Building Competencies for The China Market

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Alberta School of Business
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SESSION AGENDA

Introduction

The business environment in China: Contrast with Canada

Understanding Chinese managers & corporate governance

Doing business in China: the cultural dimension

China business plans and managing risks – strategies and financial considerations
In China, Nothing is impossible but everything is difficult
Beware of China’s speed of change

Expats vs. Chinese

Socio-economic Strata

GOVERNMENT

North-South, Rich-Poor regions

Buy from or selling to

Demographic

BUSINESS – Exports vs. domestic, private vs. SOEs
Disclaimer

Living with the bell curve
1. The Business Environment in China
Is China Capitalist?

http://intelligencesquaredus.org/debates/past-debates/item/544-china-does-capitalism-better-than-america
Socialism with Chinese Characteristics –
Market Economy as way to Socialist outcomes
Introduction of Economic Reform and Departure from Central Planning in 1978

“It does not matter if it is a black cat or if it is a white. As long as it catches mice, it is a good cat.”

Deng Xiaoping
China is less ideological than we think*

“We are the Communist Party. We will define what Communism is.”


*Chinese history/Chinese exceptionalism/nationalism*
Why China? What is your goal?

• Penetrate the Chinese market – through direct exports, local agents, direct foreign investment, or joint venture

• Set up production facilities in China for exports

• Seek investment or business partners for Canadian or other operations

Degrees of business intimacy may be different but the need to understand China and your potential partner partners is the same. The variables and issues to focus on are no different than what you are used to in Canada except they work somewhat differently because of differences in the overall business and political environments and certain cultural idiosyncrasies. The factors that would affect you depends on the sector, nature and location of your business.
Factors you may be concerned with

- The Level of demand for products or services
- Degree of competition and Ease of entry
- Availability of supply networks and costs of production
- Taxes and regulatory regimes
- Business culture and processes
- Foreign exchange and business risks
- State capitalism and local protectionism
- Developmental policies (5 year plans and FDI policies) and Politics
Describing the China Market

- State capitalism
- Intense competition
- Good supplier networks/Rising costs
- Business culture & governance
- Growing demand/Rising income

“The new Normal”

Government regulations

Developmental State/History
Key Influencers of China’s Business Environment

• State capitalism – bureaucratic corporate culture, not always profit-maximizing, agency problems with CEOs, changing government policy and regulations, emphasis on relationship with officialdom, not all private companies are truly “private”

• The overwhelming influence of government policies

• Immature legal framework and evolving regulatory regimes i.e. non-transparency, personal rule (weak rule of law and enforcement),

• An Emerging economy, new to internationalization

• Uneven development and diverse regional circumstances – there are many “Chinas,” they may communicate and operate differently

• A relationship society and economy – due diligence trust building processes maybe different, and Guanxi and Face are key in business relations and negotiations

• Accustomed to risk-taking and high returns

• In a hurry to get things done, short-term oriented and fiercely competitive
China Business Structure:
Government relations inextricably tied to business success

15 of the 20 largest State-Owned Enterprises in China are headquartered within four kilometers of Zhong Nan Hai.
China Business Structure:
Government and State Owned Enterprises
Consensus Building in Economic Policy Formation
Provincial and Central

Policy initiatives can come
From a number of ministries
And commissions

Top down
Industrial policy
in China. Bottom
Up stabilization
Policy in Canada

Govt structure
In Appendix A
Example: % of FDI Policy Changes by various policy making agencies to 2010.

Government Guidance from ministries reflects Developmental Perspective of Chinese government.
Major Chinese FDI needs the approval of various Chinese authorities, including the national or provincial authorities responsible for SOEs (the State-owned Assets Supervision and Administration Commission, SASAC), the National Reform and Development Commission (NDRC) and the State Council (depending on transaction size). Access to foreign exchange is controlled by the State Administration of Foreign Exchange (SAFE). NDRC approval usually comes after a business agreement is reached but before final approval from the foreign government. NDRC is concerned mainly with the nature of the investment and the investment parties (are they consistent with national policies?), rather than the commercial conditions.

This process ensures compliance with national goals of China i.e. the five year plans and changes in government development policy.
Being effective in China means realizing that everything is political - Executives must have a keen grasp of political and social trends ..........

The sort of linear analysis generally favored in the West divides a problem into its component parts and seeks rational solutions. Intuitive thinkers seek patterns and relationships between a problem and its context, including contradictions. “The Chinese don’t polarize - .......; we get moving instead,” says the Chinese head of a global life-sciences company.

Nandani Lynton, 
*Managing the Chinese way*, McKinsey & Company
July 13, 2013.
Goals of the 12th Five Year Plan
March 2011 to 2015

Develop China’s Western Region

Protect the Environment and Improve Energy Efficiency

Continue transition from an Export oriented to a consumption oriented economy

Improve the living standard of the Chinese people

Develop 7 priority industries and increase their share of GDP from 2 to 8% by 2015

The visible hand of Government in China Versus the invisible Hand of the market In the West.
China as a Transition Economy

• Centrally planned economy in transition depends on good governance

• Strong state is needed for the transition period – even to create a framework for a market economy

• Tension between Governance vs. human rights issues

• Institutions will evolve and be shaped by changing economic and social forces – rule of law etc.

• Social and economic forces in state of flux

Legitimacy of the CCP depends on continual growth and an improving living standard. The government is expected to create growth and to improve social welfare.
Changes in Risk Profile in transitional Economies

China is still in the transitional stage

Beware of politics & Manage relations

## China’s Business Environment: Comparative Systematic Risks

<table>
<thead>
<tr>
<th>Systemic risks</th>
<th>China</th>
<th>India</th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Extent that corruption is a problem</td>
<td>7.00</td>
<td>8.00</td>
<td>8.50</td>
<td>6.25</td>
<td>8.40</td>
</tr>
<tr>
<td>b. Nationalism and other cultural risks</td>
<td>6.00</td>
<td>7.25</td>
<td>6.75</td>
<td>6.00</td>
<td>5.00</td>
</tr>
<tr>
<td>c. Institutional weaknesses</td>
<td>6.25</td>
<td>6.00</td>
<td>7.50</td>
<td>5.00</td>
<td>6.00</td>
</tr>
<tr>
<td>d. Intellectual property rights risks</td>
<td>7.90</td>
<td>6.50</td>
<td>8.50</td>
<td>5.80</td>
<td>6.85</td>
</tr>
<tr>
<td><strong>Average score</strong></td>
<td><strong>6.79</strong></td>
<td><strong>6.94</strong></td>
<td><strong>7.81</strong></td>
<td><strong>5.76</strong></td>
<td><strong>6.56</strong></td>
</tr>
</tbody>
</table>

*Grades are scaled from zero to 10, with zero the best grade possible and 10 the worst.*

Source: Emerging Asia S.W.O.T. Report, Political & Economic Risk Consultancy Ltd. August 2011, p.57
How Does China Compare in Asia?

Grades are scaled from zero to 10, with zero being the best possible and 10 the worst.
Source: Emerging Asia S.W.O.T. Report, Political & Economic Risk Consultancy Ltd. August 2011, p.57
China’s Business Environment

Grades are scaled from zero to 10, with zero being the best possible and 10 the worst.

Source: Emerging Asia S.W.O.T. Report, Political & Economic Risk Consultancy Ltd. August 2011 p.68

China is in the 50 percentile - Still far from being easy
How far has China come

According to 2014 data, improvement has slowed.

Note: The distance to frontier measure shows how far on average an economy is from the best performance achieved by any economy on each Doing Business indicator since 2005. The measure is normalized to range between 0 and 100, with 100 representing the best performance (the frontier). The overall distance to frontier is the average of the distance to frontier in the 9 indicator subcategories shown in the figure. See the data notes for more details on the distance to frontier measure.

Source: Doing Business 2013 - China, the World Bank, Fig 1.4
China is Not One Market - Growth of second tiered Cities is an emerging appeal
Current state of the China Market

- The “New Normal” – slower growth, switch to consumption, emphasis on quality growth and Anti-corruption drive
- Intensifying competition – also from domestic firms
- Rising costs – higher min. wage than many Asian countries like Vietnam, Indonesia
- Skilled labor shortages
- Regulatory challenges, though not as bad as many emerging countries
- One China is over – regional growth centers
- MNCs are no longer guaranteed success
- More confident local firms are venturing abroad
- Being “foreign” can cut both ways
Where to do business in China – investing, manufacturing, exporting, sourcing?
# Table 4.2 Top Five Business Challenges

<table>
<thead>
<tr>
<th>Country</th>
<th>2010</th>
<th>2012</th>
</tr>
</thead>
</table>
| **Canadian Company** | 1. Inconsistent regulatory interpretation  
2. Pollution/Air quality  
3. Bureaucracy  
4. Enforcing contracts  
5. Transparency | 1. Intellectual property rules and practices  
2. Inconsistent interpretation of regulations/laws  
3. Weak dispute settlement mechanism  
4. Lengthy/complicated certification  
5. Chinese tariffs and other border barriers |
| **U.S. Company**   | 1. Inconsistent regulatory interpretation  
2. Management-level human resources constraints  
3. Obtaining required licenses  
4. National Protectionism  
5. Bureaucracy | 1. Management-level human resources constraints  
2. Inconsistent regulatory/unclear laws  
3. Non-management level human resources constraints  
4. Difficulty obtaining required licenses  
5. Corruption |
| **British Company** | 1. Retention of high qualified staff  
2. Availability of qualified staff  
3. Transparency of laws and regulations  
4. The legal and regulatory systems themselves  
5. Staff remuneration/pay levels | 1. Global economic slow down  
2. Increase Chinese competition  
3. Labour costs  
4. Inconsistent regulatory interpretation  
5. Increased bureaucracy |
| **German Company** | 1. Protection of intellectual property rights  
2. Availability of qualified human resources  
3. Legal security & compliance with business terms  
4. Bureaucracy & Authorities  
5. Corruption | 1. Finding qualified staff  
2. Increase of labor cost  
3. Retaining qualified staff  
4. Bureaucracy/Administration  
5. Corruption |

**Source:** Asia Pacific Foundation – Canadian Businesses in China Survey 2012
# Perceived Challenges for Canadian companies in China

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Mean</th>
<th>% rated as a major challenge (6 and 7)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intellectual property rules and practices in China</td>
<td>4.93</td>
<td>51</td>
</tr>
<tr>
<td>Inconsistent interpretation of regulations/laws in China</td>
<td>4.77</td>
<td>45</td>
</tr>
<tr>
<td>Weak dispute settlement mechanism</td>
<td>4.55</td>
<td>41</td>
</tr>
<tr>
<td>Lengthy/complicated certification</td>
<td>4.47</td>
<td>36</td>
</tr>
<tr>
<td>Chinese tariffs and other border barriers</td>
<td>4.26</td>
<td>38</td>
</tr>
</tbody>
</table>

**Source:** Asia Pacific Foundation – Canadian Businesses in China Survey 2012
Case Studies

Impacts of politics and ambiguous legal framework
Auto JV in China: Beware of change in Govt policies

- Volkswagen and other foreign auto manufacturers have benefitted from their JV with Chinese firms and support from government buyers in their early years in China. However, beginning in 2013, government entities are encouraged to buy “domestic.” The government spends roughly CAD$13 billion each year on buying cars. Until now Audis and BMWs have been the marques of choice for officials in all but the most remote villages. A draft list of 412 car models permitted for procurement in 2013 has no foreign cars on it at all. These are relatively small cars costing under 180,000 yuan (CAD$28,000 at 2013 exchange rate).
Foreign firms and price-fixing charges: Politics and uneven law enforcement

• Microsoft was investigated by anti-monopoly regulators for price-fixing practices investigation in July 2014 after the Snowdon case raised concerns with security flaws in its products.

• Audi, Chrysler, BMW and Mercedes charged with monopolistic practices in summer 2014—Mercedes had cut prices of parts and after-sale services by 15%, MBW by 20% and Audi was fined $40 million.

http://www.ibtimes.com/china-going-after-foreign-auto-tech-pharma-food-companies-it-says-are-gouging-chinese-1656478
The GlaxoSmithKline Case: Anticorruption campaign

• Local subsidiary of GlaxoSmithKline PLC was found guilty of bribery and fined the company 490 million in Sept 2014. Investigation started in July 2013 from an anonymous tipster. In July 2013. Two Glaxo executives in China were later convicted of “illegally purchasing information about Chinese citizens.”

• This case “raised questions about the limits of due diligence and other efforts to collect information in China, a market where industry data and corporate and executive backgrounds can be hard to come by.”

• With uneven interpretation and enforcement of laws, multinationals too can succumb to the tides of Chinese politics. Glaxo’s bribery practices, were no more brazen than its Chinese counterparts. But the anti-corruption campaign and attempts to reform Chinese health care had changed the landscape for Pharma firms.

2. Understanding the Chinese Manager and Corporate Governance

Edy Wong, March 13, 2014
Influencers of firm behaviors

Like Western firms, Chinese firms are shaped by the same ecological factors, in their own context.

Need to understand Culture, role of State and National goals

Firm Governance, business goals, & Management Practices

- Government/Regulatory
- Cultural environment & values
- Macro-economic
- Financial/business
- Institutional relations
China as an Evolving Society

Frequent government policy changes, developing nature of economy, influx of FDI, lack of systematic information and a relational nature of society mean agility, speed, flexibility and adaptability are key to success in China – this underlies views on contract, business plans, physical investment, emphasis on documentation and legal protocols, and customer relations.

**Good Enough may be Good Enough**
<table>
<thead>
<tr>
<th>Regulatory environment</th>
<th>Business environment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>In China</strong></td>
<td><strong>In China</strong></td>
</tr>
<tr>
<td>• Evolving with Frequent changes</td>
<td>• Rapid changes in economic conditions</td>
</tr>
<tr>
<td>• Fluid and ambiguous</td>
<td>• Short-term oriented</td>
</tr>
<tr>
<td>• Heavily political</td>
<td>• Non-trusting</td>
</tr>
<tr>
<td>• Fitful enforcement</td>
<td>• Government centric</td>
</tr>
<tr>
<td>• Highly bureaucratic, with multiple regulatory authorities</td>
<td>• High growth and profit expectations</td>
</tr>
<tr>
<td>• Influenced by personal factors</td>
<td>• Highly competitive</td>
</tr>
<tr>
<td>• Evolving legal tools &amp; frameworks</td>
<td>• Relationship driven</td>
</tr>
<tr>
<td></td>
<td>• Traditional management</td>
</tr>
<tr>
<td></td>
<td>• Speed equates efficiency</td>
</tr>
<tr>
<td></td>
<td>• Uneven access to Financial capital for SMEs</td>
</tr>
</tbody>
</table>

How do these differ from Canada??
The Need for Speed: Two Examples

Sany and localizing value proposition

• China has its share of inexperienced customers, undercapitalized companies, no-name brands, and unique local business customs and traditions. “The definition of quality, ..., reflects local needs. Construction companies will pay a premium for cement that dries quickly or can be poured in freezing temperatures, since they want to build at maximum speed and operate seven days a week. They will not pay a premium for cement that lasts 50 years instead of 30. Similarly, a Chinese retail chain will not pay for longer-lasting fixtures; if you remodel stores every six months, durability isn’t what you want. Localization provides companies a way to capture value—through what they offer customers and partners, and how they go to market.”

• Sany, a top construction firm in China, has succeeded by adapting to local customers and government needs. “The company’s two biggest product lines are ready-mix cement trucks and excavators, which in developed countries are sold to contractors and expected to last decades. In China they’re mostly sold to local leasing companies, which rent them to local contractors on a job-by-job basis. The leasing companies, though small, are well connected, so they compete on their preferential access rather than on durability, and demand financing so that they can keep their capital commitments down.” Sany’s customers need low capital commitments, not durability. Therefore, Sany specializes in low-end machines with a very local distribution systems. It sells with little or no down payment, and offers the most service. “It uses more managers who know more people, in more places—a very different way to go to market. Multinational rivals like Komatsu and Caterpillar, in contrast, serve the upscale market, selling higher-end machines to the few better-capitalized construction companies. Sany’s business model has generated tremendous economies of scale, so it now has raised its sights, acquiring the German Putzmeister brand and moving into a number of overseas markets.”
Developing new products quickly

• “The speed with which Chinese companies develop new products from existing technologies and ramp up large-scale production is often impressive...Goodbaby International Holdings, China’s market leader in baby carriages and child car seats, beats rivals by introducing 100 new products on average each quarter. Fast-food chains in the country, including KFC China, introduce more new products each year than their U.S. counterparts, because local variations in taste demand it.....The ability to launch new offerings is a by-product of heritage. Companies like Midea, Wanxiang, and Goodbaby started out manufacturing goods they didn’t design. They learned how to prototype swiftly to meet buyers’ demand for quick turnaround; to adapt designs to use different materials when the original materials were too expensive or unavailable; to modify equipment so that they could make different products; and, above all, to keep costs down. That flexibility helped Wanxiang, for instance, move from making bicycle parts out of scrap metal, to manufacturing components for Detroit’s Big Three, to buying and turning around the factories of struggling U.S. automotive component makers.”
Importance of State Owned Enterprises (SOEs)

Understanding China’s politics and SOEs remains an important Exercise – SOEs Still produce over 60% of China’s Industrial output

Source: China Business Insight, TUSAID, February 2013, p.4
What you should know about SOEs

1. Non-commercial goals of Management
2. The Five Year Plan & relevant economic policies
3. National or local SOEs, do they have HK list Co
4. Source of Financing and if approval is needed
5. China Policy Apparatus & FDI Policy
6. Politics & Government Business Relations
7. Business culture

Edy Wong, March 13, 2014
UNDERSTANDING THE STYLIZED CHINESE FIRM (SOE)

**governance**
- Authoritarian or top down Decision making model – though power now shared within board sometimes
- Collective Management culture – consensus within middle-management
- Senior SOE managers are appointed by “Organization Department” of CPC
- Lack (or do not value) transparency and formal processes
- Personal factors play a large role in many management and investment decisions

**Incentive & performance systems**
- SOE managers are rewarded for attaining “national goals” during tenure
- Bureaucratic Promotions prospects are important to SOE top managers
- Subjective and collective performance assessment

**Business cultural**
- Government centric
- Non-trusting of outsiders – value Guanxi
- Less rigid and legalistic than the West
- Speed is a key efficiency metric
- Accept and expect institutional ambiguity

**Source of Funds**
- Commercial bank loans – nature maybe more important than the return of projects
- Private equity or internal funds
- Institutional banks - preferential interest rates
- Finance companies – rates of return, but constraints on investment types
### North America corporations
- Focus on share prices & market standings – accept longer pay back periods
- Executive motivated by salaries & bonuses
- Operational results maybe trumped by market results
- Lobby government through politics and insiders
- Structured individualism
- IP and control concerns
- Transparent governance structure

### Chinese SOEs
- Focus and driven by strategic national goals & government support
- CEO “career” goals and personal objectives are influential
- Near term operational results may be important
- Lobby government through “Guanxi” and economic impacts
- Autocratic management (underlined by consensus)
- In search of new management model and technology
- Non-transparent governance structure

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**A STYLIZED ONTRAST BETWEEN NORTH AMERICAN FIRMS & CHINESE SOEs**
<table>
<thead>
<tr>
<th>North America SMEs</th>
<th>Chinese SMEs (non-SOE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Growth &amp; profits</td>
<td>• Diversification &amp; Capital preservation</td>
</tr>
<tr>
<td>• Strong sense of ownership</td>
<td>• Desire control</td>
</tr>
<tr>
<td>• May wish to protect Propriety knowledge</td>
<td>• Seek to learn and acquire know how</td>
</tr>
<tr>
<td>• Relationships maybe strictly business</td>
<td>• Value friendship with business partners</td>
</tr>
<tr>
<td>• Guided by Business plans &amp; contracts</td>
<td>• Comfortable with “flexibility”</td>
</tr>
<tr>
<td>• Legalistic tendency</td>
<td>• trust issues &amp; reliance on “guanxi” networks</td>
</tr>
<tr>
<td>• Family firms or small investors</td>
<td>• Likely Family firms (immigration intents?)</td>
</tr>
<tr>
<td>• Aware of need for tax planning &amp; Compliance with labor and safety regulations</td>
<td>• Unfamiliar with tax planning &amp; Cdn business legislations etc.</td>
</tr>
</tbody>
</table>

Culture, personal factors, patience and communications are even more important in dealing with SMEs from China
What do Chinese investors want?

- **Capital preservation & risk diversification for Non SOEs**
- **Technology or skills acquisition**
- **Financial returns**
- **Resource acquisition**
- **Brand acquisition & Market access**
- **Non-Commercial Considerations**
CHINA IN THE GLOBAL SUPPLY CHAIN: WHAT MOTIVATES CHINESE OVERSEAS INVESTMENTS

Target zones for Chinese FDI

Invest for:
- Market Access
- Export potential
- Technology
- Diversification

Invest for:
- Resource acquisition
- Technology
- Export potential

External Challenges Faced by Asian Countries in International Expansion

Key concerns for China businesses Going Overseas

Hurdles: regulatory, business and cultural environments

Low management and global skills a hurdle for Chinese firms in globalization”, *Global time*, July 1, 2013, p.21.
Working with Chinese managers

Think “entrepreneurs”
What to Expect

- Pleasantries and relationship building precedes negotiations and serious discussions;
- First meeting may not be as productive as in the West; info exchange prior to meeting may not be as fulsome;
- Information may not be as readily available;
- Use of Intermediary when you do not see a need;
- Consensus is important even though hierarchy reins;
- Plans of action may take longer to formulate but, implementation is very fast;
- Preference for working with “compatriots” or “friends.”
- More intuitive, and less “analytical,” in decision making
- Pecchant for “control” and creating own “ecosystem”
- Must be adroit at managing the state or government relations
- Make decisions in an ad hoc manner and are micromanagers.
- Prefer simple organization structure amenable to decentralization
Chinese Negotiations Tactics

• How you negotiate may set the stage for the long-term relationship, it is more than just the immediate transaction;
• Respect and face are important – intermediaries may be used until details are transparent and prospects for deal clear;
• Chinese tactics may involve manipulating relationships and cultivating trust, legality and “bottom line” less important;
• Negotiating from weakness is acceptable to Chinese (real or tactical) but will become assertive as more info is gained and advantages established;
• Westerners are direct and may use benchmarks, deadlines, pressure tactics other direct approaches;
• Chinese are more concerned with harmony, face and human feelings; Reciprocity even in negotiations is very important
• Westerners see contract as end of negotiations but Chinese see that as a milestone in a long process – terms are seen as more fluid;
Factors to watch for

Exit Strategy
- i.e. potential IPO, off take agreements

Adjust Communications
- Style & business processes (to multichronic, organized chaos, big picture approach), & compatibility
- Of goals

Investor Goals & source of Finance – approval in China?

Time horizons
- i.e. payback period, speed to market or market readiness, business clock speed

Relations Factor
- i.e. Prospective partner relations and demonstration of understanding of investor culture, use of “intermediary”, gifts

Be patient & flexible
- i.e. Negotiate then negotiate, reduce uncertainty avoidance

Political considerations – local government support & Adverse publicity

Edy Wong, March 13, 2014
TAKEAWAYS

• Beware of a changing regulatory and policy Environment and a government –centric business Culture

• Need to understand a relationship society and Your psyche and cultural distance from this society

• Be prepared to adjust communication styles and Business – a different Risk management model.
“知己知彼，百战百胜：Know yourself & know your enemy – and win a hundred battles” – Art of War, Sun Tse

Awareness of your own cultural tendencies & world view is important if an effective cross cultural business strategy is to be devised - what do they say about us? How do our ways conflict with theirs?
Culture is an integrated system of learned behaviour patterns that are distinguishing characteristics of members of a society. Includes everything that a group thinks, says, does and makes – its customs, language, material artifacts, and shared systems of attitudes and feelings.
The Three Layers of Culture

Manifest culture i.e. behavior, artifacts, food, music, language, clothing – Superficial elements

Expressed norms & values

Intrinsic or core values of a culture (intrinsic elements)

Source: Adapted from Ghemewat and Reiche
Comparison of Hofstede Cultural Attributes: China and Canada

The higher the number the stronger is the attribute.

<table>
<thead>
<tr>
<th>Cultural Attribute</th>
<th>Canada</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power Distance</td>
<td>80</td>
<td>39</td>
</tr>
<tr>
<td>Individualism</td>
<td>80</td>
<td>20</td>
</tr>
<tr>
<td>Masculinity</td>
<td>52</td>
<td>66</td>
</tr>
<tr>
<td>Uncertainty Avoidance</td>
<td>48</td>
<td>30</td>
</tr>
<tr>
<td>Pragmatism</td>
<td>36</td>
<td>87</td>
</tr>
<tr>
<td>Indulgence</td>
<td>68</td>
<td>24</td>
</tr>
</tbody>
</table>
## Cultural Values & Ways of Thinking

<table>
<thead>
<tr>
<th>American</th>
<th>Chinese</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Individualist</td>
<td>1. Collectivist</td>
</tr>
<tr>
<td>2. Youth oriented</td>
<td>2. Respect for Age</td>
</tr>
<tr>
<td>3. Egalitarian</td>
<td>3. Hierarchical</td>
</tr>
<tr>
<td>4. Information oriented</td>
<td>4. Relationship oriented</td>
</tr>
<tr>
<td>5. Competency based</td>
<td>5. Hierarchical</td>
</tr>
<tr>
<td>6. Institutional rule</td>
<td>6. Personal rule</td>
</tr>
<tr>
<td>7. Transparency in Law</td>
<td>7. Maintain harmony</td>
</tr>
<tr>
<td>8. Reductionist thinking</td>
<td>8. Holistic thinking</td>
</tr>
</tbody>
</table>
Chinese Cultural Traditions

• Confucianism – respect for hierarchy, emphasis on protocols and social stability, morality through knowledge.

• Taoism – Balances in life and relationships and emphasis on harmony and the Middle way.

• Buddhism - Non-engagement and non-materialism, sanctity of life, charity and harmony.
Dealing with Cultural Differences

• Be aware of the cultural differences that account for divergences in business practices.

• Cultural conflicts may depend on specific circumstances and the relational framework i.e. corporate and industry background, personal and regional factors etc.

• General principles apply only to the majority and may not be true for given individuals.
Two key Concepts: Guanxi and Giving Face
The Concept of Guanxi

- Guanxi means Reciprocal relations that entail mutual obligations. It is a measure of one’s group membership. It means more than membership in a network. It is membership in interlocking in-groups - “Friend of a friend is a friend.”

- Guanxi is only the first level of “connection” – “Gang Qing” measure the emotional attachment and depth of such relations.

- Other Important relationship categories
  - Jia ren – family
  - Shu ren – “familiar” or in-group
  - Sheng ren – “Unfamiliar” or out-group
Four Sources of Guanxi

Family

Ethnic ties

School ties

Army or work ties
Brothers
Buddies
Old friends
Friends

Levels & sources of Guanxi
In China

Family
Armies (Work)
School (class mates)
Home town (Ethnicity)
“Socializing” or relationship cultivation becomes an investment crucial to Chinese life that its value is unquestioned. Friendships or Guanxi becomes an economic asset people try to monetize to offset its economic cost. One’s social status depends on one’s guanxi.
• Guanxi is important due to in-group culture, immature Legal system, non-transparent and fluid policy/regulatory environment, non-trusting business culture, and risk management necessity. **BUT GUANXI IS NOT EVERYTHING.**

• Protocol (or good manners) means never embarrass publically and say “no” directly - This means a need to build trust and personal relationship - Do not under estimate the importance of personal chemistry and relationship despite outward courtesy and warmth. Indirectness in communication style and hierarchical structure means non-linear work processes and follow – up. **Patience is virtue.**
<table>
<thead>
<tr>
<th>Guanxi</th>
<th>Networking (Guanxi Light)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Personal and Private overlap</td>
<td>• Business oriented – personal and business are separate</td>
</tr>
<tr>
<td>• Personal – “friends of friends are friends”; personal – business comingled</td>
<td>• Generally Information focus oriented</td>
</tr>
<tr>
<td>• More like friendship groups in Canada</td>
<td>• Requires less time for its development than Guanxi</td>
</tr>
<tr>
<td>• Requires time investment &amp; relationship in its development</td>
<td>• Does not replace formal environmental scan and professional due diligence</td>
</tr>
<tr>
<td>• Outcome oriented</td>
<td>• Valuable as personal or institutional asset</td>
</tr>
<tr>
<td>• May replace formal and public information channels &amp; used for risk management</td>
<td></td>
</tr>
<tr>
<td>• Considered a personal asset</td>
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</tr>
</tbody>
</table>
Giving and Losing Face

• Giving face (Gei Mian Zi) means giving appropriate respect according to rank and seniority in gift-giving and seating arrangements, offering public praises and recognition, rendering favors for friends (and their friends), elevating others’ social status i.e. let them buy a meal, an generally making them feel and good look.

• Losing face (Diu Mian Zi) means acting inappropriately, not being treated according to one’s social status, suffering public embarrassment, and causing other to lose face. For example, arguing with someone publically or acting confrontationally would cause both parties to lose face. Losing face would undermine one’s status and credibility.
Explaining China’s Business Culture
An Example: Criteria for Dealing with Rule violations – the importance of relationship

1. Relations and Compassion
2. Reasonableness
3. Legality

The West

3. Relations and Compassion
2. Reasonableness
1. Legality
Approaches to Business Relations: Example of culture conflict

The Chinese construct

1. Relationships
2. Discussions of concepts
3. Business Agreements
4. Due diligence and implementation
5. Risk management and problem solving

The Western construct

4. Personal Relationships
3. Contract implementation
2. Decisions and negotiations on processes and goals
1. Risk management and study of potential problems.
## China as a High Context Culture

**Styles and vehicles of Communication, and Perspectives on relationship represent challenges to Westerners**

- **Covert and Indirect messages**
- **Value modesty, humility and discreteness** – reserved and avoid outward reaction, non-verbal communication cues
- **Strong distinction between in-group and out-group:**
  - Need to understand in-group dynamics
  - (Introduction and intermediary are important)
- **Non-explicit rules mean trust building before business**:
  - Value relationship more than tasks
- **Face to face meetings over written communications**
  - Trust and relationship building are a must
- **High commitment to relationships**:
  - Guanxi and in-group membership become path to success

**Relevant to Pre-negotiations Due diligence**

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Maslow’s Hierarchy and context culture

Low Context Culture
- Self realization
- Independence
- Individual Recognition
- Affection
- Security
- Physiological

High Context Culture
- Social Status
- Recognition in group
- Harmony
- Social Integration
- Security
- Physiological

Source: adapted from FEOSS, Chinese Culture and Guanxi
Polychronic Cultural Traits in Chinese Businesses

This is important to understanding business processes and management practices in China.

- Weak separation between private and business spheres
- Favor speed over details – need to multitask leads to poor focus on details
- Long work hours and over time even on weekends
- Frequent interruptions and changes at behest of leaders
- Flexibility valued over rigid processes
- Guanxi over rules - poor corporate memory and rule adherence

Need to adjust communication and work processes
China as a Low territoriality Society

This concept explains behaviors many Westerners observe as “rude and Impolite” in China.

- Small personal space
- Weak boundary between private and public space
- Value collectivism over independence
- Limited personal privacy
- Sharing seen as essential – family properties may be seen as communal
- Non-personal work space

Key to building Guanxi
A Contrast in Culture
China and Canada
What do these table settings tell us?

High degree of task specialization
- Clarity of tasks

Flexible generalist
China’s Collective Culture

The Individualistic approach

The Collectivistic Approach
When good friends meet

China

Canada

Edy Wong, March 13, 2014
Target of Recognition

The Group

The individual

Edy Wong, March 13, 2014
Liu Yang’s East Meets West Iconographs*

*Source: http://www.visualnews.com/2013/10/02/east-meets-west-infographic-portrait-yang-liu/
Handling Problem

West meets Easts
------ Liu Yang
Expressing Opinions

West meets Easts
------- Liu Yang
Human Relation

West meets Easts
------ Liu Yang
Life Style

West meets Easts
------ Liu Yang
Party

West meets Easts
------ Liu Yang
In Restaurant

West meets Easts
------ Liu Yang
Leader

West meets Easts
------ Liu Yang
4. China Business Plans and Managing risks
James McGregor on China

“Q: What do you see as the greatest danger of doing business in China?
A: Being naive.

Q: Naive in what way? How are we putting ourselves in a perilous position?
A: I’m from Minnesota, so I’m almost a Canadian. Canadians are very trusting people and believe the guy across the table is telling them the truth and he’s honest and he’s a good guy. Don’t believe that. I’m not saying everyone is bad; I’m just saying don’t take things at face value. Do your due diligence, and trust but verify.”

Non-Trust as the starting point

Ballard and Azure Hydrogen

• Ballard terminated two lucrative licensing agreements with Azure on Jan 2, 2015 for telecom backup power systems and zero-emissions buses – worth about $6-million and $11-million, respectively. Azure Hydrogen, had failed to pay by multiple deadlines and was trying to renegotiate the terms of the deal without meeting back payments (after Azure was bought out by another Chinese firm who may not have had the capital required to see the deal through, or fully understood how the licensing agreement was structured, and may have felt that they had overpaid for Azure, given the royalties that would flow to Ballard.)

• Lessons: There is a need to “stage –gate” the technology transfer process, which Ballard did not do. Working in “fast-moving markets such as China require flexibility and entering exclusivity agreements too early could leave a company exposed. CEO of Ballard also stressed that “although it is difficult in some markets, executives should thoroughly validate the ownership structure of a company, and whether that company can afford to pay going forward.” Ballard remains optimistic about China.

Pay Attention to

• Human relations and Ethics
• Timelines for business plans
• Be very flexible and “speedy”
• Working with an evolving business relationship, contract and regulatory regimes
• Operational responsibilities
• Managing Cash flows and forex
• Due diligence process
• Supplier and partner selection
• Human resource management
• Business government relations & politics
• Taxation considerations
The End
Appendix A: China’s Political Traditions and Government Structure
Background

• China defines itself as a Socialist state under the Leadership of the Chinese Communist Party (CCP) – the political commissar system i.e. administrative positioned are paired with political ones.

• The modern state was created by a revolution out of a multi-ethnic, multi-cultural “empire” – characterized by Regionalism, cultural & linguistic differences, centrifugal tendencies, and authoritarian political culture.
Key Political Principles in China

1. The CCP is the sole political party in power – traditions of authoritarianism and paternalism.
2. All power belongs to the people who exercise it through the National and Local People’s Congress.
3. The state is to pursue “socialist modernization drive along the road of building socialism with Chinese characteristics” – State Capitalism & China Inc.
5. The armed forces belong to the people, not the “state” - Army run by CCP.
6. Equality among all ethnic Groups and a wide range of political rights for citizens defined in the constitution.
Political Parties in China

• Chinese Communist Party (CCP)
• Chinese Democratic League
• Revolutionary Committee of the Chinese Kuomintang
• Chinese Democratic Nation Construction Association
• Chinese Association for Promoting Democracy
• Chinese Peasants’ and Workers’ Democratic Party
• China Zhi Gong Dang
• Jiusan Society
• Taiwan Democratic Self-Government League
Structure of the Chinese State

• The Chinese Government is subordinate to the Chinese Communist Party (CCP); its role is to implement party policies. The primary organs of state power are the National People's Congress (NPC), the President, and the State Council.
Structure of CCP

Theoretically, the party's highest body is the Party Congress, which meets at least once every 5 years. The primary organs of power are:

- The Politburo which consists of 25 full members with a 7-member Politburo Standing Committee;
- The Secretariat, the principal administrative mechanism, headed by the General Secretary;
- The Military Commission;
- The Organization department which oversees HR decisions; and
- The Discipline Inspection Commission, which is charged with eliminating corruption and malfeasance among party cadres.
China’s Political System

- **President**
  - National People’s Congress (NPC)
  - NPC Standing Committee
  - State Council (35), Central Military Commission (25), Supreme Court, Supreme People’s, Procuratorate

- **General Secretary of CCP**
  - Central Committee (370 members)
  - Politburo (25 members)
  - Standing committee of politburo (7 members)
Understanding the Role of the CPC

National People’s Congress - Parliament

Central Committee of the CPC - decision makers

Central Military Commission - Army

People’s Consultative Congress – vehicle for consulting with other political parties & leaders

State Council – government cabinet

Leadership of party all pervasive though unseen

Source: American Chamber of Commerce PRC
Everything is subject to the “leadership of the party” which is enshrined in China’s constitution, though the party is not legally registered in China. Party membership is seen as a mark of excellence and passport to a better job.
Organizational Mandates & Functions

**The Central Committee of CCP**
- Meets in plenary sessions to form key policies
- Approves nominees to the NPC.

**National People’s Congress** – changes basic Law, approves Laws submitted by CCP Standing Committee
- Meets annually for about 2 weeks to review and approve major new policy directions, laws, the budget, and major personnel changes.

**People’s Consultative Conference** includes other political parties

**NPC Standing Committee**
- Exercises Power when the NPC is not in session.
- Enacts and amends all laws not enacted by the NPC so long as it does not contravene the basic principles of original laws.

**President, Vice president**

**State Council** The Cabinet
- Enacts administrative regulations in accordance with the constitution and the laws
- Present initiatives to the NPC to approve following recommendation from the CCP.

**Supreme People’s Court, Supreme People’s Procurator ate**

**People’s Congresses at the provincial and autonomous region levels** - Enact local regulations that do not contravene the Constitution.

**Higher, intermediate, and basic people’s courts**

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Focus on the State Council

• Members of the State Council include the Premier, a variable number of vice premiers (now four), five state councilors (protocol equal of vice premiers but with narrower portfolios), and 29 ministers and heads of State Council commissions.

• It promulgates administrative regulations and rules in accordance with the Constitution; introduces motions to the NPC and its standing committee; oversees and guides the work of ministries and other state matters excluded from ministries' jurisdictions; allocates work among the central and local governments and oversee national administration; Prepare and implement economic/social development plans and state budget; & examines, nominates, and/or removes government officials. (Input from the CCP’s organizational department)
Legislative Process

- Research and consultation by State Council
- Recommendations and draft laws from State Council
- Promulgation of Law by NPC
- Administrative and Clarifying Regulations by State Council
- Implementation rules at central or local Ministries
Potential Career Paths in the government Sector

- State Owned Enterprises
- Government ministries
- Public institutions & organizations
Understand the Regulatory Environment

Source: Adapted from American Chamber of Commerce PRC
The Rule of Law in China

• Lack of Western tradition of “rule of law” and religious sanctions
• The Confucius tradition i.e. hierarchical and authoritarian social structure
• The mandate from heaven and the benevolent ruler
• Legal system in development
• A unitary state with latitude for local interpretation of laws and regulations
• Laws passed by the NPC must be supported by implementation regulations for implementation
Key reform Measures announced at the Third Plenum (policy Issues) of the 18th CPC Congress

• Relax investment restrictions and expand construction of free trade zones (FTZ) in inland and border areas.
• Accelerate globalization by easing capital inflows and outflows
• Deepen economic reform to ensure a "decisive" role for the market in allocating resources while retaining a dominant role for state ownership.
• The Communist Party of China (CPC) will strengthen its leadership role with a central leading team for "comprehensively deepening reform".
• Further reforms of the administrative system through innovative administrative methods enhancing the credibility and effectiveness of government through a law based, service oriented government.
• Fiscal system reforms to improve budget management, match between local spending and expenditures, and transparency.
• Establish a state security committee to improve social governance and safeguard the interests of the people enhancing social stability

Highlights of the Fourth Plenum (Party Governance) of the 18th CPC Congress

• Build a country with “Social Rule of Law with Chinese Characteristics”
• Ensure CPC leadership in such country
• Strengthen implementation of the constitution; promote administration by law and awareness of the public; build a law-abiding government and society; safeguard social justice; and sharpen CPC leadership in promoting the rule of law.
• Rule the country in line with the constitution and promote government transparency.
• Protection of human rights.
• Set up mechanism to monitor and supervise officials.
• China will recruit more lawmakers, judges and prosecutors from qualified lawyers.
• CPC will improve its internal rules and mechanisms.
• The PLA will promote rule of law and enforce strict discipline.
• China will guarantee the “One country, two systems” practice and promote national reunification in line with the law.

Source: news.xinhanet.com/english/china/2014-10/23/c_133737957_2.htm