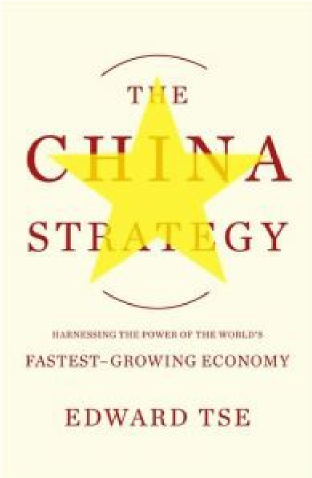

Book The China Strategy

Harnessing the Power of the World's Fastest-Growing Economy

Edward Tse
Basic Books, 2010
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Recommendation

Perhaps Frank Sinatra's familiar refrain needs a slight alteration to reflect the current reality: "If I can make it there, I'll make it anywhere. It's up to you"...China, China. No firm can afford to ignore China as a market, manufacturing base or source of competition. Management consultant Edward Tse's wide-ranging viewpoint (Tse was born in Hong Kong but educated in the US) offers anxious businesspeople clarity and direction. He lucidly describes the forces he thinks will shape China's future and illustrates how your business can prepare for this transformation. Although the book's call to action – plan now for an unknown future – may overwhelm some readers, *getAbstact* recommends this overview of China's shifting commercial climate to managers considering moving to China, those who are already active there, and those who realize the degree of China's imminent influence and want to prepare for the turmoil ahead.

Take-Aways

- Every aspect of China will mutate in the second decade of the 21st century. Firms must prepare themselves for such a radical overhaul.
- Four "drivers" will bring about deep-seated changes in China's economy:
- "Open China" means competition will flood the market and consumers will be "fickle."
- "Entrepreneurial China" is a source of stiff local and foreign competition.
- To engage with "Official China," foreign firms operating in China must align their goals with the national government's objectives for their industry.
- The "one world" feature of China's economy means that firms operating there will find themselves increasingly connected to the rest of the globe.
- To succeed in China, develop three competencies:
- Companies with "vision" recognize China as a key element of the global business environment, not just as a manufacturing base or a sales market.
- Heightened "versatility" will help your firm quickly adapt to China's erratic, unpredictable business environment.
- Leaders with "vigilance" gauge the significance of each new trend and react accordingly.

Summary

You Ain't Seen Nothing Yet

The fruits of China's economic development are obvious – from the imposing skyscrapers in its eastern megacities to its investments on every continent. China's rapid recovery from the 2008 economic crisis proved its resilience. Although the government's nearly $600-billion stimulus package played a large role, credit also goes to the entrepreneurial spirit and steely resolve of China's 1.3 billion citizens. Their attitude is a harbinger of things to come. During the second decade of the 21st century, every aspect of China will change from its 2000-to-2010 status quo: New business leaders will emerge, consumer tastes will shift, and the government will instigate new policies and move in fresh directions. Given that China's economic expansion will cause disorder and dynamism worldwide, to do business there, your firm must create a "China strategy" – a "long-range developmental plan" for working in a world where China is a central constituent. Four "drivers" will shape the future of China's economy:

1. "Open China"

China's consumers are the primary beneficiaries of its "unlocked" economy. The business world now vies for their attention with a huge assortment of cheap goods and services. Yet, foreign firms will find that China is still complex to enter. They should consider these facets of openness:

- **"Openness to outsiders"** – Critics condemn China's "unfair trade practices," but China hosts more international brands than any other country. By 1992, foreign direct investment flooded freely into China, generating jobs and injecting competition and "best practices" into the economy. China now has access to most of the business resources it lacked in the '90s. Thus, new entrants have little to offer and won't receive the same fiscal hospitality (incentives and tax breaks) China gave to its pioneer partners. Newcomers will discover a packed, competitive market. Although China's economy is wide open, the "greatest era of foreign investment's impact" is over.
- **"Regional markets"** – By 2020, 60% of China's population will live in cities. China has approximately 600 cities with populations surpassing 500,000. Each one will grow in the coming years, creating new, large, wealthy markets. Foreign firms must time their expansion into these markets carefully: Proceed prematurely, and you may lose money; dillydally, and your competitors will get there first.
- **"Improved distribution"** – China's infrastructure is expanding rapidly. One project aims to create an expressway network connecting cities of 200,000-plus people by 2030. Meanwhile, the "retail revolution" has taken hold: Open-air markets are ceding popularity to shopping centers and convenience shops. These changes will facilitate foreign firms' product distribution so they may no longer have to outsource it.
- **"Consumer culture"** – Until the late '70s, the Chinese people weren't big consumers; then a vast array of products suddenly inundated the market. Firms had no time to build customer rapport, so brand loyalty is scant and buyers are "fickle." Before entering China's market, study its complex, diverse cultures and consumer patterns.

2. "Entrepreneurial China"

China's economy consists of public-, private- and foreign-owned firms. The vast majority of China's 569,000 state-owned enterprises (SOEs) are local collectives – "remnants of China's socialist era." The state tightly controls competition in strategic industries, such as energy, steel and telecommunications, where it retains control over about 150 extremely influential, protected and highly regulated firms. Foreign firms that embark on joint ventures with these SOEs face tough restrictions and the possibility of being ousted by local firms.

> "After decades of being held back by their country's adoption of socialism, [entrepreneurs] and the rest of the Chinese population are moving forward with the force of water gushing from a broken dam."

Private business, "practically nonexistent" before Mao's 1976 death, grew to 80 million workers in 2008 and is now China's "least regulated," "most fragmented" sector. Privately owned enterprises generally receive little government protection or support – even securing a bank loan is difficult. This has made Chinese entrepreneurs very industrious. The competitive private sector focuses on the domestic market. When a foreign firm enters, a local competitor quickly blooms. Today, foreign businesses produce 60% of China's exports. But as domestic industry expands, this share will fall. Global companies are taking full advantage of China as a base for doing business via "value-chain migration." During the 1980s and '90s, the first entrants relocated only their manufacturing operations, but as China's economy accelerates, many corporations will bring in their entire value chains – from R&D to customer service. Knowing that China's usual inefficient, low-cost strategy is not viable, the Chinese – in reaction to change – will move toward high-quality production, a "culture of innovation" and a sustainable, knowledge-based economy.

> China's "wave of energy and entrepreneurship is changing the world, but its impact has just begun to be felt, and it is still often misunderstood, both by outsiders and by China's own people."

One form of Chinese innovation creates a lot of contention: the production of *shan zhai* goods – cheap, knock-off products "tailored to local requirements." Future Cola, which began as an imitation of Coca-Cola, is China's third-most popular cola. In many ways, shan zhai entrepreneurs typify China's domestic business culture, which has six features:

1. **"Bursts of entrepreneurship"** – Chinese firms happily assume risks and make quick "rough and ready" decisions when opportunities appear.
2. **"An emphasis on speed"** – Taking action outweighs careful planning.
3. **"A preference for imitation and experimentation over innovation"** – Trial and error have led to "a significant number of breakthrough models."
4. **"A 'good enough will do for now' attitude"** – The current model or process doesn't need to be ideal. Firms can iron out the kinks later.
5. **"Acceptance of 'the Confucius inside'"** – Hierarchical, top-down leadership models prevail. "Obedience" is a characteristic of all work teams.
6. **"A 'why not me?' view of success"** – The Chinese believe anyone can succeed internationally by grasping any available opportunity.

3. "Official China"

A foreigner may be forgiven for thinking that the Chinese Communist Party (CCP) has faded into the background. Party slogans no longer adorn the building facades, and the CCP no longer controls every aspect of citizens' lives. Foreigners may go many months, or even years, before directly encountering the party. However, the CCP is a 70-million-strong, "omnipresent" organization, whose vast power pervades "every level of government and society," including academic, military and commercial institutions. Its goals are "economic growth, social stability and continued Communist Party rule." Leaders need "subtlety and understanding" to negotiate with official China. Research how the government sees your industry. Banking is strategic and highly regulated, with tough government restrictions that tightened more after the 2008-2009 fiscal crisis. The government says Western banks are not an apt model for China. Official China sets goals for each industry. If officials think your firm is conducive to meeting those goals, they'll let you "participate."

4. "One World"

Any major multinational firm operating in China will become increasingly integrated with the rest of the business world. As the country connects further to the worldwide economy, two significant trends emerge that could reshape global business: The first is the growth of Chinese innovation. Soon, other countries will turn to China's evolving R&D sector for knowledge and staff. Second is the accelerating rate of "value-chain growth...from China to the rest of the world." Business networks of Chinese and foreign firms have developed in China. As this trend grows, whole value chains, not just single firms, will compete. Chinese and foreign companies in these multinational value chains will have to work harder to sustain their positions.

> "China's development over the next decade and beyond will shape the economic and perhaps the political landscape of the rest of the world."

"One-world companies" – that is, "international enterprises that can combine the best elements of international and Chinese operations in unified value chains" – will benefit most from these trends. While China attracts countless one-world companies, no such Chinese firm has emerged. Chinese companies still need to adjust their "management practices." Private companies place too much power in the hands of a single dynamic leader, while SOEs mire down in complicated decision-making protocols. Secondly, other nations, particularly the US, have shown "hostility" by blocking some of China's acquisitions and criticizing its actions abroad. China needs at least 10 years to surmount these obstacles.

> "Dramatic change and uncertainty can be found everywhere in China. Many decisions are gambles. This will remain true for the foreseeable future."

Most Chinese firms lack the resources to expand globally. Those that eventually emerge as one-world companies will have to create international partnerships to boost the weaker elements of their value chains. The Chinese government will continue to control how much companies can integrate with the global economy. The party will keep protecting strategic industries, and it won't let private business develop "oligarchs or a tycoon class" that could threaten its hegemony.

Developing a China Strategy

The four drivers of change create a complex international business climate, but you can create a China strategy to deal with the transformation. Develop three competences:

1. "Vision"

Myopic firms enter China to exploit it as a cheap manufacturing base or to penetrate its huge market. They are either "dismissive of China" or "China-centric." Yet, visionary one-world companies enter China because they see it as "a place of strategic value." Instead of "isolating China," they integrate it into their global approach. To develop a holistic vision for China, ask: How much freedom does your industry have there? Would your firm be able to import elements of its value chain? How can you incorporate its strong suits – "manufacturing, innovation, new business model incubation, talent development" – into your global value chain? How can you obtain the local knowledge to compete there? Can your firm handle risk and uncertainty?

2. "Versatility"

In China, "business takes place on a greater scale than almost anywhere else." Thus, maintaining versatility is crucial. That requires:

- **"Mental fluidity and resilience"** – When faced with uncertainty, which is rampant in China, leaders must remain strong to continue pursuing their original vision and goals.
- **"Organizational nimbleness"** – Prepare a plan of action for numerous possible scenarios so you can adapt with agility.
- **"Coordination...among markets"** – China's abundant, diverse markets are at various stages of development. Synchronize your strategies for each region.
- **"Monitoring of new developments"** – If you constantly observe industry trends, you can make quick decisions in the face of cultural, social or regulatory shifts.
- **"Managing human capital"** – China's dearth of skilled workers and managers persists, and strong cultural differences impede progress. Many firms overcome these obstacles by working to understand Chinese employees' attitudes and investing large sums in training.
- **"Establishing and maintaining relationships"** – Preserving strong connections with official China and with your business partners is important. Chinese regulations are often opaque, but the right local partner can help you navigate.
- **"Running Janus-faced operations"** – Model your firm on Janus, the Roman god who had a face on the front of his head and one on the back. In other words, "run integrated operations that simultaneously look in toward China and its possibilities and outward elsewhere to see how these China strengths can be leveraged globally."

3. "Vigilance"

The wind of change is blowing across China. Learn to gauge the significance of any given change, and react in a fitting way. "Vigilant leaders" plan a decade or more ahead. They keep an "external focus" by consulting outside sources and professional networks for advice. These executives have good "organizational skills," and they empower others to make decisions. Leaders of foreign businesses should understand that China can change rapidly. What works in business today may fail tomorrow. Events don't always unfold as planned, so brace your firm for the next big change.

About the Author

Management consultant **Edward Tse** is Booz & Co.'s chairman for Greater China. He has worked for the World Bank, the Asian Development Bank and the Chinese government.