


# Getting a (business) grasp on the emerging Chinese marketplace

| The economic rise of China can present simultaneous challenges and opportunities: A market as a competitor, a supplier, and a customer



| This typical pagoda-style building is part of the Longhua Temple, the oldest and largest temple in Shanghai, built in 242 AD (1,765 years ago).

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| At a temple near Shanghai, a moon door invites a pedestrian to go left or right. The Chinese character expresses “yuan,” a concept that is closely tied to the Taoist/Buddhist belief in Fate. So if we have yuan, we’ll meet even though we’re thousands of miles apart; if we don’t have yuan, we won’t know each other even though we’re face to face.

## The social/political situation

**Geosynthetics magazine:** Are there international travel restrictions on Chinese citizens by China or by the United States?

**James Chan:** U.S. citizens can travel to China freely on tourist or business visas. However, most Chinese travelers to the United States are on business visas and have little control over when they can get their entry visas to plan their trips in advance.

**GEO:** Is the yuan expected to be revalued further?

**JC:** Since July 2005, the yuan has gained 7.1% against the U.S. dollar. I think the trend will continue, but I cannot predict how much it will continue to rise and how soon that will happen. It is not China’s style to give advance notice for fear of currency speculation or to be perceived as being coerced by the West to appreciate its currency.

**GEO:** Is there a difference between China’s state-owned enterprises and privately held companies?

**JC:** State-owned enterprises can get bank loans much more easily than privately held companies. Some industries in China are monopolized by state-owned companies. An obvious example is the defense industry; a less obvious example is the publishing industry.

With the exception of high-ranking cadres, employee wages in state-owned companies are lower than in privately held enterprises or foreign-funded enterprises. That said, state-owned companies still account for 70% of the Chinese economy.

**GEO:** What is the Chinese mind-set in doing business with foreign countries or suppliers?

**JC:** China is self-centered in the way it looks at foreign countries and suppliers. It is trying to raise the economic well-being of the country by exporting to the West, especially to an America that is used to buying imported goods. China wants to recreate the West within its own national boundaries. If a Chinese entrepreneur finds a product he or she considers new, marketable or worthwhile, that person will find a way to duplicate the product at home.

**GEO:** How can communication difficulties be overcome?

**JC:** Whether you are exporting to China or outsourcing from China, it is critical to have someone who lives and works in China and who can communicate with you.

- Find an agent, representative or distributor who lives and works in China and has the same values and professional standards that you have.
- Remember that finding a good agent, representative or distributor is a process, and it may take a few months or a few years.
- Get bilingual help at your company.
- Travel to China to meet with your agent, representative, distributor or employees at least once a year.
- Talk to your China contact regularly. Don’t call only when there is a problem.
- Never take anything people say for granted. Check out the information.
- To get to the truth, always talk to people individually. You won’t get much authentic information in a crowded sales seminar.

**GEO:** American and Chinese perspectives on social and political issues may differ. Can these differences cause problems for business?

**JC:** There are many ills in the Chinese society. The country has many internal problems that are now masked by rapid economic growth. Americans will continue to buy Chinese for a number of reasons.

We live in a society that is deeply committed to the *laissez faire* system of freedom of choice. Companies and individuals have a choice to not buy Chinese, but it is hard to stop others from doing so. Consumers generally don’t care where goods are made, as long as they like the price and are satisfied with the quality. Consider Japan’s relationship with China. China has not forgiven Japan for its invasion of China and the massacre of the Chinese people during the war years from 1937 to 1945. History textbooks in Japan continue to ignore the atrocities of Japanese soldiers. Yet, despite deep-seated mutual distrust, China and Japan do a lot of business.

## The industrial fabric market

**GEO:** Is it different doing business with a government-owned Chinese company vs. a privately-owned one?

**JC:** Government-owned enterprises are just as likely—or unlikely—to extend credit to U.S. customers as privately held firms. It depends on how well the company knows or trusts you. Prudently-run companies ask for one-third of total payment before they begin manufacturing and collect the balance upon delivery.

**GEO:** How can companies introduce and sell their products in China and overcome the lack of protection of intellectual property rights?

**JC:** There is no easy way to protect a company’s technology in China, no matter what industry. Each company is responsible

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# Piracy in the China marketplace

| James Chan offers advice about protecting intellectual property.

**It is said that the Chinese will copy any item with disregard to patents and copyrights. Why doesn't the U.S. government enforce its own laws?**

Responding to pressures from the U.S. government and private industry, the Chinese government has tried to curb rampant piracy. The severity of piracy in China might subside somewhat in one industry, but intensify in another. More than 90 percent of all copyrighted products sold in China are counterfeit. Piracy of copyrighted music CDs, computer software and movies cost U.S. companies alone \$2.6 billion in lost sales.

It is crucial to know that Chinese companies pirate one another's products all the time. The behavior is *not* aimed only at the United States. A successful furniture maker in Shanghai came out with a very popular wood wardrobe, and the product was so successful that the "pirates" copied it, made cheaper, look-alike wardrobes and drove the inventor out of business.

Despite rampant piracy, don't become frozen by the fear of piracy and not attempt to sell in the China market. There are many ways to make handsome profits if you're able and willing to conquer the fear of entering a new market.

**How can a product design be protected if it's being made in China?**

**Put it in writing.** Make sure to have a written agreement (or order) with a Chinese partner. Even though law enforcement is shaky in China, it is important to prove that your rights have been violated. Chinese fear losing face in public, but you must be willing to go public.

**Register your trademark.** You can apply for trademark, copyright and other forms of intellectual property

rights protection in China. This procedure may not give complete protection, but it can deter potential offenders.

**Don't put all your eggs in one basket.** A high-end furniture maker in China said that his designs are often copied by pirates, who sell cheaper versions overseas, but he prevails because the pirates can only imitate the look, not the craftsmanship. Still, to protect his designs, he spreads his know-how among craftsmen in different departments. A pirate would have to hire his entire top management and craftsmen team to truly duplicate his designs.

**Guard your core secret.** A major U.S. company has a joint venture with a Chinese partner to manufacture cable equipment used with television sets. Everything is made in China except a crucial technical element, which the joint venture company must import from the U.S. company.

**Sell what cannot be duplicated.** I've helped a specialty bearing manufacturer market very sophisticated, high-end bearings since 1984. The Chinese are able to duplicate the low-end bearings, but they can't duplicate the high-end ones because they use a specialty metal that the Chinese simply can't make.

**Be mindful of what you're asked.** Perhaps the most effective way to protect your secrets is to be aware at all times that your customers in China will ask for your source codes, machine tolerances, machining procedures or software that you use. Don't answer them.

**Turn the pirate into a partner.** For decades, a Chinese pharmaceutical company was able to duplicate a European company's pills and sold them in the China market at such a low price that the European company could not compete. The European company sought out the pirate and offered to form a joint venture with the Chinese



| Piracy or permission? The Chinese obsession with branding is evident in this building in Shenyang City, made to look like a Louis Vuitton piece of luggage.

company and to teach them how to perfect the manufacturing process. The joint venture included the condition that the European company will market the China-made tablet in Western markets in which they have effective legal controls.

**Turn the pirate into a distributor.** I used to sell books and journals to Asia and I knew a pirate in Taiwan who printed Western-language scientific, technical and medical books and sold them there. As copyright laws improved in Taiwan, and as more students and professors could afford to buy the real, imported books, we signed him up as a distributor. After decades of selling pirated copies, he had the perfect customer list!

**Find and groom a sales representative you can trust.** If you want things to work in China, you must have a sales representative who can be your eyes and ears on the ground, giving you information from the marketplace.

**Send the best and brightest people.** If you decide to do business in China, send your best people to tackle the China market. You need people who are smart and intelligent, but who are also able to read people's character and personality and manage them effectively. The China market is not for amateurs.

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| This billboard in the lobby of a state-owned manufacturing company in Hangzhou City pictures model employees expressing personal mottoes exhorting others to be like them. For example, the employee in the 4th column and 4th row refers to the rise and fall of a nation and indicates that each person has a responsibility.

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for coming up with a way to protect its secrets—and when the time comes, to let them go. A Fortune 500 company sold the Chinese government a \$900 million technology transfer. The company was willing to do so because it was an older technology. In the company's estimation, no one in America wanted that technology and it would not have sold anything like that design again. (See related article regarding protecting intellectual property on page 32.)

**GEO:** Reports suggest that the Chinese government is looking at reducing cut-throat competition and improving price realization of goods manufactured in China—investing in better quality and more design. How will that affect manufacturing in China?

**JC:** Except in industries that are monopolized by the government, cut-throat competition will continue, regardless of government policy, because privately held companies in China are free to compete with one another. Improving quality or coming up with better designs happen simultaneously as people find ways to wipe out their competition.

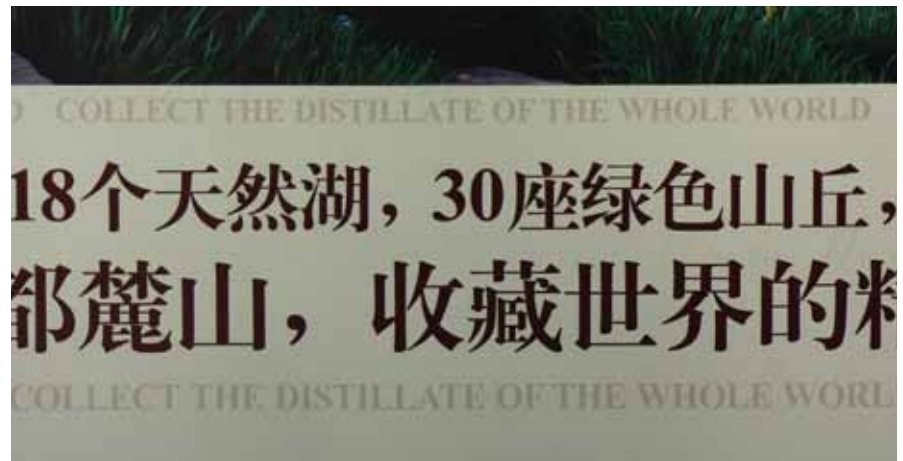
**GEO:** What percentage of manufacturing companies in China are owned by the government vs. privately owned?

**JC:** All major privately held companies have ties with the government and 66% of “privately held” companies are owned by the government.

**GEO:** How can a North American manufacturer of equipment for sewing industries still located in the Western Hemisphere insulate itself from the threat of low-priced Chinese products?

**JC:** Do not think about insulating yourself. Rather, adopt an aggressive, proactive approach. Travel to China to check out the strengths and weak-

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| Advertising “This Place Has Everything,” a sign in the Shanghai airport lures people to buy a luxurious second home in the local foothills amid 18 natural lakes and 30 green hills. The English added to the sign to up the appeal gets lost in the translation.

nesses of your competition. Learn to sell American-made products in China instead of looking at China as a source of products. The Chinese people love and admire American things. Find a sales representative you can trust and cultivate him or her to become your “insider.” Focus on specific products that suppliers in China can’t compete with. Develop new products or designs that keep you ahead of low-priced suppliers.

**GEO: What difficulties do North American importers of products made in China encounter? How can these difficulties be exploited by American manufacturers?**

**JC:** Importing is not as easy as many people think it is. An importer needs to know how to get the orders (this is the single most important reason why Chinese suppliers need a “middleman” in America). An importer also has to deal with difficulties caused by time difference, language, cultural behavior, business practices, customs and red tape on both the Chinese and American side. It is not easy for Chinese suppliers to sell directly in the American market.

**GEO: One reason given for the low cost of Chinese-produced goods is their low cost of labor. How can products having a high material content and low labor content still be sold at such low prices?**

**JC:** You can’t look at low labor cost as the main reason for a low “China price.” A combination of factors contributes to the phenomenon. Some Chinese or-

ganizations are able to get certain materials, even if they are imported from other global marketplaces, at good prices. Many Chinese suppliers get 14% of the 17% value-added tax (VAT) reimbursed if the imported materials are used to make products for export. Wages in rural areas in inland Chinese provinces are a third of those in urban areas and coastal cities. Environmental and labor rules and regulations (such as OSHA) are not enforced adequately or consistently. Local government officials have many creative ways (some illegal) to help manufacturers cut costs if they make products for export. Not infrequently, some Chinese suppliers make their workers work long hours (12 to 16 hours per day) or don’t pay them. Rents are low. Some companies don’t pay taxes. Unless you have an insider who is in the know about what is going on at a particular factory, you’ll never know why some prices are so incredibly low.

**GEO: Is it a good idea to collaborate with a company already doing business there?**

**JC:** Yes, it is, but you must choose your partner carefully. You have to judge the character of your partner. Even then, you must have a savvy manager who keeps track of your operations there on a daily basis. Improving industrial efficiency is welcomed by many firms in China. Anything that can give a Chinese firm an edge over its competitors will be very attractive. If you want to sell anything in China, hit hard on this point.

***GEO:* When establishing a relationship with a Chinese supplier/partner, what short- and long-term issues must be addressed?**

*JC:* The short-term issue is the willingness on the part of the U.S. company to perform due diligence on an appropriate and reliable supplier. It is crucial to find a partner in China with whom you see eye-to-eye on major issues. Long-term issues include political and market risks, such as the possibility of political conflicts between China and the U.S., political unrest in China or piracy.

The China market is high maintenance. Under no circumstance should you get a partner and expect the person to run the business without you checking, monitoring, talking and managing him or her.

## **The business climate**

***GEO:* Can manufacturers of products in other parts of the world compete with China? How?**

*JC:* You can compete in the China market if you have the following advantages or conditions:

- Your company invented a product, system, procedure, brand or method that is unique in the global marketplace.
- Your product cannot easily be copied or duplicated perfectly.
- You possess a raw or synthetic material that no company in China can make or that is always in short supply there.
- Your industry is leaving the U.S. and your customers are outsourcing or setting up their own factories in China.
- You've come up with an ingenious way to keep your proprietary secrets, and you're able to guard such secrets.

***GEO:* Has there been any relocation of manufacturing from China to other countries? If so, which countries and industries?**

*JC:* Relocation of manufacturing from China to other countries is not new, and Vietnam, Thailand and other Southeast Asian countries have benefited from this. Labor-intensive industries such as furniture and textile products fall into this category. Quite a few companies that are based in Southeast Asia are owned by ethnic Chinese who have ties with relatives, friends and investors in Mainland China. A Chinese company that invests in a



| This road sign near Nanjing could be confusing—for locals and visitors alike!

Vietnamese company and ships its products to the U.S. from Vietnam can eschew the perception that it is exporting from China.

**GEO:** The banking system in China is reported to be in trouble. What impact does that make?

**JC:** Western banks don't seem to be fazed by the Chinese banking environment, despite what has been said for years about insolvent Chinese banks, corruption, embezzlement and lack of transparency. The Chinese government has allegedly spent \$70 billion over the past few years to bail out troubled banks.

Since January 2007, China has opened its banking sector more fully to the West to satisfy World Trade Organization (WTO) requirements. For this reason, some of the world's biggest financial institutions are eager to gain access to the \$1.46 trillion in savings accumulated by 1.3 billion Chinese citizens. They want to offer credit card, wealth management and a full range of banking services in a country in which the newly minted middle class—defined as households with \$5,000 or more in annual income—is expected to double from 80 million in 2006 to 160 million by 2010.

**GEO:** Wages in China have increased. What do you think will happen in the next five years? Is there a wage difference between Eastern China and Western China?

**JC:** Wages in China doubled in 10 years during the 1990s. Average wages in urban China are about \$1,000 per year, three times higher than wages in

inland China. The same can be said between Eastern (coastal) China and Western (inland) China. Reducing the wage gap between Eastern and Western China has been a key political task for at least 10 years.

**GEO:** Do you see prices for products coming out of China rising significantly over the next 10 years? Why or why not?

**JC:** Many factors are at work to make prices go up. One factor worth highlighting is the slow but gradual introduction of good business practices that some Western buyers have begun asking Chinese suppliers to adopt. For example, in the electronics industry, the procedure is called "Electronic Industry Code of Conduct" (EICC). In other industries, a similar compliance procedure is the "Social Accountability 8000" (SA 8000). These requirements are created by industry groups (namely, the buyers) and imposed on Chinese suppliers to root out possible abuses including child labor, prison labor, long hours, bribery, sexual harassment and harsh working conditions. These procedures are voluntary industry standards, but suppliers that don't comply will not get the business. These procedures will contribute to price increases.

**GEO:** Are China's companies subsidized by the Chinese government? If so, to what extent?

**JC:** No, if you're talking about privately held companies and companies formed by Chinese entrepreneurs. Privately held companies account for

30% of the Chinese economy compared to fewer than 1% 25 years ago. They are not subsidized by the Chinese government. In fact, entrepreneurs and privately held companies have long complained about the inability to get bank loans from Chinese banks, which favor state-owned companies. Whether or not state-owned companies are subsidized by the government is a moot point. They are arms of the government.

When China became a member of the WTO, the latter agreed that the U.S. would not have to reconsider China's nonmarket status until 2015. Not all nations consider China a nonmarket economy. The Chinese government claims that 37 nations have accepted China as a market economy, including such countries as New Zealand and Thailand.

**GEO:** What challenges does China face in its quest for continued growth?

**JC:** Despite China's phenomenal rise, the country faces a host of internal economic, social and political problems. It faces shortages of various raw materials. There is a shortage of food grains. Local governments are converting rural land into factories and high rises. People in rural areas go to the cities in search of higher-paying jobs. Chinese farmers switch from growing food grains to growing more profitable cash crops. Labor unrest is a troubling issue to the government. State-owned companies are laying off 8 million to 9 million people a year. Air and water pollution is an ongoing problem and it is getting more severe with time. The government has begun spending to deal with water pollution. The problems of air pollution are put on the back burners.

**GEO:** Now that China is a member of WTO, is China playing by the same rules required by WTO members? Will China honor its WTO commitments and ease trade restrictions to allow easier access for North American manufactured goods?

**JC:** China submitted its membership application to the General Agreement on Tariffs and Trade (GATT), the predecessor of WTO, in 1987, and became a member of the WTO in 2001. Since China's accession to the WTO, it has revised more than 2,300 national laws and regulations

## Chinese marketplace

you know the market, set up your own wholly owned subsidiary.

**GEO:** China's cost of manufacturing will increase exponentially over the coming years. Can we coexist until some parity is seen in the world's level of competition?

**JC:** Right after WWII, America helped lift Japan by its bootstraps. The economic development of Japan in the 1950s and 1960s was hailed as an economic miracle. The costs of manufacturing in Japan began to increase, and Japan became an expensive place in which to do business. China will go through the same experience Japan has gone through, but because of China's immense size and population, it will take decades longer for China to turn into another Japan.

**GEO:** Will the U.S. government ever step in to assist manufacturing in the U.S.? Will we become a service society?


**JC:** The U.S. government is trying, but progress is limited. We're already a service economy—70% of our gross domestic product is generated by services. Manufacturing now accounts for only 11% of the American economy.

**GEO:** What is the ability of China's current economic surge to maintain itself?

**JC:** China's phenomenal growth rates may level off after the 2008 Olympic Games in Beijing.

**GEO:** And, finally, what happens when the bubble bursts?

**JC:** The "China bubble" could burst, just as it happened to Japan in the early 1990s. The disparity between the few very rich people and the vast sea of poor Chinese is a source of anxiety for the government. The disparity in income between cities and the countryside, and between coastal and interior provinces, is widening. People have been protesting in the streets. State-owned companies are laying off employees and have reneged on pensions, health and other benefits as they are prospering. China is facing severe environmental pollution problems that need to be resolved immediately.

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| The low buildings in the foreground show the drab building construction of Shanghai in the 1960s and '70s. The new construction with the Shanghai Orient Pearl TV tower in the background has changed the landscape since 1980.

that ran counter to WTO rules. Average import duties have declined from 15% to 10%. The government is gradually opening up the country's service sector to global companies including banking, securities, distribution, legal services, tourism and education.

**GEO:** How does China plan to deal with its insatiable need for energy and power? Has the high price of oil hurt China's profits?

**JC:** Unlike the U.S., China is bent on raising its economic well-being by exporting to the world. China has \$1.2 trillion of foreign currency reserves as of March 2007. It will use this capital to acquire energy and fuel resources, especially in African countries. Despite high oil prices, China's trade surplus surged to a record \$177 billion by the end of 2006.

**GEO:** Who is financing China's huge economical growth and expansion?

**JC:** China itself (for obvious reasons), multinational corporations that contribute to more than half of China's annual exports, and the global financial system. About 12% of Chinese exports to the United States go into the 3,500 Wal-Mart

stores across the country. Wal-Mart buys in excess of \$15 billion of goods each year made by 4,800 Chinese suppliers. Wal-Mart's purchases from China make up about 1% of China's annual gross domestic product. We live in a global economy, where companies seek low wages wherever they can find them and sell their products wherever they can get the highest prices.

**GEO:** Who are China's primary competitors in the global marketplace?

**JC:** Vietnam, the Philippines, Indonesia, and other developing countries that know how to solicit business from the West and get organized are the primary competitors.

**GEO:** Does China accept joint ventures in setting up manufacturing operations in China? Is it better to outsource or set up a joint venture?

**JC:** The Chinese government definitely accepts joint ventures and it is embracing manufacturing with open arms. Start exporting your products to China or begin an import operation on a small scale. If your business continues to succeed and grow, form a joint venture. Once you feel