BUSINESS STRATEGIES FOR ENTERING CHINA

The last few years have seen tremendous growth in the number of US companies establishing operations in China. These decisions will have a profound impact on US China trade for years to come. What's missing from this migration to China is the long-term strategic impact these moves will have, not only on the participating companies, but the US in general. China is a tremendous growth opportunity for US firms if the strategy is sound and implemented correctly. Yet many US companies are rushing to China the way gold prospectors of the mid 1800's rushed to California--blind and overly optimistic! Success in China requires an iron clad vision and a strategy consistent with the overall business strategy.

Common Pitfalls in a Chinese Strategy

Here are some common pitfalls of companies that do not properly develop their Chinese strategy:

1. Global low-cost sourcing. Global sourcing is an issue driving many companies to establish lower cost manufacturing operations. China can provide firms with attractive sourcing alternatives. However, if the strategy is cost based only, companies run the risk of a sharp upswing in the Chinese Yuan. As part of Chinese government policy, the Yuan (RMB) has stayed pegged to the US dollar at a rate of 8.3 to 1 since 1994. There's increasing pressure from the G8 and other countries for China to float the Yuan against the US dollar. Most observers feel if the Yuan were to float it would rise 10-30% against the greenback. This would put upward cost pressures on those operations that established operations in China for cost only.

A China procurement strategy makes sense when dealing with commodity products. However if a US company is a niche market player, China may not be the ideal sourcing location. Smaller based economies such as Australia, New Zealand or Ireland may offer similar cost advantages since their manufacturing sectors are set up for niche volume production.

Another often-overlooked issue is intellectual property protection. According to the Intellectual Property Alliance, China's software piracy rate was as high as 92% in 2002, the highest in the world.

2. Our customers are in China. This is a dilemma for many companies. To be considered as a preferred supplier to large multinationals, firms are directed by their clients to have operations in proximity to the clients' operations in China, a potentially expensive and resource-consuming venture. The key is to develop a global strategy the converts these customer requirements into growth opportunities.

Riding the customer's coattails can provide advantages to the supplier in terms of support from the customer. Companies that take advantage of this requirement will use the operation as a launching pad into the Chinese domestic market.

However, if a company views a Chinese operation as a distraction or a burden they will create a mindset within their organization that their China operation is a drain on their core business: In other words a cost center versus a profit center. This will result in the organization not fully supporting the Chinese operation, creating incoherent strategies and possibly conflict with other parts of the company.

3. Opportunistic entry through a Chinese connection. Many times opportunity comes knocking on the door. Companies that haven't thought of China or have done little due diligence will be approached by Chinese businesspeople offering to help them set up operations. These opportunities are usually discovered at conferences, trade junkets or cocktail parties.

The key to remember is who these people represent. If they have established partners in China most likely they have the interest of their partners in mind and not necessarily your business. This doesn't mean one cannot establish an effective relationship with them and their partners. However, it does require the US company to fully understand the dynamics of the relationship before entering into a program.

Another overlooked factor is that, unlike the US where business people have contacts nationwide, China is more provincial. Chinese agents tend to have well-established contacts in one region or province. This limits the US company's options. If a US company is looking to enter China, they may be better served by working with intermediaries with relationships in multiple parts of China to ensure that the region they establish their operation in is best aligned with company objectives.

4. China is to big for us to ignore. There's no doubt that China offers a tremendous opportunity for US companies to expand. China's business is booming and consumer spending is on the rise. However there are many market characteristics to be analyzed before jumping in, such as:

A. The buying power of the average Chinese is not the same as that of the average American.

B. The value proposition for products and services may be significantly different in China.

C. The time to create a brand image in China will take longer than most companies estimate.

D. Indigenous competition will develop rapidly once a product's value proposition is established.

E. Market channel development requires significant resources to launch and support products.

F. There are many government restrictions to distribution particularly in the retail industry.

What's a Company to do?

We've discussed some of the pitfalls. How can a company successfully enter China? It's important to have a clear vision of what China means to the firm--what will doing business in China accomplish?

- Increase revenue?
- Entrance into the Chinese domestic market?
- Platform to launch into the rest of Asia?
- Component sourcing?
- Enhanced corporate image?

Once the vision is established, the management team needs to embark on a strategy aligned with overall corporate strategy. The desired outcomes entering China will determine how to implement the strategy. The success of the implementation is proportional to the upfront due diligence. Some points to consider when conducting due diligence on China are:

- What structure fits the company's needs?
  - Manufacturing facility
  - Sales office (if government allows it)
  - Agents or distributors

- What are the company's financial objectives?
  - How will the venture be financed?

- How will intellectual property be protected?
  - Use the Coke Cola model?

- How will earnings be repatriated?

- What are the company's alternatives to investing directly into China? ?
  - Joint ventures with Chinese companies

- What is a realistic time horizon for seeing success?
  - Will the management team be around to see the rewards!

Conclusion

The intent of this paper was to share thoughts about "Why China?" This paper was based on our experiences and observations of companies entering this market. We welcome your comments along with your experiences in dealing with China. The following are references to let you explore further:

- Hutchings, Graham. *Modern China: A Guide to a Century of Change.* Harvard Press. ©2000.

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- Whitcomb, Vanessa and Michael Benson. *The Complete Idiots Guide to China.* Pearson. ©2003.

About Mountain Global

Mountain Global is a global business development and management services company focused on helping small to mid size businesses to successfully launch their global strategies. Bob Thilmont is President of Mountain Global. Bob has over 25 years of experience in the Automotive, Industrial and Power Generation industries. He also has over 10 years of global business development experience in Asia Pacific, Mexico and Latin America. For more information see http://www.mountainglobal.biz.

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