to China should be wary of terrorism, particularly in the predominantly Muslim northwestern Xinjiang region. As 2008 Olympic venues are completed, foreign visitors could be targeted by terrorists.

Behind China's Robust Economic Growth Trends, What Are the Lurking Problems?

China–U.S. trade statistics are startling. The American trade deficit with China for 2004 was \$162 billion! Dominance in trade is a growing issue. At a time of rising protectionism in the U.S. Congress, China appears to be a flag-bearer for free trade. In late 2005, China was pursuing free-trade pacts with 25 countries, up from zero in 2003.

Several negative conditions with the fire-breathing Chinese (economic) dragon may be worrisome to American entrepreneurs contemplating business dealings in China.

- **Currency Revaluation.** In July 2005, the People’s Bank of China, as reported by Bradsher (2005b) raised the value of the yuan by 2.1 percent, to a yuan/dollar rate of 8.11. The U.S. trade/currency issue with China is fascinating. The U.S. trade deficit has approached \$700 billion. In effect, the U.S. is exporting electronic dollars, and China (and other countries) is sending the U.S. widgets.

Then China takes those dollars and buys our debt, helping to keep our interest rates low. Currency issues may not, however, be the overriding cause of the U.S. trade deficit, since eventually, with continued upward revaluation of the yuan, the U.S. demand for goods would just be shifted from China to other countries. The local concern is that the upward revaluation of China’s currency can hurt New England small businesses outsourcing to China by increasing costs and lowering margins. On the flip side of the currency issue, of course, are New England firms manufacturing states-side and competing against cheaper Chinese imports; they want upward currency revaluation.

- **Counterfeit Products.** In a sense, the trade deficit could be construed as an indirect measure of how well American companies—including New England entrepreneurs—are doing in importing Chinese goods, exploiting China’s low-cost manufacturing. The trade deficit is, however, exacerbated by Chinese pirating of American intellectual property, depriving U.S. companies of income.
 - In the software area, Fishman (2005) reports that the Chinese use nine bootleg software packages for every legitimate one, resulting in a loss to the global software industry of \$3.8 billion.
 - China’s counterfeit trade is worth upwards of \$80 billion (U.S. Commerce Department).
 - Based on 2002 data, 91 percent of DVDs and video discs in Chinese homes are pirated.
 - With new peer-to-peer (P2P) streaming TV technology, China is leading the world in pirated on-line pay TV, according to Fowler and McBride (2005). This case of technology outpacing international law enforcement is clearly a threat to the U.S. cable TV industry (\$57.6 billion in 2004) and the satellite TV services market (\$18.5 billion in 2004).
- **Corrupt Banks.** As reported by Bremmer (2005b), China’s banking system has been plagued with scandals of loan fraud and embezzlement. Consider the negative impact of corruption on the Big Four state-owned banks.
 - *Industrial and Commercial Bank of China* required a \$30 billion government bailout in 2004, with its 20 percent rate of bad loans.
 - *China Construction Bank* needed \$22.5 billion of government capital in 2003; has been pursuing a possible \$8 billion IPO, comanaged by Morgan Stanley. (More on its potential privatization in the “Franchising” section.)
 - *Bank of China* also needed a \$22.5 billion 2003 bailout; has an alliance with Royal Bank of Scotland, which has a \$3 billion stake in the bank with a provi-

sion for payback if the bank fails to go public within three years.

- *Agricultural Bank of China* supports the farm sector, but has 30 percent of its loan book underwater; will need a huge government bailout.
- *Troubled Stock Market.* The Chinese are learning about the vicissitudes of public equity trading. Barboza (2005a) reports that the Shanghai and Shenzhen stock exchanges, where the 1,400 SOEs are listed, were down 40 to 50 percent in 2005 from 2001 highs. A \$15 billion bailout fund has been suggested.

Chef's Surprises

Every so often we may experience the joy of the unexpected—like the time my company staff dragged me over to the old Joyce Chen's restaurant in Cambridge and, off-menu, we were served an elaborate Peking duck banquet feast that I can still savor in my mind. We all love pleasant surprises (e.g., beating sales and profit forecasts is always smile-inducing!). It appears that China has a few "chef surprises" of its own in the following areas of significance to the entrepreneur:

- Medicine
- Alternate energy
- Consumer protection
- Individual freedoms
- Advanced computing

What Medical Advances Are being Pioneered by China?

Since Chinese scientists benefit from regulatory standards less restrictive than in the United States, labs in China can fast-track their investigations. As reported by Morrison (2005), the UK's Department of Trade and Industry determined that China is at the world's leading edge in stem cell research, and engages in "significant recruitment" of U.S. and other Western scientists, luring them with incentive packages that involve greater scientific freedom and well-funded research centers. Another Chinese medical research community is addressing severe acute respiratory syndrome (SARS). Chen (2005) reports that in December 2004, the Chinese Academy of Medical Sciences and Chinese biotech company Sinovac completed successfully a first-stage clinical trial on a SARS vaccine. The academy's research group has developed a protein chip to detect antibodies against the SARS virus, and has established analytical techniques for diagnosis, involving SARS serum mass-spectrum fingerprinting, and enzyme-linked immunosorbent assay (ELISA) test kits. New England's bio-pharma community needs to monitor these developments.

What Is China Doing to Improve Its Terrible Record on Energy Efficiency?

In addition to competing with the West for fossil fuels, China

appears to be taking the longer energy view toward renewables. Chen (2005) reports that the Solar Energy Institute at Shanghai Jiaotong University has built a prototype house with photovoltaic cell arrays, wind turbines, heat pumps and solar water heating panels. Given the solar insolation¹ in Shanghai, the goal is for the sun (and wind) to provide 70 percent of the needed energy. In the transportation sector, the research group for clean-energy automobiles at the College of Automotive Engineering at Shanghai Tongji University is developing a line of research cars that have independent electric drives for each wheel. These "Chunhui" (or "Spring Sunlight") cars are powered by lithium batteries and hydrogen fuel cells, with only water vapor as an emission. New England's robust alternate energy industry should take notice of China's initiatives (both offensively and defensively).

What About Consumer Protection in China?

Consumers can be lured and duped by businesses. My generation was brainwashed to believe that Wonder Bread builds bodies "12 different ways" and that we should "walk a mile for a Camel!" Ironically, in those days U.S. products that were deemed simply too dangerous for our own consumption were dumped on China and other Asian countries. More recently, however, the rise of American consumer groups and special-interest political blocs has caused U.S. companies to become better corporate citizens. The exhaustive (and exhausting) chatter of Internet chat rooms has contributed to the pervasive presence of activist consumer vigilance. Recently in China the vigilance of consumer protection has also become more prevalent. In China, American consumer stalwarts like P&G and McDonald's, according to Cheng (2005), have recently paid fines and withdrawn ads because of overstated claims (skin creams making one look "12 years younger in 28 days") and inappropriate cultural images (Chinese customers shown kneeling and begging for a discount). The government, naturally, is quite comfortable with controlling industry practices toward consumers.

Not all consumer issues in China are straightforward. Technology-induced health issues, such as the safety of genetically-modified rice, as one fascinating example, can cause ethical dilemmas for the Chinese. Barboza (2005b) reports that the "anti-pest" rice has been ruled illegal by the government on the one hand, and is distributed through government stores—with a wink and at a price premium—on the other. What if something is silently dangerous about how the altered rice impacts the human genetic structure? ...1.3 billion wandering zombies straight out of a Robin Cook novel?

What About Individual Freedoms in China? What's Really Changing?

There's no argument that the Chinese government is highly

uncomfortable with an open and free press. In its efforts to promote technology, the Chinese government may, ironically, be a victim of the omnipresent video cameras and laptops it has been promoting. The rate of information flow with the West has been growing exponentially. The nouveau “Urban Elite” class of Chinese wants the same freedoms that they observe in the rest of the world. Some media have become emboldened. Newspapers like *The Epoch Times*, which debuted its Chinese-language version in 2000, claims that its series of editorials has caused 1.9 million people to leave the “lies, tyranny and terror” of the Chinese Communist Party, according to Jurkowitz (2005). The newspaper has been accused of being a backer of Falun Gong—a spiritual and health-related movement begun in China in the 1990s. Traditionally, the Chinese government cracks down on any group that has the capacity to organize people outside of the state’s purview.

This government fear of organization relates directly to religious freedoms. There is some official level of religious freedom in China. The government recognizes five religions—Catholicism, Protestantism, Buddhism, Daoism, and Islam. According to Hutzler (2005b), there are roughly 35 million Protestants and 12 million Catholics in China. The state is actually building churches for these groups, undoubtedly so it can supervise the congregations.

With the prospect of Pope Benedict XVI soon visiting China, and thus ending 50 years of estrangement between Beijing and the Vatican, and the scheduled hosting of the 2008 Olympic Games, individual freedoms should continue to loosen up. These relaxations should improve the general social climate for the visiting American entrepreneur.

What About Leadership in the High-Tech Arena?

China has an acknowledged reputation for providing low-cost production for the electronics industry. But China is moving beyond the spec sheets of fabrication and assembly to the basic scientific equations of the high-tech big leagues. As Chen (2005) reports, the Chinese Academy of Sciences in 2004 unveiled the Dawning 4000A, a supercomputer that performs more than 10 trillion operations per second, ranking it in the world’s top 10 for speed. China is also developing its own “Godson” series of home-grown computer chips, giving its information industry its own royalty-free source of processors. U.S. entrepreneurs can view China’s advanced electronics initiatives in both an offensive and defensive context.

Franchising Opportunities How Receptive Is China to Foreign Investment?

If only the entrepreneur’s investment decision to “doing Chinese” was as straightforward as investing in our metaphor-

ical Chinese restaurant! Experience shows that a well-run restaurant has predictable cash flow, good capacity loading of its facilities, precisely-crafted margins, and specific and leveraged uses of proceeds in the capital raise-up. A chi chi theme-restaurant (e.g., Planet Hollywood), in contrast, generally displays more glitter than substance, and more concern about franchising “the theme” over and over again, before management ever gets the first location “right.” Investors’ capital often falls into a black hole.

The metaphor translates well to “the China strategy.” The notion of “getting it right first” before launching an American company’s trade initiative in China is vitally important. The entrepreneur should have a product or service that is operationally and economically sound, has enjoyed success in the states, and will only benefit additionally from a China hook-up.

The ancient proverb says: If you have money, you can make ghosts and devils turn your grindstone. The obvious big bucks come from the mega-firms. The large U.S. multinationals have already introduced a Western flavor to China’s integration into the world economy. Rosenthal (1998) wrote an entertaining article in the *New York Times* entitled, “Funny, I moved to Beijing and Wound Up in Pleasantville.” The author describes typical weekend activities in Beijing, driving her kids to soccer games in a SUV made by Beijing Jeep (a joint venture with DaimlerChrysler), buying household supplies at Price Smart, swinging through for a Big Mac at one of Beijing’s 40 McDonald’s, and then over to Dairy Queen for a sundae. Or she could have tried a KFC outlet; number 1,500 in China opened in October 2005.

As detailed by Huang (2003), foreign direct investment (FDI) in China is pervasive. In the 1980s and 1990s, China absorbed \$346 billion in FDI. Between 1992 and 1998, on average, FDI flows into China accounted for 13 percent of the gross capital formation of all firms annually. Chinese officials, foreign business practitioners, and the World Bank have credited FDI as the major driving force behind celebrated China’s economic success. Huang makes a counterargument that the inefficiencies of the SOEs increase their capital needs, and the political pecking order regarding capital allocation favors SOEs, and thereby deprives nonstate firms—especially entrepreneurial ventures—of growth capital. In any case, FDI capital is flowing into China, and there are opportunities for China-U.S. capital transactions. It should also be noted that the Chinese, overflowing with trade surpluses, are aggressively pursuing brand-name Western companies (e.g., Maytag).

Are American Venture Capitalists and Investment Bankers Responding to the China Opportunity?

For American venture capitalists (VCs) funding American start-ups, the frequent question is: “What’s the China strate-

gic element in your business plan?" China is a presumed part of the entrepreneur's thinking. Ignoring China is viewed as ignoring opportunity.

Increasingly, there is American interest in funding Chinese entrepreneurs. As reported by Ante (2005), one of the pioneers in establishing an in-country fund is Boston's Patrick J. McGovern, the magazine entrepreneur who founded International Data Group (IDG). Despite many unfavorable factors—the dominance of the Communist government in directing the economy, the virtual absence of any seasoned entrepreneurs, and the lack of an exit position for a venture investment via a national stock market—the IDG Technology Venture Investment Inc. venture fund was established in 1992, and has earned a 42 percent IRR on its \$170 million China investment.

On the face of it, this investment climate is intriguing and perhaps seductive. IDG's success belies the difficulty for VCs in finding deals, qualifying entrepreneurs, and establishing exit positions. Most deals are transacted through offshore entities so that VCs can take their portfolio firms public on overseas exchanges. Since assets are effectively moved out of the country, Buckman (2005) reports that the Chinese government responded in June 2005 by enacting new rules and regulations requiring disclosures and approvals for Chinese citizens to move company assets overseas.

Despite these difficulties, capital continues to flow into China. Maney (2005) reports that in 2004, American VCs invested \$1.3 billion into China, a 29 percent increase over 2003. A key to VC success appears to involve having a U.S. presence on-site in China. Chinese entrepreneurs want more than capital. They want access to American business savvy, international contacts, and personal mentoring.

What About Later-Stage Investment?

Private equity firms such as Bain Capital (the sister organization of consulting firm Bain & Co.) and Thomas H. Lee (THL) Partners L.P. are setting up high-profile funding shops in China. As reported by Galante (2005), Bain, with \$25 billion under management, is entering China by itself, while THL Partners, with \$12 billion under management, is teaming up with H&Q Asia, a transpacific private equity firm with offices in China, Japan, South Korea, Singapore, Taiwan, and the United States. Other American investors entering China include Blackstone Group, Kohlberg Kravis Roberts & Co., and Carlyle Group.

How Can China's Entrepreneurial Climate Fully Blossom without the Underpinnings of a Modern Commercial Banking System?

The underpinnings are being improved with a little banking help from the West. The inefficiency of the SOE banks has been a significant deterrent to commercialization of early-

stage companies. Like everything else in China, change is in the offing. In June 2005, Bank of America (BOA) acquired a 9 percent equity interest in China Construction Bank (CCB) for \$3 billion, as reported by Barboza (2005c). The CCB has more employees—310,000—than any bank outside China. With 14,000 branches, CCB will need all the help it can get from BOA to reform its outmoded banking practices. It is anticipated that this BOA investment is the first step in CCB's path to privatization via an IPO. CCB would lead the way as the first of China's four mega state-owned banks to break away from the governmental cocoon. Since 1998, the Chinese government has poured more than \$250 billion into the four banks to restructure their balance sheets and to clean up nonperforming loans. Corruption has been prevalent. CCB has had two chairmen resign in three years as a result of bribery accusations. With reduced government interference expected—because of foreign investors—these behemoths may have a chance to change their ways and help entrepreneurs commercialize. Otherwise, they will be ill-prepared for 2007 when China's banking sector opens to global competition.

Departing "Doggy Bag" Thoughts What Are the Primary Concerns for the American Entrepreneur in Approaching China?

Although entrepreneurs are often depicted as risk-takers, they are more typically managers of risk. To manage the risk associated with a trade relationship with a Chinese partner, the entrepreneur must become educated on China. The biggest fear can often be the fear of the unknown. If American entrepreneurs based their views of China on xenophobic "impressions"—say the Tiananmen Square incident in 1989 or the movie *Red Corner* (1997) where Richard Gere plays a visiting American executive jailed and framed for murder—then China deals would never get transacted!

Negotiating with the Chinese is a counterintuitive experience for most entrepreneurs. Experts in the field, like Blackman (1997), have delineated elaborate guidelines to help explain the interplay of Chinese "collectivism" with Western "individualism." American entrepreneurs typically solve a business negotiation challenge step-by-step, in a series of well-controlled meetings. The collectivist Chinese will typically introduce into a business process a formal banquet dinner in a restaurant to entertain the visiting American. The entire office staff attends, from the managing director to the clerk, to bond the group together. Blackman has developed a four-page negotiating matrix that relates Chinese characteristics to cultural background and suggests how Westerners might effectively respond. Key considerations in the East vs. West negotiating dialogue include the following Chinese gambits vs. American responses:

- Chinese haggling vs. the entrepreneur maintaining harmony
- Anti-foreign attitudes vs. personal bonding
- Repetitive questioning vs. entrepreneurial impatience
- Hidden agendas vs. outsider “ethics”
- Paternalistic threats vs. patient spelling-out of consequences
- Stalling vs. the time pressures of the entrepreneur’s travel schedule
- “Muddy the water to catch the fish” tactics

The entrepreneur must study and become knowledgeable in these varied tactical and confusing interplays. The entrepreneur must remember that the Chinese probably understand the West better than the West understands China, and the Chinese can “hide” behind various rules. In China, the rules may be fairly rigid, but the individual people can be flexible. Accordingly, the entrepreneur must, with chosen advisers, gain access to powerful personal networks—or *guanxi*. Appropriately sensitive dealings with business partners and government contacts will assure the entrepreneur’s *guanxi*.

What Is the Best Way to Cultivate and Sustain Guanxi?

Caufield and Ting (2004) emphasize that small gestures are important. To avoid looking like a *sha lao wai* (i.e., “silly foreigner”), the entrepreneur should take certain precautions, for example:

- Always present business cards with both hands in giving them to a Chinese host.
- Offer product samples and literature about the business.
- Give modest gifts like a carton of cigarettes or a bottle of liquor.
- Avoid “Made in China” gifts (viewed as mocking), expensive gifts (viewed as bribery), and white gift wrapping (viewed as the symbol of death).

Advice to the American entrepreneur: In the end, be patient, be polite, do not take anything that is said or done in negotiation as personal, and do not lose perspective on the overall goal of getting a business relationship established.

What Is Needed for the Entrepreneur to “Do Chinese?”

The short answer is for the entrepreneur to do all the “right” things he or she would do back home in New England to establish a strategic alliance. Be very, very wary about anything not well-understood; and employ qualified, trustworthy advisers. Adapt to China. Emmons (2005) reports on a Harvard MBA (’03) graduate, Andy Klump, who works in Beijing and notes, “Establishing strong relationships with your colleagues is critical, as they will be in a position to support you or sink you, sometimes without you even knowing

it...you need to have a wide range of interests and experiences in order to relate to many types of people; be able to learn quickly and read people and situations through body language and context; and, finally, be willing to take risks and drive for results amidst ambiguity.”

Once the entrepreneur grasps the essence of China’s cultural issues, the American team can proceed by first planning the initiative: preparing a detailed plan evaluating opportunities in specific regions and provinces of China; developing a feasibility study; and creating a localized procurement plan, detailing suppliers and outsourcing relationships. Specifically:

For distribution arrangements, a few straightforward steps are suggested:

- Select the Chinese partner *proactively*, based on due diligence. Don’t *react* to random meetings, say at a trade show.
- Identify partners who can develop markets across an industry, not just provide “first contact” door openers with individual customers.
- Treat Chinese distributors as long-term partners, not order-takers.
- Commit adequate resources to assure a chance at success.
- Maintain on-going control over strategy and translate the strategy into market and performance measures.
- Recruit a bicultural member to the entrepreneurial team.

For outsourcing arrangements, there are many pitfalls to avoid:

- Understand that while there are anecdotal China success stories from New England entrepreneurs, there are many companies that have tried and failed in the China connection. MIT lecturer David Meeker, as reported by Malone (2004), suggests his research shows that outsourcing savings is a myth since it adds an average of 24 percent to unit cost.
- Don’t partner with an unknown “rookie” organization that hasn’t dealt with the West before and may not have adequate government connections.
- Have a trusted member of the team on-site to represent the company’s interest. As the Chinese proverb says, “You can’t fight a fire with water from far away.”
- Make sure there is an exit strategy with monthly or quarterly contract terms at the beginning, tied to performance objectives.
- For any company processes being located offshore, assure that results, quality, and worker performance can be measured with precision. Know the product/component design and cost detail.
- Remember that outsourcing is based on certain assumptions about cost-savings goals and protection of intellec-

tual property. Constantly assure that those assumptions are valid. Always assume that anything you share with the Chinese will be copied. Keep the family jewels (customer lists, product drawings and software code) away from the Chinese partner personnel. The goal is not to spawn China's entrepreneurs.

- Pay the bills in an intelligent way. Start the accounts receivable clock ticking when the components arrive at the dock, *not* when the goods are put on the ship. This can save six to eight weeks of working capital availability, or avoided borrowing against a line of credit.
- Make haste, but go slowly. Try one production piece for outsourcing; then a subassembly; and then the whole component. As the Chinese proverb says, "If you're in a hurry, you will never get there."

What Are the Sources of Information for the Entrepreneur Interested in China Business Opportunities?

There are many resources available to the entrepreneur. Rather than plow through the thousands of Google hits one might get to a particular question on China trade, try the following:

- China Business Information Center (www.export.gov/china) provides access to leads on trade and tips on export, market research, and regulatory guidelines
- U.S. Export Assistance Centers

Endnote

1. Insolation is a scientific term used in renewable energy circles to explain, in short, how much sunshine is available (e.g., photons per square inch per hour.). Tel Aviv has high solar insolation, London has far less!

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(www.export.gov/comm_svc/eac.html) provides trade specialists in more than 100 offices around the United States for advice to the aspiring China rookie.

Other contacts include:

- American Chamber of Commerce: Beijing (www.amcham-china.org.cn)
- Shanghai (www.amcham-shanghai.org)
- Guangdong (www.amcham-Guangdong.org)
- Hong Kong (www.amcham.org.hk/home.html)
- U.S. of America-China Chamber of Commerce (www.usccc.org)
- U.S.-China Business Council (www.uschina.org)

Personal contact through friends, colleagues, and alumni associations are potentially fruitful. There is a constant barrage of "China Networking" seminar circulars, promoting practical ways to develop a China entry strategy. Check them out.

When Does the Entrepreneur Know If It's the Right Decision to Pursue China?

All good entrepreneurial decisions are based on risk-reward assessment in the presence of good information. The foregoing array of factoids, case histories, anecdotes, and opinions is just a sampling of information available on trade with China. The referenced web sites provide additional data. Like many things Chinese, once you start, you'll soon be hungry for more! In the end, the answer to the China question is "If not China, then where? If not now, then when?"

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