Top Misconceptions about Doing Business in/with China

Introduction

Throughout the years, JJ Wellesley Group helped many small and midsized enterprises (SME’s) from the west to do business in/with China. Interestingly, we discovered that a significant number of western SME managers/owners had some preconceived notions as to how it would be like to do business in/with China. Some of these notions are downright wrong; and some of them are only applicable in very limited settings.

We observed, on many occasions, that some of these misconceptions helped to cause western SME’s to make incorrect business decisions. Therefore, we think it is important for us to reveal some of the most commonly held misconceptions and explain why they can have negative impacts on your China initiative.

Why do we have misconceptions?

China has a long and complex history. The current culture and business practices of mainland China have been shaped by numerous factors. We list some of the major ones in the following:

- Traditional Chinese religious, philosophical, and superstitious beliefs (e.g. Confucianism, Taoism, Buddhism, ancestor worshiping, and etc)
- Communist rule since 1949 (which has forcefully pushed certain social and cultural values, e.g. atheism, proletarianism, and patriotism/nationalism)
- Cultural Revolution 1966-1976 (and a number of national political movements preceding the Cultural Revolution) (during which time almost all traditional Chinese religious and philosophical beliefs/practices were branded as superstitious and/or counterrevolutionary; China became one of the world’s poorest and most isolated countries; many Chinese were personally tortured; many Chinese families were destroyed; many Chinese, particularly those in the rural areas, were starved to death; Chinese citizens had very limited freedom or financial means to travel within China; traveling internationally was entirely impossible for ordinary Chinese citizens; and the country’s young people were “taught” to rebel against any kinds of rules or authorities)
- One child policy since 1979 (a significant percentage of the Chinese urban population born after 1980 were brought up as the only child in their families)
- The economic reform policy since 1979 and subsequent rapid economic development and social changes and a vast amount of west cultural influence (In less than 30 years, China went from a dirt poor and more or less egalitarian society to a fast growing economic power with incredible income gaps among its citizens)
Some of the above the factors are quite unique and they are not part of a common experience shared by the Chinese people living outside mainland China (e.g. people living in Hong Kong, Taiwan, and etc) or other East Asian peoples (for example, Japanese and Koreans). The rapid economic changes are also driving fast changes in other aspects of the peoples’ lives in the country. What was true about China yesterday can become completely outdated today or tomorrow.

Meanwhile, many western SME executives formed their notions about the culture and business practices of China based on the following:

- Social, personal, or business interactions with ethnic Chinese individuals or communities in western countries. It is important to point out that a significant percentage of the ethnic Chinese living in western countries are not originally from mainland China; the experience of living as immigrants or members of a minority community has helped to create a unique culture of the overseas Chinese, which is often vastly different from the one in mainland China. Needless to say, mainland China has a fairly homogeneous society, mostly dominated by the Han Chinese people born after 1949.

- Social, personal, or business interactions with Chinese in Hong Kong, Taiwan, Singapore or other Asian countries/regions. As noted above, the recent histories of these countries/regions are drastically different from that of mainland China.

- Interactions with other East Asian cultures (Japanese, Korean, for example). Most East Asian cultures have been influenced by the Chinese culture to a certain degree, but all these cultures remain to be distinctly different from one another. And the business practices in East Asia are also varies from country to country.

- Press reports of some of the most spectacular successes or failures of the business dealings in China by major western multinational corporations (MNC’s), some of which started their expansion to China as early as the beginning of the 1980’s. Many of these reports are related to dealings with very senior Chinese government officials in the pre-WTO China. (China was admitted to WTO, the World Trade Organization in 2001; and a significant number of the country’s restrictions imposed upon foreign businesses have been released or relaxed).

Finally, issues relating to doing business in/with China have not been studied with any academic rigor. While there are many in the west who write about their experiences in doing business in/with China (any casual English speaking reader would have already found out the staggering number of books on doing business in China published in the west in recently years); there is very little rigorous research or analysis. Many top Fortune 500 companies have good insights, but they have very
little incentive to go public with their hard learned lessons. As a result, many so-called China hands or gurus are still spreading many clichés and misconceptions. During the past few years, JJ Wellesley staff participated in many seminars on doing business in/with China throughout the US and Canada. We were disappointed to find that misconceptions and clichés were often repeated and reinforced during these so-called seminars.

**Five Commonly Held Misconceptions about Doing Business in/with China**

1. **You have to have a local partner in order to be successful in China.** This statement would not be wrong if “a local partner” broadly means someone who can provide effective assistance within China. Unfortunately, many western SME executives have been led to believe that to successfully enter China, a western business has to find a Chinese entity/individual to form a joint venture (JV). It is true that as recent as a few years ago, JV was the most common market entry approach western businesses took. Chinese JV partners can be extremely helpful in a western company’s customer acquisition efforts and government relations management (among many other things). But more importantly, before China’s WTO accession in 2001, many Chinese industries were restricted, i.e. foreign companies were not allowed to enter China without first forming a formal partnership with a Chinese entity under the legal framework of an equity joint venture (EJV) or a cooperative joint venture (CJV). However, incompatibility with Chinese JV partners in the areas of business objectives, corporate governance, management approach, and corporate culture has been notorious as a potent poison that broke up many Sino-foreign joint ventures. With many Chinese industries having lost the “restrictive” status in recent years, JV as a market entry approach is rapidly losing its popularity. As a matter of fact, many large western MNC’s have converted their long-term JV’s in China into WFOE’s (wholly foreign owned enterprises). As a WFOE, a foreign business can still hire capable local Chinese managers/employees and/or form partnerships with other Chinese companies/individuals who can help to acquire customers and manage government relations. To us, a more appropriate statement would be “you have to have a strong locally based team in order to be successful in China.”

2. **The biggest problem is the language barrier.** It is absolutely true that the percentage of the Chinese population who can fluently communicate in English is very small. The inability to communicate freely can be extremely overwhelming to a western business executive. However, we believe that too much emphasis on the language barrier can create problems in other important areas, including the following:

   a. **Selecting the wrong Chinese partners.** Consider the following case. A small western manufacturing company, after several frustrating years of
working with Chinese suppliers who did not have employees fluent in English, decided to shift most of its purchase to a very small/unstable factory in Shanghai. The reason for this decision: the Shanghai factory owner happened to have just hired a relative who had lived in Florida, USA. Sure, the telephone/fax/e-mail communication between the western manufacturer and Shanghai supplier was almost instantaneously improved. However, one fluent English speaker could not solve some of the fundamental problems the factory had. Poor product quality, missed delivery deadlines, constantly changing prices all happened on a regular basis. Naturally, the relationship did not last very long. Another example involved the general manager of a small western luxury goods company, who, after spending frustrating weeks in various Chinese cities looking for a retail partner, decided to initiate the partnership discussion with the owner of a transformer factory in a small northern Chinese city. The reason for this unusual partner choice? The transformer factory’s owner has a daughter who just graduated from college and speaks good English. Obviously, the partnership discussion never went anywhere. Undoubtedly, China lacks English speakers (actually, we would put even more premiums on Chinese individuals/companies who have a proficient understanding of western business and management practices as opposed to just the English language); but recruiting fluent English speakers alone would often not be sufficient to solve the problems western businesses have with China.

b. **Appointing the wrong people to lead the China initiative.** A midsized western auto parts manufacturer decided to set up a manufacturing facility in China. The only Chinese speaker in the company at the time was a recent college graduate of Taiwanese decent. This individual had only been with the company for a few months, and his main responsibility had been to e-mail/fax purchase orders to established Chinese suppliers. But this individual, due to his ability to speak both English and Chinese, was essentially appointed as the project manager for the China initiative. Obviously, the complexity associated with getting government approval and determining the site location proved to be too challenging for this inexperienced “project manager”. As a result, the project was completed 24 months after the originally planned launch date. Another example involves a western developer of specialty software which decided to set up an offshore center in China to serve the increasing demand from MNC’s operating within China. The management team decided to appoint a senior software engineer at the company’s home office in North America to lead the effort of setting up the operation in China. The qualifications of this software engineer? He is originally from China and speaks Chinese, of course. With no business experience of any kind (let alone the experience of launching a business in a different country), this engineer
spent 10 months to just draft the initial business plan. Eventually, the CEO of the company had to spend a significant amount of his own time on the project. The offshore center was set up 36 months after the planned date.

3. **Chinese people value long term relationships a lot more than short term profits.**

Many China hands and gurus in the US often blame US executives for being “ugly Americans” and putting too much emphasis on short term results. “Chinese people value long-term and mutually beneficial relationships! You have to be patient and develop a long term view” these experts would often passionately proclaim in various US corporate conference rooms.

It is true that many traditional Chinese philosophical and religious thoughts are known for emphasizing long term consequences of human behaviors. What makes things even more interesting are the frequent western media reports about how some top western companies achieved gigantic financial rewards after patiently spending millions of dollars and many long years of *guanxi* (Chinese: connection or relationship) building in China.

But here are two important facts business people in the west need to understand. First, most of the mainland Chinese people born after 1949 are neither overly philosophical nor too religious in their way of going about conducting business. Secondly, many of the top western companies (for example some of the bulge bracket Wall Street investment banks) willing to spend a number of profitless years in China mainly because they were betting that certain market opportunities would soon become available (mostly due to anticipated legal/regulatory changes). They went to China just to make sure that they would be ready when the opportunity materializes. These same companies would take the same approach in many other emerging markets. This approach does not have too much to do with whether Chinese people value long-term relationship or not.

Compared with their peers in the west (and other regions of the Greater China market, i.e. Hong Kong and Taiwan), we believe that many business people in mainland China appear to be much more opportunistic and tend to focus much more on short-term profits. The turbulent years of the Cultural Revolution and the constant policy changes throughout most of the time since 1949 all contributed to the making of the Chinese people’s short-term outlook and an unusually strong desire to accumulate the maximum amount of personal wealth in the shortest period of time possible. Of course, the many overnight millionaires
created during the last two decades of rapid economic growth also reinforced this desire.

Obviously, we encourage western businesses to develop long-term business goals/strategies for the China market. But we think it is crucially important for western businesses to create, at an early stage of their China initiatives, tangible value propositions that would address the current needs of the China market. And as an SME develops the value propositions, it should keep in mind that effective value propositions should be based on the current market condition of China and have the real prospect of quickly benefiting both the western company itself and its Chinese partner(s).

Consider the following two cases. One western security product manufacturer signed a distribution agreement with a large Chinese distributor in Shenzhen in the mid 1990’s. Years passed, but this western manufacturer did not make a single sale in China. Why? The China market was not quite ready in the 1990’s for the high end products made by the western company. The Chinese distributor did not make any efforts to market the products. Now the Chinese market has become more mature, but a couple of large international competitors of the western manufacturer have already grabbed the leading market shares. The Shenzhen company entered into the distribution agreement for two reasons. First, they wanted to be associated with reputable western companies (so that they could boost their prestige in the industry). Second, they were involved in reverse engineering and pushing knockoff products at lower prices. Looking back, the CEO of this western company said he wished they could have created a lower end product just for China so that his company and the Chinese distributor “could have grown with the market”. A leading western glass manufacturer bought a significant equity position of a sizeable Chinese glass factory in the mid 1990’s. The western company wanted to use the Chinese concern as a springboard to get more business for the potentially exploding demand for the auto glass business in China. But the Chinese company did not have a long-term strategy for the domestic market; instead, they had a small but profitable business of exporting low end products to the west. The Chinese sold ownership to the western conglomerate because they needed capital to expand the manufacturing capability for their existing export business. Naturally, the western conglomerate withdrew from the partnership within a very short period of time.

4. In China, guanxi is everything.

Guanxi is a tricky Chinese word. Depending on the specific situation, this word, in present day mainland China, can mean contacts, connections, networks/networking, relations, or relationships. Similar to the way they feel about a small number of exotic-sounding Chinese words such as kowtow, some in
the west have simply become infatuated by the concept of guanxi. As a result, this word gets repeated very often by some people in the “China trade.” Some self-proclaimed China gurus would even go as far as announcing that nothing can ever get done in China with some proper guanxi. A top US business school faculty member of Taiwanese decent even wrote extensively in his popular book on the indispensable role guanxi supposedly plays in the Chinese business world. We too believe that guanxi building can be important in China. But the issues we see in over playing this concept are as follows:

a. **Guanxi is often random. Random guanxi will usually lead one down the road of inefficiency, ineffectiveness, and downright failures!**

“My brother in-law’s girlfriend, Grace Xiaozhen Zhang is a Chinese graduate student at the State University. She is an incredibly beautiful and intelligent lady. Grace said her uncle is the Vice General Manager of a big government hospital in an eastern Chinese province. I think the province is called Zhe…Zhechang…or Chejiang, not sure of the spelling…but it is a big and prosperous province. Grace said her uncle will help us to find a good distributor of our products. I think we are on our way…” bragged a beaming sales executive of a small medical equipment manufacturer located in a western state of the US in early 2005. In late 2006, this same executive admitted that the guanxi of the beautiful Grace never yielded anything interesting (except a few disorienting baijiu (Chinese spirits) dinners with Grace’s chain smoking uncle in an expensive but noisy restaurant in Shanghai). “We spent too much time on this…I guess things just move slowly in China….as a small company with limited resources, this may not be worth of our time….I guess we are just not ready for China.” concluded the once optimistic American salesman. Here is an important fact. China is a rapidly developing economic giant and just about every major industry in the country has complex challenges (customer behavior, competitive landscape, and legal/regulatory environment). As a SME from a western country, it is absolutely not appropriate to rely on a random personal contact to propel its entire China market entry effort. The fact that personal connections may sometime carry more weight in certain business dealings in China would not alter the business fundamentals/merits of a particular market entry effort. When one is stuck with a random contact, usually two things would happen:

- The contact just endlessly drags the process of “helping out” by engaging in useless activities
- This actually happens very often. The Chinese contact will try forcefully to fit the western SME’s business proposition into one or several of the Chinese own business or personal dealings which may not have anything to do with the business objectives of the western SME. With the above mentioned US medical equipment company,
for example, Comrade Old Zhang, the uncle of the beautiful Grace, was actually engaged in a nasty hospital privatization project. Old Zhang was desperate for capital. The need for hard currency was actually the main reason he got drunk with the young American exec because he was really hoping the “rich foreign devil” would be willing to invest some dollars into an ailing public hospital.

b. Deep guanxi cannot be built overnight. You can certainly buy a “good” guanxi; but most likely this kind of dealings has legal and moral ramifications.

The classic Chinese guanxi (when the word means long term human relations) by default cannot be built overnight. This kind of guanxi typically refers to the relations among people who have sacrificed their own interest to do significant favors for each other for a long period of time. Most western SME executives just having “discovered” China simply do not have this kind of deep guanxi. A distant relative’s Chinese friend, the owner of one’s favorite Chinese restaurant in a western country, or an impressive Asian businessman one meets on the plane will typically not become one’s deep guanxi within a short period of time. These people at best can be viewed as some interesting and random contacts one makes. Nevertheless, many of these contacts would often appear to be very much willing to help a western SME executive to “build some really strong guanxi.” This is where a western exec needs to be very cautious. Usually, this kind of guanxi cannot be built for nothing. Whether a guanxi is tradable for cash, an invitation letter for a visa application, or some other significant favors, one needs to first think through the legal and moral ramifications of this kind of dealings.

Guanxi is important but it cannot replace careful planning and well managed execution of a SME’s China initiative.

5. The Chinese are not looking for money.

A small US private equity firm was, in conjunction with one of its US based portfolio companies, negotiating with a Chinese SOE (state owned enterprise) on setting up a entertainment business in China. “We are very cash rich. We are not looking for any money. Our side will be responsible for most of the investment needed for this venture. Working with you, however, makes our venture more international. By the way, a European group is also very interested in working with us. If you can put a symbolic amount of money, you are welcome to do so. But we really do not need any money.” This was the opening remark the Chinese SOE general manager made at the first round of meeting with the US PE group. But less than 48 hours later, it became abundantly clear that
the so-called investment from the SOE was not much more than the right to use a semi abandoned old theater (which the proposed entertainment venture would theoretically be able to use its venue for the show it was supposed to stage in China). The SOE was actually expecting the US PE group to investment all of the startup capital (which was estimated to be $20M).

As China became the world’s largest holder of foreign reserves, the country now has many entities and individuals loaded with cash. China’s investment is everywhere, reaching far corners of the globe. Large oil drilling ventures in Africa as well as some fancy tourist hotels in Cuba are all funded by Chinese money. It is very easy for a western SME executive to think it is possible to find Chinese entities/individuals to co-invest in a business venture in China. However, within the micro Chinese economic environment where many western SME’s would most likely find themselves to be situated, the term Chinese investment remains an oxymoron. “You invest in China; China does not invest in you. It is that simple,” remarks a long time China business observer. We also observe that in the minds of many Chinese, the term foreign business people is still synonymous to foreign investors. In this environment, Chinese business people usually enter into discussions with foreign businesses for one or both of the following: a) capital injection; b) technology know-how. However, Chinese business people are typically not very direct with their intentions (at least not during the initial phase of the discussions they have with foreigners.) There are two reasons for this indirectness. First, it is genuinely part of Chinese culture that it is considered to be rude for someone to ask for things (particularly money) from people he/she does not know very well. Second, many Chinese business people have learnt during the past few years that western business executives have now become very leery about Chinese asking for money or technology know-how.

Conclusions

There are obviously other misconceptions about China. In fact, new misconceptions will continue to be formed as it is human nature to develop opinions on things (even including things about which we do not have firsthand knowledge). But to make business decisions based on preconceived notions can be harmful.

We fully understand that China, culturally and linguistically, can appear to be an utterly foreign environment to many western SME executives. But the fear (or even awe) for
“the mysterious Chinese” language and/or culture (and the natural desire to guard oneself against this fear) cannot drive the process of a serious business initiative in China. At the end of day, a western SME should pursue the China market with the same rigorous planning, analysis, and execution as it would in the west. This means major business drivers (such as customers, competition, products/offers, and legal/regulatory environment) should be thoroughly studied and analyzed. Just as in their home markets, western SME executives should start every China business initiative by asking fundamental questions such as “What are our business objectives? Who are our customers? What is the revenue potential? Cost? Who is our competition?” That is to say, a fact based business case will need to be first made. Then the SME needs to develop a solid implementation plan (i.e. a plan with specific time lines, staffing/recruiting arrangements, and budgetary needs). If along the way, the SME finds that it needs to form a joint-venture with a Chinese company, then it should go ahead and explore the best way to do that. Needless to say, if it discovers the language barrier impedes progress, it should find ways to bring in bilingual capability. We think it is simply counterproductive to have the mindset like the following, “we are expanding to China, so let us find a Chinese joint venture partner” or “we are doing business with China now; but we do not speak Chinese, so let us first find an English/Chinese bilingual speaker to lead the effort.” This kind of thinking based on misconceptions and clichés is dangerous.
ABOUT JJW GROUP

JJW Group, LLC is an international business advisory firm based in Shanghai, China and Los Angeles, CA. Our mission is to help international companies to successfully pursue major business initiatives pertaining to China. We collaborate with our clients to create and implement strategies in multiple areas, including:

- Market Entry
- Sales Strategy & Distribution Strategy
- Sourcing & Supply Chain Management
- Recruiting & HR Support
- Business Due Diligence

We are committed to providing customized and results-oriented solutions to our clients.

With years of management experience gained from many world class international companies, coupled with a deep understanding of China, we aspire to become a leader in the China business consulting arena.

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