Doing Business in China FOR DUMMIES®

by Robert Collins, MBA, and Carson Block, Esq

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Wiley Publishing, Inc.

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About the Authors

Robert Collins, MBA, is a senior executive with a major Fortune 500 financial services company. Rob is also a former senior consultant with a leading international business consulting firm. He has more than 20 years of commercial and business development experience in international markets. Rob is an active member of the Mayor of Chicago's Shanghai Sister Cities' Business Committee.

Rob gained a strong understanding of Chinese business and management while living and working in Beijing and Hong Kong, China, for more than 12 years. He managed one of the earliest representative offices in China. While working there, Rob was an officer with the American Chamber of Commerce in China.

Rob obtained a joint MBA degree from the Kellogg School of Management at Northwestern University and the Hong Kong University of Science and Technology.

Rob and his wife, Sarah, have three children and reside in suburban Chicago. The family is active in supporting Chinese-related educational initiatives. The Collins family has hosted numerous Chinese exchange students in Hong Kong and the U.S.

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Carson Block, Esq, is the founder and Managing Director of YBS Investment Consulting, which is based in Singapore. In this role, Carson advises high net-worth individuals and families on their investments. He also advises companies and investment firms on China-related investments. Prior to founding YBS, Carson practiced law in Shanghai with Jones Day, a U.S.–based law firm. In this role, he advised foreign clients on China foreign direct investment and mergers and acquisitions. Before joining Jones Day, Carson was an equity analyst and partner in W.A.B. Capital, a Los Angeles–based investment boutique.

Carson obtained his Juris Doctor (High Honors) from the Chicago-Kent College of Law. He earned his BS in business (finance) from the University of Southern California.

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Dedication

Robert Collins: I dedicate this book to my lovely wife, Sarah. Over many, many years, she has provided me with unwavering support that has enabled me to produce, among other things, the most contemporary work on doing business in China. Sarah, you are the greatest gift that life has given me.

As young newlyweds, we moved to a far-off place called Beijing, China, in 1983. We were truly pioneers. Together, we witnessed the beginning of China's powerful transformation into the modern world.

This book is for my children, too. Thanks to your tremendous commitment to the Mandarin Chinese language, you're well positioned to participate in what China has to offer. My delightful daughter is a treasure in more ways than I can express. G.R., you're an incredibly talented young man with all the makings of great success. And Z-man, born in modern China, you just simply rock!

And last but not least, I dedicate this book to my parents, Mike and Evelyn, who consistently encouraged me to pursue my passion.

Carson Block: I dedicate *Doing Business in China For Dummies* to my father, Bill. When I was a teenager and college student, he gave me the opportunities to travel to Asia and to study Chinese (including in Beijing). When I graduated from college, he provided the backing that allowed me to go to Shanghai and try my hand at business there. Without his support for my China endeavors, neither this book nor my China career would have been possible.

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Contents at a Glance

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Introduction

For many Westerners, something about China is so intense and exciting that it's a social glue among those who've spent some time there. We met through a mutual acquaintance who knew we had backgrounds in China. Over lunch, we swapped stories (and laughs) about living and doing business in China — how challenging the market is, how strong a role government plays in business there, how overwhelming the country can feel, and how everything seems to take so much longer to get done. We both admitted that a solid how-to guide could've saved us a good deal of time hard spent climbing the learning curve. And so *Doing Business in China For Dummies* was born.

We think (and hope) that you can find this book useful as a starting point and reference in your China business adventure. As you find out when reading the book, little about doing business there is easy. Your company needs to figure out how the Chinese business system works and how to develop and manage Chinese relationships — and your company needs to be willing to make a commitment to the market for the long haul. You need a lot of patience along the way, too. But with this book as your guide, your company (and you personally) can benefit from the opportunities that China offers.

About This Book

Doing Business in China For Dummies tells you what you need to know to succeed in China. How does business really work there? How do you get started? What do you need to do to get your business up and running properly?

You decide where to start and what to read. This book is a reference tool for you and your business when and where you need it. It's designed so you can read and understand chapters of interest without having to read the rest of the book. (Of course, you'll be better prepared if you do read the whole thing, even if you don't do so in order.) Just use the table of contents or index to find the topics you want.

This book is organized for easy reference. It's divided into five parts, each with multiple chapters. Within each chapter are various sections that discuss some aspect of doing business in China, such as

- The types of approvals you need to get started
- Deciding where to set up shop
- Auditing factories
- Advertising
- Enjoying a Chinese business banquet

After you read this book, you won't be ready to do business on your own in China; you will, however, have a much better sense of where you need help — through attorneys, translators and consultants, and the like. You'll also have learned from mistakes other foreign businesspeople have made in the Middle Kingdom. In that way, you'll start out better prepared than a lot of businesspeople who've ultimately been successful.

Conventions Used in This Book

We use the following conventions throughout the text to make things consistent and easy to understand:

- All Web addresses appear in `monofont`.
- New terms appear in *italics* and are closely followed by easy-to-understand definitions. Italics may also indicate emphasis.
- **Bold** highlights the action parts of numbered steps and key words in bulleted lists.
- Chinese words are written according to the official pinyin system of Romanization, usually followed by phonetic spellings.
- The word *domestic* refers to China; *foreign* refers to anywhere outside of China.
- The Chinese government controls exchange rates of the Chinese renminbi (RMB), or yuan; because the government has been gradually appreciating the RMB, we don't convert it to U.S. dollars. You can find the current exchange rate at `finance.yahoo.com/currency`. We do, however, offer equivalents of Hong Kong dollars.

What You're Not to Read

We've written this book so you can find the information you want when you want it. We think you're probably too busy running your business to want to read every word from start to finish. We've identified some information in this book as skippable material. You may find this information of interest if you have spare time on your hands, but you won't sink a business deal just because you skipped over it! So we won't be offended if you don't want to look at information such as

- **Text in sidebars:** The sidebars are the shaded boxes that appear here and there. They share mini business case studies and observations on China. Some of them are funny or outrageous. They can be useful illustrations of points that we've made in the text.
- **Anything with a Technical Stuff icon attached:** This information is interesting but isn't required reading to get an understanding of business in China.
- **The stuff on the copyright page:** Maybe you want to save this info for some late night bedtime reading while you're trying to overcome the jet lag from your trip to China! (Otherwise, if you're thinking of knocking off this book, rest assured that it's protected by copyright.)

Foolish Assumptions

We wrote this guidebook on China with some thoughts about businesspeople like you. Here's what we assume about you, our valued reader:

- You're a business professional with some know-how about running a company. You may have some knowledge about international markets.
- You're looking for solid advice on how to understand the Chinese business system and the Chinese culture, too. You want a book that explains China business in a way that can add immediate value to your company and can be put to good use today.
- You've heard the hype and want to understand if and how your business can benefit by being in China. Or you have a great idea for a business and want to figure out whether it'll work in China. You want to know what opportunities in China make the most sense.
- You're part of a small- to medium-sized manufacturer looking for sourcing or a small company looking to sell your product or service in China. You want to do business within China or from abroad.
- Much of what you know about China comes from reading Western news sources.

How This Book Is Organized

Doing Business in China For Dummies is divided into five parts, and the parts are divided into chapters. In the following sections, we give you a brief look at what you can expect from each part so you can get started right away with the area that interests you most about doing business in China.

Part I: Building Your Foundation

The best way to get up to speed on China is to understand the possibilities of expanding your business to China. Starting in Chapter 1, we help you determine whether your company is a good fit for China and suggest the first steps to take. In this part, you get a rundown of China business basics, including its challenges and opportunities. Along the way, we show you how you can ensure that your business plan is strong and executable. We help you determine what to include and what to prepare for.

Part II: Starting Up in China

Figuring out how business works in China calls for a novel take on business as you know it. We give you the lay of the land when it comes to setting up shop. You also get a feel for the different regions where you may consider setting up. We introduce you to key geographic areas that you may want to concentrate on.

From there we talk you through the Chinese government — a key player for any business in China. Building your business in China wouldn't be complete without finding the right people to work in the business, so we give you advice on hiring a local team. And then we show you the keys to unlocking the mystery of finance in China.

Part III: Conducting Daily Business

After you're committed to doing business in China, you're ready to go on location. Don't be intimidated by the vast land mass that makes up the Middle Kingdom, though. We first help you understand the Chinese way of doing things. Their traditions are deep, but you can find ways to make them work for you. We help you literally find your way: From flights to taxis, converting money to finding health care, consider this chapter your basic day-to-day personal guide. Getting down to business, we tell you all about sourcing, selling, and manufacturing. And we also explain how to negotiate with your hard-nosed Chinese counterparts across the table.

Part IV: Building Successful Business Relationships

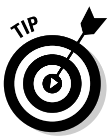
As you figure out in this part, relationships are important to business in China. We guide you to better understand the importance of *guan xi* (connections/relationships) to help you develop and cultivate your most important business relationships. You discover how to successfully navigate the lavish, long-winded Chinese business banquet with grace. We also give you what you need to know to make you look smart rather than foolish. And lastly, we get your business prepared for whatever comes your way in China.

Part V: The Part of Tens

The Part of Tens gives you and your business a bunch of good pointers such as good contract provisions and tips on how to make a profit in China. To take your mind off your work, we share our hand-picked list of ways to enjoy your downtime (in the event you have any!) in China. China's an exciting country worth exploring, and we want you to do just that.

Icons Used in This Book

To make this book easier to read and simpler to use, we include some icons that can help you find and fathom key ideas and information.



This icon appears whenever we have a shortcut to share or an idea that can make your plans even better.

Anytime you see this icon, you know the information that follows is so important that it's worth locking away for quick recall later.

This icon flags potential pitfalls for you or your business in China.

This icon appears next to information that's interesting but not essential. Feel free to skip these paragraphs.

Where to Go from Here

We've organized this book so you can go wherever you need to and get the information you want. Working on your business plan? Check out Chapter 4. Want to know how to get money into China? Head to Chapter 10. If your company wants to sell in China, go to Chapter 14. At any time, you can use the table of contents to find more information or the index to look up more specific topics.

We suggest that you start with Part I if you don't know where you want to go. Starting at the beginning is always a good idea — especially in a complex place like China! Part I gives you what you need to know about the basics of doing business in China and more.

Part I
Building Your Foundation

The 5th Wave By Rich Tennant

"The interpreter we had at that meeting made everything I said sound good. I wonder if he interprets expense accounts?"

In this part . . .

Here, we give you a clear understanding of opportunities in China and help you determine how ready your company is to do business there. And we discuss why you should consider doing business there in the first place. To get you started on the right foot, we point out some cultural differences you need to know about.

This part also looks at where China as a country is today and how it got there. We give you some helpful background on the Chinese Communist Party and point out how China's modernization plan is changing the way people do business there. Finally, we look at how you can develop a solid business plan for your company in China.

Chapter 1

So You Want to Do Business in China

In This Chapter

- Understanding the opportunities
- Recognizing that you're on a journey like no other
- Seeing whether your company is good for what China has to offer
- Finding the correct path for your future
- Taking the next steps

China certainly has plenty of prospects for foreign companies. The flip side is that it can be a tough place to do business. Your company's China team will be challenged to deliver results on time and within expectations. Even some of the world's biggest and best companies have stumbled hard in China. Before you consider investing in China, your company needs to figure out whether the opportunities are a good fit.

Finding the right path for your company is key. You need to understand how the market really works and what role the government plays in your business. Be prepared to change course from time to time in response to this fast-changing market. You may face some of the most brutal negotiations you've ever seen. You have to play by their rules on their home turf, doing business the Chinese way.

Consider this chapter your personal guide on your business trek to China. Your guides have successfully been down this path many times. The journey will probably be long and exhausting, but it'll likely be very rewarding in the end. Let the journey begin!

Understanding China's Appeal

The dragon called China has emerged on the world scene as a new economic powerhouse. Since China opened its doors to foreign business in the late 1970s, its transformation has been absolutely remarkable. Over the last 25 years, China has transformed itself from a centrally planned socialist state to a semi-market-driven, semi-command economy. For more than a decade, China's GDP has grown over 9 percent each year.

China recently attracted over US$70 billion worth of foreign investments in a single year, more than any other country by far! Since China opened her door to overseas companies, approximately US$700 billion in foreign direct investment (FDI) has landed in China. China now ranks as the fourth-largest economy on the planet after the U.S., Japan, and Germany. Soon, it'll be the second-largest economy in the world. Many economists are saying that China will be the world's largest economy by 2025.

If the booming economy isn't enough, this section can help you understand China's appeal. (For more on potential opportunities for you business, see Chapter 2.)

Cutting costs to meet global demands

Manufacturers based in China have considerable cost advantages over companies producing goods in Europe or North America. Foreign investors in China continue to chase cheaper wages and lower operating costs, which translate into improved margins and greater profits. (However, as we explain in Chapter 13, most companies don't lower their per-unit labor costs by moving manufacturing to China. Instead, the improved margins usually come from lower utility costs, one-stop shopping for suppliers, and using more flexible manufacturing models that don't usually work in the West.)

Strong global demand from consumers for low-priced Chinese-made products is driving much of the foreign investment. You've no doubt heard about the large multinational companies that have poured billions of dollars in investment in China to produce goods for export to the West. For foreign companies operating there, *Made in China* can mean making customers in Europe and North America happy by keeping prices as low as possible.

Looking past the veneer

China's economic miracle can almost take your breath away. As you stroll through a major city, you see signs of progress almost everywhere you look. China's urban centers are teeming with people and activity. Shiny new offices and residential towers are popping up all over. Construction cranes dot the horizon as far as the eye can see. Newly built automobiles are clogging up the city's arteries. Consumer product brands from around the world are all the rage.

Your day is filled up with wall-to-wall meetings with the Chinese. The opportunities seem to hold much promise for your company in China. At the end of a long day as the sun starts setting in Shanghai, you find your lower jaw suddenly begins to drop. You see the city's new skyline unfold in front of you as the sun falls behind the hundreds of gleaming new skyscrapers. You think to yourself, "*This* is a land of opportunity."

In China's major cities, you'll no doubt be impressed by the posh five-star hotels, high-speed bullet trains, gleaming new airports, and modern business districts that have risen out of swamps. Some foreigners can easily get a little too carried away with China. But you come to understand that the country has a certain veneer to it. China wants you to believe that everything is A-okay.

As you begin your journey, you realize that China is full of promise. But China is full of challenges, too. Many Western businesspeople tend to underestimate the challenges they'll face. They don't see the trap door ahead of them before they fall through it.

We've heard many horror stories of doing business in China — the Chinese scam artists; companies posing as legitimate businesses; manufacturers producing products from stolen intellectual property; and employee theft and embezzlement. The list goes on and on. China can be a very good market for your business. At the same time, be aware that it can be a very bad place for your business. So keep your business on high alert at all times while working in China.

Accessing a fast-growing local market

Foreign companies aren't going to China just to lower their production costs (see preceding section); they're also looking at getting a piece of the fast-growing domestic market. China's sheer size and growth prospects are a big draw for foreign companies. With the creation of more highly skilled jobs, China's incomes are rising. And rising incomes translate into greater purchasing power for the Chinese in urban centers.

Considering Ways to Get In on the Action

Many people ask themselves, "What's the best opportunity for my company in China?" Business executives and managers may not be clear about what the opportunities are, never mind how to develop them. You should sit down and search in depth to understand the possibilities for your business.

Despite certain challenges, China is a good place for many companies. Foreign companies have the opportunity to sell into China, manufacture in China, or source products or parts from there. This section can help guide you to make better decisions about your company's opportunities in China. We begin by looking at several of the most common possibilities.

Selling into China

Exporting your products to China is one way to enter the market, and it may be less risky for your company, too. China has an estimated 200 million middle-class consumers, and it's adding millions of new consumers who are buying all sorts of consumer products and financial services. A fast-growing middle class, mostly in or near the coastal cities of China, is paving the way for strong selling opportunities. Retailers, financial services companies, and consumer product companies are jumping into the market to aggressively expand their business.

Retailing in China is taking off like a rocket. Soon, sales are expected to reach US$1 trillion. China has more than 20 million retail outlets now. New hypermarkets, supermarkets, department stores, and electronics, appliance, and home décor shops are popping up everywhere in eastern China (see Chapter 14 for details on retail markets).

With the explosion in retailing, the China market is witnessing more consumer products and brands (prestigious foreign brands are particularly popular). New types of consumers are emerging with different needs and wants. The markets are becoming more segmented as consumer buying behavior differs from place to place.

Financial services firms are also starting to enjoy some good times. Foreign banking institutions are expanding their capabilities and services. Foreign insurance companies are starting to gain local market share by providing much-needed protection for Chinese consumers. And because the Chinese savings rate is a whopping 50 percent, financial services companies in particular are salivating at the opportunity to tap into Chinese household savings!

Selling to businesses in China is another huge opportunity. Just about every Fortune Global 1000 firm is now doing business there. Thousands of small- and medium-sized foreign companies are present, too. Opportunities for sales of business services to foreign companies operating there include management consulting, human resources, accounting, legal services, real estate, and so on.

Manufacturing and sourcing

Foreign investors have made China the world's factory. With a good supply of labor (and other lower costs) and high-quality production capabilities, China continues to attract foreign manufacturers. Because China is highly competitive on making products at a lower cost, many foreign companies look to source parts and components there. Some large foreign multinationals are moving their global procurement centers to China. As China moves up the food chain into higher-value products, more companies are procuring higher-quality products and components from China. Chapter 13 can tell you more about manufacturing.

In the meantime, China has made massive investments in the country's infrastructure. New airports, highways, bridges, tunnels, trains, and ports have sprung up across eastern China. This brand-new infrastructure has the potential to allow transportation companies to develop more sophisticated support services for logistics and express carriers, air cargo, and sea freight. Third-party logistics services in China are seeing explosive growth in supporting manufacturing-driven export services. (However, logistics and distribution are still highly fragmented and inefficient, as we discuss in Chapter 14.)

The sourcing capabilities aren't just for the benefit of large multinational companies. Small- and medium-sized companies are jumping on the bandwagon, too. They can now get access to high-quality products and components to stay internationally competitive. They can also avoid middlemen or buyer's agents to keep their prices even lower. Many small- and medium-sized companies are trying to secure their future by lowering costs while maintaining high quality standards. See Chapter 12 for details on sourcing.

Deciding Whether China Is a Good Fit for Your Business

Many traditional manufacturers face rising business costs. Spiraling wages, higher energy costs, and other cost-drivers have taken their toll. Manufacturers have seen others go under before them. As they look for ways to become more competitive, their eyes turn toward China.

Some companies are better suited than others for doing business in China. This section can help you and your company understand some of the important characteristics of a business that's likely to succeed in China. By taking stock of your company, you can evaluate your company's readiness for China.

Your company shouldn't go to China because everyone else seems to be going there. And going to China as the last resort — because your business is already on its knees — isn't a smart move either. Consider doing business in China for one reason: because it makes good business sense.

Considering your employees

Many companies take pride in the fact that they've been a local manufacturer in their home community. Some companies have been in business for several generations. These companies have created jobs for local people, and the company leaders are part of the fabric in the community where they live. Unfortunately, many of these companies are under extreme pressure to improve margins, lower costs, or boost productivity.

For companies like these and other less-established firms, going to China may be an option to seriously consider. But no company leader really likes to outsource jobs overseas. Restructuring your company while laying off loyal company employees is no picnic, either. And other political, ethical, or financial concerns about China may weigh on businesspeople like yourself.

Consider all your options — both in and out of China. As you begin to get a grip on the trade-offs for your business, you'll be in a better position to understand some of the likely consequences as well — and be prepared to explain your decision. Laid-off workers may find some consolation that they aren't losing their jobs simply because somebody else is willing to do their job for a much lower wage. Maybe doing business in China is a survival issue. Perhaps you need a growth engine for new sales. Whatever the reason, make sure you know why China may be your best bet.

Having international experience

Ideally, your company has some proven skills in successfully developing international business opportunities. This experience can be importing or exporting products to selected overseas markets. It may be managing overseas distributors of your products in Europe. It can be sourcing components from a supplier in Malaysia. Maybe you already manage a production facility in Mexico.

International business skills aren't necessary for doing business in China, but they're highly desirable. You have to be a very fast learner if you're new to the international business game and plan to make your mark starting with China. A company with no international experience can do well, but it needs to be extra prepared for what lies ahead. For more information on business planning, go to Chapter 4.

Getting company leaders on board

Some companies know that China is an option for their business, but the owners don't have the time, energy, or inclination to figure out how to make China work for the company. They don't know where to start. They don't have a roadmap to help them find their way. It seems all too foreign for the owners. And it seems way too hard. If your company leadership has this type of attitude, don't attempt to do business in China.

You need to have strong leadership that's committed to making your China business a success in the long-term. Without your company leadership's full commitment, the chances of failure increase drastically.

Having patient capital

Your China business will likely require a significant amount of financial resources to get started and to keep your business up and running. Most companies find that making a profit in China takes longer than it does in the West. Generally, you can expect getting profitable to take twice as long. In part, this delay is due to China's competitive business landscape. Getting to critical mass takes time, too. If your financials aren't at full strength, stay away from China — your company doesn't need to take on any more risks.

Dealing with the government and laws

To set up in China, your company should be comfortable working with government workers and officials. You'll face a lot of red tape with many permits and approvals required, too. And China's government bureaucracy has a well-deserved reputation for moving at a snail's pace. On top of it all, the government official you deal with today may be gone tomorrow. If your company isn't prepared for dealing with government bureaucracy, China likely isn't the place for you to do business.

China's business laws are quite different from what you're used to. Make sure you do your research and can get some good legal advice. Here's what you have to be ready for:

- Your company needs to have its various business activities preapproved and then stay within them (unless you want to get more approvals).
- The currency, the *renminbi* (RMB), has a lot of exchange restrictions, so you want to structure business in a way that optimizes your ability to repatriate money. (See Chapter 10 for details on money.)
- You're not allowed to own land in China — you may only own rights to use the land for a period of time. And the types of rights vary, so you have to be careful about which ones you're receiving.
- China has different systems for taxation, labor regulation, and resolving disputes (among other things).
- Many of China's laws are somewhat business-friendly. Getting to understand how they affect your company is imperative.

One area where China's laws are very weak is intellectual property rights (IPR) protection. Don't sell or manufacture in China if you need to rely on intellectual property laws alone to protect technology or processes. Go somewhere where you'll have more protection. See Chapter 17 for ways to protect your company's IPR.

Appreciating cultural differences

Different cultures do business in different ways. If your company has trouble adapting to new ways of doing things or respecting a culture that's different from your own, your company is probably not well suited for doing business in China.

On the other hand, your company's culture can also be its biggest draw in the labor marketplace — the Chinese are often hungry to work for foreign companies that offer more flexible and creative cultures than Chinese companies do.

Tracing the Path to Success

China is certainly not for the fainthearted. Many businesses over the years have tried and failed. Some foreign investors have failed more than once! The good news is that we know of many success stories in China, too. You can find the path to success — you just need to know where to look for it.

What this book can deliver is a great deal of hands-on experience and know-how about doing business in China. You need nerves of steel, the patience of a saint, and the cunning of a fox. But your company can win in China. We're here to guide you down the right path.

Getting the right knowledge of China under your belt

Before you get started in any new market, you need to get the lay of the land. Finding your way through the maze takes time. China's certainly like no market that you've ever done business in before.

The best way to look at the situation is to consider yourself a really big sponge. Soak up as much as you can find out about the China marketplace. Squeeze as much information out of good sources as possible. With the knowledge of what the business environment is like, how the government gets involved in business, and some of the market challenges you'll likely face, you'll be much better prepared for the journey ahead.

WARNING!

Don't believe just anyone who says he or she is an expert on China. The China market is way too complicated for anybody to be a true expert on business. (And because the market moves so fast, becoming out of date very quickly is easy.) We're here to serve as your guides, not your gurus.

To get a head start figuring out China and how to develop the right business plan for the market, check out Chapters 2, 3, and 4.

Starting your engine

Visit China a few times before you start making any decisions. The best information and advice in China comes from people who've done what you're trying to do — especially if they're only a little further along than you are. Put your feet on the ground just to do some networking. Take people out to lunch and pick their brains. Then start thinking about making some decisions. The more slowly you go and the more patient you are, the more information you'll collect and the better your chances of success. See the following section titled "Taking the first steps: What you can do today."

After you've broadened your knowledge of China, you're ready to get your business started. Some companies plunge right in with a real physical presence in China; others do business from a distance. Still others go halfway by setting up in Hong Kong. You have to figure out the right approach for your situation.

For newcomers to China, organizing a new company can be a real challenge. You'll soon be asking yourself what kind of company structure you need for your company's business in China. You have other considerations, too, such as geography.

And getting the right people in China can be a difficult task. You may encounter a shortage of talented managers with the right mix of skills and abilities. All this startup activity comes at a cost, too. If your company needs to be physically present in China, see Part II.

Getting down to business the Chinese way

When you first start doing business in China, you may think you've landed on another planet! But armed with an understanding of how business really works over there, you'll find it's not as hard as it seems. For information on the how the Chinese go about business, go to Chapter 11.

The hard part comes when your company starts to negotiate with the Chinese. They're tough as nails when bargaining, and they have a reputation for being some of the hardest-hitting negotiators around. *Cunning* is probably the best way to explain their style, which is very well developed but can seem outrageous and unprofessional to foreigners. To find out what you can expect when you sit across the negotiating table from the Chinese, go to Chapter 6.

Organizing your team for China

Putting a good team together in China is a balancing act. Many successful investors do well in part because they make sure their top one or two China managers are long-time company employees from home markets. If you're going to succeed in China, you have to ensure that your company's culture in China is foreign yet respectful of Chinese culture.

One must for attracting and retaining talent in China is to make sure you have a clear idea of how you can help your Chinese employees develop their skills and careers. You may find that Chinese employees are hungrier to learn than any other employees you've had. If you don't feed that desire — even for unskilled laborers — you're going to have problems with retention. To find out more about organizing your team, go to Chapter 9.

Remaining flexible while staying the course

Advising you to keep your eye on the ball with China would be wrong — you have to keep your eyes on a number of balls at the same time. Don't fixate on any one thing (such as minimizing taxes) while ignoring others. Don't marry yourself to any one strategy or plan, either.

You're learning, and you'll make mistakes. Don't be afraid to recognize and correct mistakes. Your operating environment can change at the drop of a hat, too. Be ready to make large and fast changes to keep up. Even though you likely have to change quickly and often, stay committed to China. Don't expect overnight success — you'll get there eventually.

Respecting the country for what it is

China can look modern at first glance — glass skyscrapers, Chinese with Western MBAs toasting fine wine at Jean Georges restaurant, and glitzy neon displays in downtown shopping districts. This setting may be interesting, but it's not China.

China was isolated from the Western world for the better part of three decades. It's an old society with an old culture. Although it's changing, the vast majority of China hasn't been transformed yet. Don't ground your expectations on your experiences in the West. Some things are easier in China, but many aren't.

You should give the Chinese some credit where it's due — dragging millions out of poverty and overhauling a plodding centrally-planned economy. Chinese society today faces many strains and has plenty of growing pains. Don't hold this against the Chinese — they're doing a pretty good job when you look at the challenges they face.

Staying on the lighter side

Keep your sense of humor about you. If you can't laugh at yourself when you're doing business in China, you're going to go crazy! Doing business in China may be the most challenging thing you'll do in your business career — humor helps to keep things in perspective.

Taking the First Steps: What You Can Do Today

Ancient Chinese philosopher Lao Tzu once said, "A journey of a thousand miles begins with a single step." That's good advice for someone exploring the China market for the first time. This section can give you some valuable ideas on how you can get started now.

The right next steps to get you and your company headed in the correct direction aren't that difficult. Here are three simple steps to assist you in getting started on your journey:

1. **Read.**

   A lot of information on China is in the media and online. You can find some good info from government and official agencies, such as your country's commercial or trade service and the chamber of commerce. Some countries offer specific China-related resources for businesses thinking about doing business in China. Check out what specific China information and services your home country government may provide.

   Some of what you read may be of limited value. China is so big and diverse that generalizing about it is almost impossible. Moreover, some writers step off the plane, see modern buildings and new cars, and write about China as though it's as developed as Luxembourg. A lot of sources don't give you a realistic picture. Be wary of any literature that seems overly positive or overly negative on China.

2. **Go there.**

   Take business trips to different parts of China. Consider visits to both large- and medium-sized cities to get a flavor for each. Go to a city in the north and the south. And perhaps visit a city somewhere in between, maybe a place outside of Shanghai.

   Attend business networking functions while you're there. Go to some trade shows. Visit factories if you can. Look around, smell the smells, and observe keenly. Most of all, don't be too wide-eyed — try to scratch the surface and find out what's underneath.

3. **Reach out.**

   The best people to meet are people who're doing something similar to what you want to do. Sometimes, the most informative contacts are only a few months ahead of you on the road. Arrange beforehand to see people you think may be helpful. Follow up with contacts you make while networking — even if they don't seem to know much more info that can help you (you never know who they know or may meet). By talking with others who have experience, you can start to piece together your plan. Be careful to get a diversity of viewpoints, though — don't overly rely on a few people for advice.

If we can leave you with just a couple of themes for the rest of this book and successfully doing business in China, they're patience, flexibility, and persistence. The more time you take to plan, or find a business site or partner, the better your chances of success. The better you are at quickly adapting to changes in the operating and regulatory environments, the more likely your success will last.

Chapter 2

Brushing Up on China Business Basics

In This Chapter

- Outlining why you want to do business in China
- Seeing some expert picks for what industries should do well
- Understanding the business environment
- Getting a sense of the challenges of doing business in China

Many large multinational companies have been in China for years, but even if you're part of a small or startup business, you can still find plenty of opportunities. This chapter gives you some food for thought about how to do business in or with China, gives you a big-picture view of the business environment, and outlines some of the challenges you're likely to face.

Considering Why and How You Want to Do Business in China

Before making the jump into China, consider your goals. Some people want to use China to improve their existing model or to sell into a growing Chinese market. Others think about China because their competitors are already there. Whatever your reason for considering China, think carefully about your objectives and keep them in mind throughout the course of planning and executing your business. The following sections explain the basics about how you can use China's enormous population to achieve those goals.

Manufacturing in the World's Workshop

China is often referred to as the World's Workshop because of the many goods it produces for export. Since the 1990s, China has taken over manufacturing from many higher-cost countries and regions, such as the United

States, Japan, and Western Europe. It has also welcomed manufacturers from places such as Hong Kong, Taiwan, and Mexico. Shifting factories to China has meant job losses in some countries, but it's kept prices low for consumers everywhere.

At first, China manufactured low value-added products, such as toys and sunglasses. The country continues to do so, but China is becoming a larger player in manufacturing high value-added products. For example, China today is a major producer of semiconductors, mobile phones, and computers.

Surprisingly, China's manufacturing labor costs — which are a fraction of the cost in developed countries — aren't the lowest in the world. Other Asian countries, such as Vietnam and Indonesia, are developing large manufacturing bases with lower labor costs. But China's other advantages equal money-savers that beat out cheaper locations. Years of dealing with foreign manufacturers means China's policies are more investor-friendly than those of its rivals, such as Vietnam. With its existing manufacturing base, China offers a one-stop shop for sourcing inputs for almost any product. Plus, China has better infrastructure than its Asian competitors because of its massive investments in roadways, ports, air, and rail over the past couple of decades. Foreign companies continue to come to China in part because they can get things done more cheaply overall.

Manufacturers coming to China are generally (but not always) trying to export their products rather than sell them in China. For info on domestic sales, see "Reaching untapped domestic markets," later in this chapter.

Harnessing people power to export services

In addition to manufacturing (see the preceding section), China presents opportunities for providing services to the rest of the world. With modern telecommunications, companies can perform many business functions at locations far away from where they're used.

China's plentiful and cheap technical talent makes it a good place for certain service businesses. A Chinese engineer may cost as little as 10 percent of his or her counterpart in the developed world. Also, each year, China is graduating substantially more engineers and scientists than the United States is. The caveat is that *good* technical talent isn't plentiful. If you can hire well or design your business processes in a way that less-skilled technical people can add value, then exporting services can work for you.

One way to take advantage of China's lower wages and technical skills is to set up internal service divisions in China. For example, Microsoft has a research and development center in Beijing. (Of course, Microsoft can hire the best of the best from China, and its R&D center also helps provide market access in China.) Another approach is to establish outsourcing companies that can handle technical work, such as IT programming. Also, some companies operate call centers in China to service customers from all over the world. We briefly discuss outsourcing business processes in Chapter 12.

REMEMBER

One challenge service exporters face is English proficiency, so you need to realistically assess your needs and the talent pool. Despite the high number of college graduates each year, relatively few graduates are fluent in English. Therefore, some observers think India is a better place for service exports. China is making progress in improving its English proficiency, though.

Reaching untapped domestic markets

If you have the right product or service and the right plan — and some knowledge about selling in international markets — you can do very well selling to the Chinese. We explain a bit about the development of consumer culture and the challenges of selling in the domestic market in the following sections. For more on selling in China, see Chapter 14.

Birth of a consumer culture

China's domestic markets offer tremendous potential in many areas. After the communists took over in 1949, China was almost completely closed to Western (and most foreign) influences for several decades. The 40-plus year period between 1949 and the early 1990s was a pretty drab time in China. People mostly dressed the same, usually wearing black, white, and gray clothes in the style of Mao Ze Dong's plain clothing. The goods available to consumers were quite limited — usually just basic necessities. Travel outside of China was restricted and usually limited to the elite. Basically, people didn't have much money, and even if they did, they could do little with it.

Now that China's economic system has opened up and the semi-market economy is putting money in people's pockets, consumer culture is beginning to flourish. Especially as credit becomes more widely available, you see consumers wanting and buying more and more goods and services. China is also seeing an unprecedented wave of urbanization, with millions of Chinese people moving from the countryside to the cities.

As China creates massive amounts of wealth, it presents growing markets for all price levels of products. On the high end, mainland Chinese are now among the world's biggest purchasers of designer luxury goods and luxury cars. High-end real estate prices in Beijing and Shanghai are up there with those of many wealthier Western cities. In terms of the mass market, within a half generation, goods such as refrigerators, air conditioners, color TVs, and washing machines have become standard for many tens of millions of people. The bottom line is that the Chinese are beginning to fall in love with consumption and are creating lifestyles to match their increasing affluence.

Many goods and services are available in the West but have yet to spread throughout China. And of course, someone can always create a good or service specifically for the Chinese market. If you spend a little time in China, you'll probably experience a couple of times where you think to yourself, "What they really need here is. . . ."

Facing the challenges of selling in China

Selling into the Chinese consumer market can be quite rewarding, but it's a challenge. Distribution is extremely costly and complex. Also, China is the fastest-changing consumer market in the world, which requires your company to constantly create the impression that your offering is new and improved.

Another problem is that the Chinese are extremely price sensitive in many product categories. Consumers there usually pay more attention to price than quality. Selling higher-priced products requires training a sales force to sell in ways that are new to many Chinese. Realize that Chinese people do pay for products that give them face, or status. In other words, products that others can see, such as mobile phones, give them face. Products that others don't see, such as toasters, don't.

Competing in the domestic market against products that Chinese companies manufacture is difficult for foreigners. Many Chinese manufacturers, especially large ones, have political connections that get them extremely cheap financing or other bonuses. In some cases, your competitors may be able to sell products for less than what they cost you to manufacture. (Foreign manufacturers may be better able to compete domestically in China by making *components* for products made in China by either foreign or domestic manufacturers — see Chapter 13 for info on manufacturing.)

REMEMBER

China is many discrete markets, each with its own type of consumer, so look for niches. You also need to be attuned to overarching cultural differences that affect marketing and product/service acceptance. For example, Chinese women don't usually buy tampons because they feel that using an applicator is too risqué. And Chinese people prefer their skin to be pale, so self-tanning products tend to meet a chilly reception.

The Experts' Choices: Some Long-Term Growth Industries in China

China's biggest areas of growth are mainly consumer products and financial services, but they also include real estate, transportation, retailing, pollution control, and much more. In an economy growing as rapidly as China is, you see a great deal of long-term growth industries. Here we've made a short list of areas that experts have identified as having particularly bright long-term growth prospects.

Services

You can make good money by providing services either to Chinese people and companies or to other foreigners. On the Chinese side, here are some areas expected to grow substantially over the long-term:

- Travel
- Financial services
- Education

And here are some growing areas in catering to foreigners:

- Legal
- Consulting
- Manufacturing support

If you want to focus on the foreign consumer business, you can also find good niches there, depending on your business's location.

Healthcare

China's healthcare market should continue to grow rapidly for a number of years because of China's aging population, increased wealth, wider availability of insurance, and greater interest in health issues. Also, China's massive number of smokers (see Chapter 5) may boost demand for healthcare.

You should see opportunities across the board in healthcare — from opening medical clinics to making and selling pharmaceuticals and medical devices. Some analysts estimate that the size of the Chinese pharmaceutical market will be the same size as that of the United States by 2020 — and pharmaceuticals are still rapidly growing in the U.S.!

You may find opportunities in hospital and medical clinic operations in China (and with such a large number of elderly people in China, long-term care facilities may be quite attractive to investors). The quality of China's hospitals varies quite a bit — especially between the cities and rural areas. For several years now, most Chinese hospitals have been profit oriented. However, many of them lack modern management methods to both deliver solid care and generate strong profits. Businesspeople or investors with managerial skills should find a large, growing market.

TIP

If you're thinking about bringing more-advanced healthcare to China through foreign doctors and/or high-tech equipment, make sure you understand whether the market in your target location can afford such services.

Environment and energy

As China continues to develop, industrialization leads to increases in energy consumption and pollution. Your business may be able to help China address these issues.

A need for clean energy

China's economic growth is already straining its energy resources. Much of the increase in oil prices from $25 per barrel not too long ago is due to China's growing demand. China's economy is highly energy dependent — lots of factories, machines, and mega-cities. And improving standards of living are demanding ever more energy, too, with millions of people buying cars for the first time and hundreds of millions of people buying new electronics. If your business can bring more power or increase power efficiency, a big market may be waiting for you in China.

China gets most of its electricity from coal, a resource that China has plenty of. But here's the major problem: China's coal-burning plants are clouding the air not only in China but also as far away as Los Angeles. The government is making big efforts to produce more energy in less environmentally harmful ways.

China provides business opportunities for companies that can provide clean energy sources, such as "clean" coal, natural gas, wind power, hydropower, solar power, and so on. The government has already enacted laws that provide incentives (such as tax breaks) to investors in those fields. In addition, because clean energy programs help local governments achieve political goals, your company may be able to negotiate additional sweeteners. (For more on developing government relations, see Chapter 8.)

WARNING!

The energy business in China is difficult in part because the various grid operators make transmitting electricity quite costly. The government controls the energy sector fairly tightly. One solution is to build power supplies at the site of the end user. Or you can be a component supplier or build and operate a power plant.

Getting back to green

China has serious pollution problems throughout the country. Unfortunately, pollution has badly affected the country's air, soil, and water supply. China may be a gold mine for businesses that can help it clean up. Whether your business performs remediation or can give China a cleaner way to do things, you're likely to find a warm welcome from the government and a lot of potential business.

Agribusiness

With 22 percent of the world's population but only 7 percent of its arable land, China has too many people to feed. As Chinese people get wealthier, they'll want to eat more — and more expensive — food. Many experts are projecting that over the next couple of decades, China's growing affluence will make the demand for food soar. At the same time, China's farmland is rapidly giving way to factories and industry. China's usable water is also decreasing due to pollution and overuse. All of this means that China is going to need a lot more food from abroad, making agribusiness a good place to be.

This trend is already noticeable. During the past several years, prices for many food commodities, such as soybeans, have gone up quite a bit. Much of the increase has been due to growing demand from China.

One of the nice things about doing agribusiness with China is that you can do it from anywhere in the world where you can grow crops and produce food. Of course, you may also produce food within China, where most farms and agribusinesses use outdated technology and techniques. Affluent Chinese — particularly those with children — are now starting to get interested in organic food out of health concerns, so if organic's your niche, some of these old techniques may not need much modification.

Understanding China's Business Environment

China's business environment is rapidly changing and complex — especially for foreigners. The following sections should give you a good idea of the factors that play the biggest roles in China's business environment.

The economy: Getting the goods

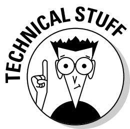
China's economic growth is one of the major changes of our time. Over the past 20 years, its gross domestic product has grown by an average of approximately 11 percent annually. But there's much more to the story than impressive numbers. Read on.

A history of government ownership and production

When the communists won the civil war in 1949, they began to take control of banks and most large businesses. Basically, the government started running the economy. Following the Soviet model and communist doctrine of the time, the Chinese focused on the rapid development of their heavy industry. The most important goal of most state-owned business was output, output, output — even when that meant losing money! China's economy more or less stumbled along that way until Chairman Mao Ze Dong died in 1976.

Rapid growth and opening markets: China as a social(istic) climber

Since 1976, China's economic strategy has changed a bit (see Chapter 3). For one, China didn't want to collapse the way the Soviet Union did after years of ignoring calls for economic reform. In the 1990s, the Chinese focused almost single-mindedly on boosting GDP growth. Their thinking was that high GDP growth would create jobs — and they were right. China's investment and economic policies opened the country up to foreign investment. At the same time, the central government gave local and provincial governments a lot of control over their local economies.



Today, industry accounts for almost half of China's economic output. Officially, agriculture is a little over 10 percent, but that number is probably low because it doesn't include a large group of subsistence farmers. About 40 percent of the economy is services.

Private businesses create more jobs than state-owned enterprises (SOEs) do now because many SOEs are shedding jobs and/or becoming privately owned in order to become more efficient. Foreign visitors often talk about how China is now more capitalist than the West — and it's still supposed to be a communist country!

Continued government involvement

Despite moving to a much more market-based system, the government still exercises some old-fashioned economic control. For instance, the government keeps tight control over the renminbi (RMB), or yuan. The RMB isn't fully convertible (see Chapter 10), which means that you usually can't exchange it outside of China, Hong Kong, and Macau.

Also, China still protects some sensitive industries from foreign and even domestic competition by enacting laws that prohibit or make it hard for businesses to compete. Such industries — such as telecom, energy, and air transportation — may be key to national or economic security.

Or these protected industries may be politically sensitive because they employ a lot of people or make a lot of money for the government. One very high profile example of this was the attempt of the Carlyle Group, an American private equity firm, to acquire Xugong. Xugong is a profitable state-owned heavy construction equipment manufacturer; however, the planned transaction became a political flashpoint in China. Ultimately, Carlyle had to buy far less of the company than it had planned.

Although the state-owned enterprises (SOEs) are becoming a smaller portion of the economy, they're still a major force. The government uses them to carry out policies, such as creating jobs in areas with high unemployment. In other instances, the government is letting SOEs fail and training the former workers to work in private industry.

Resulting problems of China's development

Although the living standards and incomes of virtually all Chinese have improved during the past 20 years, the economy hasn't benefited the Chinese equally. There are enormous (and growing) differences between the haves (a relatively small but rapidly increasing number) and the have-nots. About 1 billion of China's people live in abject poverty. Three hundred million or so have achieved at least middle-class lifestyles. Among that 300 million, China has sizeable numbers of millionaires, making it among the largest markets for many luxury good sellers.

The differences in progress are clear when you compare areas on the coast with areas in the interior, cities with the countryside, and the well-educated with the not-so-well-educated (a relatively large number). Most of China's wealth is along the coast, with some wealthy cities farther inland along the Yangtze River. The have-nots notice the differences in development and wealth because they were taught that China is a socialist country.

Some of China's economic growth is from unproductive investments. By *unproductive,* we mean that the investment capital is used in a way that doesn't make business sense. When the government gave provinces and cities a lot of power over economic decisions, the only requirement was that the local governments deliver GDP growth and jobs. In response, many local governments went crazy building things — especially skyscrapers, roads, and bridges. Sure, these projects created jobs and put money into the economy. But in many cases, funding the projects cost the government much more than they were worth. Plus, many local governments were kicking peasants and farmers off land for these frivolous investment projects. (For more on how the sensitivity of land rights affects your business, see Chapter 7.)

By 2004, almost every small city in China wanted to resemble a mini-Shanghai and light up the sky at night with dazzling neon displays, which the government often paid for. Partly as a result of this and similar waste, China began having electricity shortages in many areas at this time, even causing factories to shut down. Private businesses also got into the act, with a number of industries in China adding capacity at any given time when there was already too much. Unfortunately, economists can't even come close to agreeing on the amount of unproductive growth in China. (The West isn't immune to this phenomenon, either — remember the dot-com bubble?)

The road ahead

China's government has launched a drive to make a "harmonious society," the idea being that it'll be more balanced, particularly economically. The central government realizes that to make this idea happen, it needs to reestablish control over parts of the economy that it gave up to local governments in the 1990s. Don't expect the local governments to necessarily play along — they've realized it's good to be king!

Going forward, China should continue to grow its manufacturing and to move into higher-end products. But with China's rapid aging population, something will have to eventually give — either the one-child policy or China's dominance in manufacturing. Services will continue to develop, but China needs to continue to invest in education to really develop services well. Right now, India appears to have an edge on China in the service area, mainly because India has more people who speak English.

One of the really interesting trends to watch over the long-term is how much consumption grows. Among the world's largest economies, China has the lowest amount of consumption as a percentage of GDP. If the Chinese aren't consuming, they're saving. That means that most of the things they produce are bought in other countries, which becomes a very political issue in the importing countries. It also eventually limits how much the economy can grow because the world can import only so much from China. The government is actively encouraging Chinese to save a little less and spend a little more to simulate the domestic economy. We'll see how it plays out.

Politics: Grasping the state of affairs

Although you should be careful about talking politics with your business acquaintances in China, having some understanding of the subject definitely helps. Chapter 3 provides an overview of the Chinese Communist Party (the CCP). In this section, we discuss the political environment.

A lot of Westerners misunderstand the extent of the CCP's power. China is a one-party state, but it's not held together as tightly as a lot of people think it is. For most of China's history, the nation was a feudal society with weak central control. A country as massive as China — in land and people — was and still is very difficult to govern. Each year, China reports many tens of thousands of official "disturbances" in which people have rioted or protested at least somewhat violently.

Government efforts to modernize the country

For better or worse, the CCP sees itself as the best way for China to modernize and raise its people's standard of living. Although Westerners sometimes perceive the CCP's actions as heavy-handed, the CCP views them as necessary for the greater good. This divergence in views is most apparent in assessing the government's June 1989 reactions to the Tiananmen Square rallies.

The CCP is constantly performing a balancing act. It wants to modernize the country and provide greater opportunities for its people. In order to modernize, though, China has to end the "Iron Rice Bowl" policies that guaranteed workers lifelong gainful employment at state-owned enterprises. Because China has been a poor country until recently, and also because of the effects of the Cultural Revolution (see Chapter 3), the majority of Chinese people lack modern skills or education. As a result, when a state-owned factory is privatized and the new owners lay off workers, the outlook for those workers isn't bright. The government is trying to address this problem by training laid-off workers.

The large and growing numbers of displaced workers threaten stability. With some people in China becoming quite affluent, the unemployed workers' anger intensifies. For this reason, China often seems to have to take two steps forward and one step back in its drive to become a modern economy and society. But despite the need to slow down or postpone some reforms, the pace of change in China is still incredible.

Suspicion of foreign investors

Foreign investors are always a political issue in China. The Chinese are quite proud of their rich culture and long history. For centuries, they were an extremely advanced civilization. However, the Chinese also view themselves as having been humiliated throughout the late 19th and 20th centuries by various foreign powers. In the late 1800s, the British actually went to war with China because the Chinese government tried to stop Great Britain from selling opium to the Chinese. Foreign wars, such as World War I, often resulted in treaties that carved up parts of China among foreign nations, without giving China any say-so in the matter. In World War II, the Japanese invaded China and were so brutal in their occupation that it remains a major obstacle in their relationship today. When you take a proud people who feel like they were humiliated by foreigners, you get some mistrust.

On the other hand, the Chinese are practical enough to realize that they can learn a lot about business from foreigners. They also know that foreign investment capital is crucial to their economic development. However, you often see political pressure to protect Chinese businesses from foreign competition. The effectiveness of that pressure varies. Occasionally, it can even make foreign investors targets of public blame for problems such as environmental pollution and land seizures from peasants and farmers.

The Chinese may be suspicious of each other as well. See the upcoming "Gaining trust" section for details.

Sudden changes in governmental policies

Chinese politics, even before the CCP took power, have been legendary for their intrigue and unpredictability. Westerners still can't totally understand how the Chinese government works. Some scholars see a constant battle between reformers and conservatives; other scholars think members of the government are pretty much on the same page but are just making Westerners think it has disagreements. Sometimes your Chinese friends may be able to read the tea leaves and figure out whether a change will affect your business; other times, the government will catch everybody by surprise.

Birth-planning and the labor force

After the famines in the 1960s and 1970s, China instituted a policy that limited urban families to one child per household. Some estimates hold that if there were no one-child policy, China's population would be 300 million people larger than it is today! However, because of the policy, China is becoming a society with fewer workers to support more retirees. So far the government has shown no sign that it plans to get rid of the policy, although it has been loosened slightly.

China's government isn't worried about a manufacturing labor shortage now, but because of the growing number of manufacturers, along with the one-child policy, the nation may see an uneven balance of work-to-workers in the long-term. The birth-planning policy has also had some small short-term effects. Over the past few years, wages in China's two major manufacturing regions, the Yangtze River delta (around Shanghai) and the Pearl River delta (in Guangdong province), have been rising as manufacturers have had to compete a little harder for labor.

Culture: Taking in the social scene

Even though you can find some of the most modern cityscapes in the world in China, China and its people still reflect their thousands of years of cultural heritage in many ways. Here are the most important cultural differences for you to understand when you first do business in China.

Staying on the same page

REMEMBER

The Chinese place a premium on acting as a group. This idea really means two things:

- Decisions are often made by consensus rather than by one person.
- Members of the group are expected to fully support and respect the decision after it's been made.

Some Westerners who've witnessed closed-door Chinese meetings observe that after enough people (or enough senior people) have stated that they prefer a certain choice, the rest of the group seems to magically express the same opinion when asked. So it's tough to say how much of a consensus is really behind these "consensus" decisions. Nonetheless, don't expect a Chinese person to break ranks with his or her group to help you.

Pulling rank

The Chinese pay a lot of attention to hierarchy. Typically, Chinese employees are very aware of where they rank in the company food chain. Power always has its perks in China — and the differences in perks between pay grade are often not that subtle. Chinese people typically defer in public to people who outrank them in ways that may seem strange to Westerners. For example, on the way to a casual lunch, junior employees may all but dig their nails into the doorframe rather than walk through the door before their mid-ranking colleagues do. For more on hierarchy in the workplace, see Chapter 9.

Don't assume that subordinate Chinese will appreciate your egalitarian insistence that they're entitled to the same perks as you are. Breaking with the system may make some subordinates uncomfortable, even if you think they're benefiting from your flexibility. Also, the Chinese may think that you're disrespectful if you don't respect the higher positions of your superiors.

Saving face

Face is a key cultural concept to understand when doing business in China. If you cause somebody, even by accident, to lose face (honor), don't expect to ever receive their cooperation again. In fact, the consequences can be a lot more extreme than that. To make sure you don't make mistakes with face, read Chapter 11, which also tells you how to give face.

Identifying the in-group

Relationships are an important part of doing business in China (see Chapter 15). One reason is that the Chinese usually don't trust or even concern themselves with people who aren't their friends. This idea has its roots in Confucian philosophy, but the Cultural Revolution reinforced it. For more on trust issues, see "Buckle Your Seatbelt: Preparing for Common Challenges," later in this chapter.

Laws: Surveying the government say-so

The biggest myth about China is that it's lawless. China has plenty of laws — and many of them are actually enforced! Fortunately for businesspeople, you'll recognize a lot of the laws governing contracts in China. However, that doesn't mean you can rely on your experience dealing with the law elsewhere. On the whole, the legal framework is getting better, but many Chinese laws are intentionally vague. Just know that there are laws to protect you and laws that pester you. Enforcement can vary by locale, but as we discuss in Chapters 17 and 18, you can protect your rights. The following sections explain how laws are written and implemented, as well as the hierarchy.

Vague for a reason

Many of China's laws are vague to allow officials to use their judgment. Consistent and clear laws are easier to understand, but on the other hand, the way some countries rigidly apply their laws regardless of the result makes the Chinese way seem to make sense. As some say, in China nothing is permitted, but everything is possible. Thank you, ambiguity!

The legal suggestion box

All levels of the Chinese government are constantly at work making new laws. Fortunately, the process is becoming more open. With many important laws, the government now circulates drafts of the laws before they make the laws official. That way, lawyers, businesses, and other people who have a stake in the law are able to comment. The best way for you to give feedback on a draft law is to contact your country's chamber of commerce in China and ask them to convey your views. The government's even listening to the comments, too!

The way Chinese laws are usually enacted may seem strange to many foreigners because the law is usually extremely vague. In fact, it's usually more or less just a long statement of legal principles. For example, a law may say that companies with dominant market share need to receive antitrust approval before a transaction, but it won't define *dominant.* Sometimes, these questions are answered when the implementing measures come out for a given law. The *implementing measures* are regulations that explain how officials are supposed to interpret and apply the actual law. You may wait for a year for implementing measures to come out, and then the measures may be vague in order to give local officials authority to develop their own policies.

Following a hierarchy

Usually, laws enacted by the central government take priority over provincial government laws, which usually take priority over municipal government laws. Finding laws enacted by different levels of government that are in complete conflict with each other isn't unusual. Even stranger, you may find laws enacted at the same level (national, provincial, or municipal) that conflict! Even laws on the same tier have a hierarchy.

China is an administrative state, which means that various bureaucracies can issue their own laws and regulations — this is a significant risk to foreign businesses. Explaining the hierarchies is beyond the scope of this book, but just know that it can be complicated, so get expert advice from lawyers when you encounter conflicting laws and regulations. For more on dealing with lawyers and other professionals, see Chapter 4.

Laws dealing with foreign investments

Some laws deal specifically with foreign investments. They may restrict how much of businesses you can own in certain areas. Just keep in mind that you have to pay attention to a combination of laws, especially those that discuss foreign companies.

Buckle Your Seatbelt: Preparing for Common Challenges

For many people, the challenge is one of the reasons that succeeding in China is so rewarding. Here are some common obstacles to prepare for.

Gaining trust

Trust is a big part of doing business in China. The country doesn't have a credit rating system, so a lot of business is done on faith. Earning trust with the Chinese is a challenge, but you want to earn it, so be patient. Don't be surprised if your business is moving slowly until you've earned the trust of others. Then it'll start picking up speed.

Ironically, Chinese people are often less likely to trust other Chinese than they are to trust an outsider. In fact, some Western businesspeople in China question whether employees' inability to trust each other will prevent Chinese companies from becoming true global competitors. If you're going to be managing Chinese employees, understand that they're usually suspicious of each other. You'll have to work hard to encourage your employees to be open about their work and cooperate.

Although the majority of people you meet in China are fair businesspeople, some people may try to screw you over, so don't trust anybody too much. Don't give people too much access to your proprietary knowledge or too much money. And don't make it obvious that you don't trust them, which can cause them to lose face. If push comes to shove, though, letting people figure out that you don't completely trust them may be a lot cheaper than a major mistake on your part! See Chapter 17 for more on protecting yourself.

Wading through the bureaucracy

You commonly hear that China's very bureaucratic. It's true! China is the perfect storm where the Soviet love of bureaucracy meets the tradition of thousands of years of vast imperial bureaucracies. For the businessperson trying to get something done in China, this legacy means working with government agencies (Chapter 8 discusses dealing with the government). Even relatively simple tasks, such as setting up a company, usually require the approval of multiple agencies. Often, you have to shuffle back and forth between agencies. Don't expect them to cooperate with each other or to be on the same page. Quite the contrary — China's government agencies often compete to get responsibility for implementing new laws when the laws are unclear about who'll implement them and how they'll be implemented.

And don't expect government agencies to compete with each other to provide you with the best service. Rather, various agencies may tell you that you need their approvals, and those approvals often have differing requirements. One advantage that Special Economic Zones (SEZs), which we discuss in Chapter 7, usually provide is that they help streamline many of the agency processes.

Chinese bureaucracy also means lots of paperwork. The government gives you lots of forms to fill out in order to move forward. Often, these forms ask you the same questions repeatedly. You also have to bring a lot of papers relating to you and your business with you when you deal with government agencies. Chapter 7 explains the paperwork you need to set up shop.

Finally, the bureaucracy means using lots and lots of *chops,* or official company and agency seals. They appear on almost every official document as an organization's signature. When you get company chops made, you usually have to do so at a licensed chop maker.

Responding to rapid changes

The pace of change in China is both amazing and daunting. Keeping up with the changes — especially in laws and regulations — is difficult for foreigners. The best way to prepare yourself is to join business organizations, such as your country's chamber of commerce or a business council (see Chapter 4 for some resources). Having good relationships with government officials can also help. They can sometimes give you a heads-up that a change is coming.

Surviving cutthroat competition

The Chinese are excellent businesspeople. But they're not as good at seeing the big picture, nor are they as sophisticated about deciding whether to start businesses — and this lack of preparation can be a big problem, because the Chinese love to be entrepreneurs. China really began to reform its economy only recently, so the lack of the big-picture view and sophistication should change as people become more educated in market economics.

In China, many aspiring entrepreneurs decide to go into business without thinking about the size of the market and how much competition it can handle. Instead, they choose a certain business after they see a few business owners in that industry driving fancy cars. And they all seem to do it immediately, so all of a sudden, competitors start pouring and pouring in. If they do, they'll commoditize your business. When this happens, everybody's margins drop to the point where barely anyone is making money. Most of the time, a lot of businesses (first movers and newcomers) go under.

TIP

If you're successful, plan for an onslaught of competition. Here's how:

- Always have money. Be conservative with investments so you have cash on hand to survive a shakeout.
- Delay the onslaught by not being too obvious about your success.
- Try to enter a business that's very hard to copy and commoditize.
- Protect your company's IP (including trademarks) through legal and practical measures. See Chapter 17 to find out how.
- Create or bring a recognizable brand, which is easier to protect.
- Conduct thorough market research before going to China. For more on planning for China, see Chapter 4.
- Never provide exclusive distributorships in China. Always establish multiple distribution channels (see Chapter 13).

If you do get hit by a wave of competition, know that the industry should recover within a few years. Also, if you're able to stay liquid, you can buy out your competitors when they're desperate. Then you'll be in an even better position!

Bridging the language gap

One of the most important things to get right is bridging the language gap. The following sections discuss both the written and spoken word.

Speaking up through interpreters

The quality of your interpreter, who works with speech, says a lot about you and your company to the Chinese. With knowledge of the language and your business, interpreters can do more than just convert one language into another; they can help you understand whether the Chinese side really got the message and whether you're getting closer to reaching your objective.

You may be lucky enough to have someone in your company do the interpretation for you. However, representing your company and being your company's interpreter at the same time is difficult — most people playing a dual role miss important items. Businesspeople acting as interpreters also often throw in their own thoughts or change what they're interpreting without the principal or Chinese party's knowledge.

Interpreters don't have to be expensive — if you're simply building relationships (see Chapter 15), Chinese university students may be qualified for the job. If you've done some networking, your contacts may be able to recommend people. Of course, professional interpreters are always an option, but they may be pricey.

For formal meetings, there's no substitute for a professionally trained interpreter. He or she may not understand your company, industry, and objectives in China, but you can benefit by getting the interpreter involved early in the planning stages of business meetings. See Chapter 11 for advice on using interpreters at meetings.

Many Chinese companies offer interpreting services. The best way to find an interpreter is through a referral. Do your due diligence on the interpreter's capabilities before putting him or her in front of your Chinese contacts. Ask for references. You want your interpreter to have more than just good English. It's important that your interpreter be experienced so that he or she is good at conveying long stretches of speech. If you think your interpreter is ineffective or unprofessional, look for a new one. Find someone neutral who's also bilingual to give you feedback on the quality of the interpreter.

When using an interpreter, make sure your Chinese contacts understand that you're the boss. If you're the leader, you should sit directly across from or next to the main decision-maker. Also make sure that your interpreter knows that he or she shouldn't offer an opinion on anything other than a language issue, even if the Chinese side asks. If asked for an opinion, he or she should defer to you. Particularly in a social setting, watch to make sure that your interpreter doesn't overshadow you.

Getting it in writing with translators

As with interpreters, you should do your due diligence when looking for people to translate your written material into Chinese. You have two options for how you want a document translated:

- **You can have it translated and rewritten.** By translating and rewriting, you can hopefully ensure that documents read smoothly. However, finding someone who can translate and rewrite can be difficult, and judging the quality of the rewrite may be a challenge.

  Don't have legal documents rewritten after they're translated into Chinese. The usual practice — a direct, literal translation — ensures accuracy.

- **You can have it translated directly into Chinese.** A direct translation may convey the point to the Chinese, but it'll read strangely. When you're in China, you'll undoubtedly see a lot of strange English signage — particularly in advertising. Much of this results from direct translation.

Chapter 3

Getting Acquainted with the Powers That Be: China's History and Leadership

In This Chapter

- Getting to know China's history and rise as an economic superstar
- Discovering how the government encourages business
- Understanding the Communist Party
- Looking at China's entry into the World Trade Organization

China has had a long and colorful history over many thousands of years, and knowing a few of its key elements can help you better understand today's general business practices in China. By showing that you know some Chinese history, you can also demonstrate to the Chinese business community that you're serious about doing business there.

The rise of the Communist Party made a tremendous impact on modern China. The party still sets policy and controls the future direction of China, so you want to understand how the government works. This knowledge is especially important as China moves from a centrally planned economy to a market-driven one. And with China's entry into the World Trade Organization, the country is taking a big step forward as a major player in global business and trade.

In this chapter, we give you an overview of China's political and economic history and explain how it affects China's business climate today. We also go into China's current government setup as well as the government's relationship with state-owned companies, private businesses, and foreign-owned enterprises. Finally, we wrap up with the impact of China's entry into the World Trade Organization.

Understanding the Big, Historical Picture

China's civilization is one of the oldest on the planet, dating back almost 4,000 years. Of course, you don't have to go back quite that far to get an idea of the historical events that shaped China's current business scene. The following sections give you a briefing on some of the more pivotal events and situations. Understanding some Chinese history is essential so you sound knowledgeable about China in front of your business partners or contacts.

Introducing the Middle Kingdom: The rule of dynasties

The founding father of imperial China was Qin Shi Huang, or the First Emperor. Shi Huang was a member of the Qin (pronounced *chin*), the strongest kingdom in China at the time. They came into power in 221 BCE. Before Qin's rule, China was controlled by smaller and less powerful kingdoms that didn't recognize any central government in China. Qin brought the country together.

Qin's accomplishments are considered to be among the greatest of any ruler in the history of the world. Qin standardized the written language, weights and measures, and coins. He also expanded China's borders by seizing territory in the south and to the north of China and was the impetus behind the first Great Wall northwest of Beijing and the marvelous Terracotta Army soldiers in Xi'an.

Qin developed the imperial system in China that would last for more than 2,000 years. Along the way, China made incredible advances in science, medicine, military, agriculture, and more, making China one of the most advanced civilizations in the world for a long, long time — a great source of Chinese pride. (In today's China, the leadership is looking for the country to modernize and advance, too, from space exploration to leading-edge technology to the most sophisticated hydropower capabilities in the world.) The First Emperor set the stage for future emperors to rule a larger, more powerful, unified Middle Kingdom.

Following the Qin were many other dynasties including the Han, Song, Tang, Yuan, Ming, and the Qing, the last dynasty. There was little handing down of power from generation to generation. Old dynasties were overthrown by new, more powerful dynasties for centuries. Finally, the early 20th century brought an end to imperial rule.

Ushering in modern China and the rise of the Communist Party

In the mid-19th century, China had some bad experiences with foreign influences. The West was entering its Age of Imperialism, and everyone seemed to want a piece of China — and its markets. The British insisted on selling opium to China, even though using the drug was illegal in both countries. This dispute led to two wars, and the eventual peace treaty forced China to open ports to foreign trade, set low tariffs, pay war reparations, allow foreign missionaries and embassies within the mainland, and hand over Hong Kong to the U.K. Other Western nations — and Japan and Russia — sought similar perks through other not-entirely-equal treaties. Foreigners made their own laws in China. And the Chinese, on their own soil, were governed by foreign laws. This was a great insult to the Chinese. Many Chinese are wary of foreigners to this day.

Famines, opium wars, military defeats, economic hardship, poverty, and Chinese tradition weakened the leaders' rules. Qing leaders were incapable of managing the foreign occupation of China's cities. Civil unrest was on the rise. Anti-foreign sentiment came to a head in the Boxer Rebellion (1899–1901), when Chinese peasants began attacking foreign railroads, embassies, and missions. Western powers banded together and suppressed the uprising, and many Chinese people lost faith in the current government and saw the need to modernize. China's last dynasty finally collapsed in 1911 because of internal pressures and foreign influences.

Competing warlords once again fought for power. A leader named Sun Yat-Sen, considered the founder of modern China, attempted to organize a new democratic government in China after the fall of the last dynasty but failed to do so due to competing warlords and other forces. He died in the mid-1920s, and one of his followers, Chiang Kai-shek, gained control of the Kuomintang, or National Party (KMT). The KMT loosely unified all of China.

Meanwhile, a new political faction called the Communist Party of China (CCP) formed in 1921 in opposition to the KMT. Soon the two forces were involved in a Chinese civil war. During the Long March, a Communist retreat to get away from the Kuomintang army, a young man named Mao Ze Dong made a name for himself. After 20 years of war on China's soil, the civil war ended and the Communist revolution had won. Mao and his Red Army defeated the Kuomintang. On October 1, 1949, Mao Ze Dong established the People's Republic of China and the Kuomintang retreated to Taiwan. As they say, the rest is history.

The Civil War ended in the 1950s with the CCP in control of mainland China. The nationalists (KMT) fled to Taiwan before the Communists could retake it, and the U.S Navy's 7th fleet was sent into the Taiwan Straits. This move guaranteed the separation of Taiwan from the mainland. Taiwan's leaders claimed to be the legitimate government of China, which caused friction between Taiwan and the People's Republic of China that still goes on today.

Sending in the Red Guards

First-time visitors to China often note the callousness of the Chinese toward one another. Much of this relates to the Cultural Revolution. It's the one mistake that many Chinese are officially willing to admit that Mao made. In 1966, Mao was over 70 years old, facing some public criticism, and possibly losing some power. He decided to rally China's youth and university students against what he saw as a CCP that was losing touch with the revolutionary ideals of the People's Republic of China. He convinced the Party that China was leaning toward capitalism. The Party allowed Mao and his close circle to begin a campaign to rid the party of any and all threats. And so began the Cultural Revolution.

It started by trying to create zeal among students, but quickly spiraled out of control. China's schools and universities were shut down for years because academics were considered counterrevolutionary. Public humiliation of honest people, the banishment of doctors and intellectuals to farms in the countryside, book burnings, the damaging of Chinese cultural relics, and other horrors were regular events during the Cultural Revolution. In perhaps the darkest time of the revolution, intellectuals and party officials were sent to prison camps for reeducation.

People who had grudges against each other frequently tagged their enemies as counterrevolutionary, even if it wasn't true. That "enemy" often ended up beaten or killed by a mob. Family members testified against their own blood in order to avoid being accused themselves. The Revolution created a sense of paranoia so deep that people worried more about protecting their own lives than using the truth to save others. No one felt safe, and the whole country was terrified by Mao's Red Guards. The Cultural Revolution ended in 1976 after Mao died, but its effects linger even today.

Industrializing with Mao: The first five-year plans

In 1954, Mao Ze Dong was made chairman of the Communist Party of China. His goal was to make China a great socialist state and a world power. China was a mess after decades of war and hardship for its citizens. Hundreds of millions of peasants were barely getting by. Mao borrowed the planning model from neighboring Russia. After forming the People's Republic of China, Mao created its first five-year plan.

Mao's first five-year plan in 1952 called for China to industrialize with the help of Russia, which sent about 10,000 industrial engineers to China. Soon, China started to develop new industries while improving old ones. It was such a success that China developed another five-year plan. For the first time in a long time, things were looking pretty good for China.

The second five-year plan in 1957 was interrupted by the Great Leap Forward. Unfortunately, it was anything but. Because of some bad judgments by Mao (and to be fair, some extremely bad luck with the weather), food production fell drastically. In the years of the Great Leap Forward, China experienced one of the worst famines in the history of the world. Millions of people died from starvation.

Many people became disillusioned with the Chinese communist leadership. Most of the ordinary Chinese people went back to the old ways of doing things. Because of mass starvation in some rural areas, local leaders and peasants took matters into their own hands by reinstating private land ownership for farming.

Mao gave up his title as president of China, and a junior Chinese leader named Deng Xiaoping took over after 1976 to clean up Mao's mess. Deng and others restored order to the Chinese country and economy in the early 1980s. Despite his failings, Mao is viewed as a cult figure today.

Opening the door to foreign investment

After Chairman Mao Ze Dong died, Deng Xiaoping gained more authority in the late 1970s. Deng never held the top government job, but he primarily wielded the power. Deng wanted to modernize China by introducing faster reforms, saying about capitalism versus communism, "Black cat or white cat, either will do as long as it catches mice."

Deng and his comrades created the Open Door Policy, which allowed foreign investment into China for the first time since the founding of the People's Republic of China. Deng saw the need for China to modernize and to open to the outside world after too many years of isolation. In the early 1980s, China opened its first Special Economic Zones (SEZs), mainly in coastal cities, which allowed for more flexible and capitalist policies. Foreign money began rushing into the SEZs — mostly in manufacturing. The SEZ experiment was a huge success, and the government began relaxing its control of the economy. The government then started to let private (initially mainly Chinese) investors buy state-owned companies (more commonly called *state-owned enterprises,* or SOEs) and even created stock exchanges.

Deng Xiaoping called this system *socialism with Chinese characteristics,* which is now China's official term to describe its economy. (For more information on China's economy, go to Chapter 2.) Some other people describe it as market socialism. China's mixed economy allows private and state-owned businesses to compete in the marketplace. But socialism isn't fading away altogether; after all, China is a party-state government.

With some exceptions, the socialist market structure now in place sets its own prices based on supply and demand. China's government generally allows the market to work by itself with little interference except in sensitive areas such as currency exchange, strategic industries (such as telecommunications and energy), and anything related to the military industrial complex.

Overseas Chinese

The Chinese have emigrated all over the world. Many of the emigrants are now significant investors in China. Those who live abroad, the *overseas Chinese,* are estimated to number more than 60 million. The most significant pockets are in Southeast Asia, the U.S., and Canada. Your company may be able to use this talent pool to its advantage. About 200,000 foreign-trained and -educated Chinese have returned to China in recent years. They're commonly called *sea turtles,* or *hai gui,* because they're returning to where they were born.

Party On: Understanding Who Controls the Country

Communism is an ideology that stands for the redistribution of resources: from each according to ability, to each according to need. In practice, one political party controls the social, political, and economic activity of the country.

The Constitution of the People's Republic of China states that the Chinese Communist Party (CCP) is the ruling party, but it leaves room for the establishment of others. The CCP is supposed to get its ideas from the people. In reality, it's more of a top-down than bottom-up government. China has more than one political party, but the other parties exist to bolster the CCP.

The government structure has three bodies:

- **The Chinese Communist Party (CCP):** Establishes policies and direction for the country
- **The state:** Implements and carries out the policies through various branches, councils, and ministries
- **The military (People's Liberation Army, or PLA):** Provides security and enforcement on a national level

Overall, the CCP runs China's national, provincial, and local governments as well as the military. The following sections fill you in on government roles and some of the major players. The structure can be confusing for foreigners, but the chart at `www.uschina.org/index/browse.php?cat=166` can help clarify.

The Chinese Communist Party (CCP)

The CCP started out with fewer than 100 members in Shanghai in 1921. Now headquartered in Beijing, the capital city of China, it has about 70 million members.

The CCP has formal authority. It sets policy and controls the agenda, and the state carries out the CCP decisions. Today, the Chinese Communist Party is in total control!

The *general secretary* of the CCP — the top dog in the party — runs the show. The general secretary is also the president of China. (***Note:*** The *president* title is ceremonial — having the president post alone doesn't mean you have any power.) He or she also manages all the committees under the National People's Congress (NPC), the government's legislative body (see the section "The People's Congress and other lawmakers" later in this chapter).

The highest-ranking party officials — including the general secretary — are part of the *Central Committee*. It's the highest authority within the CCP, but it doesn't exercise authority over the state. The committee is a very small group of people who are part of the inner circle of party officials who run the show. These powerful people have a lot of clout.

For more information about the CCP, go to their official Web site: `www.china.org.cn/english/features/44506.htm`.

The state

The second body of China's government is the state. It includes the State Council, the president, the National People's Congress, and various ministries and commissions.

The State Council and its ministries and commissions

The *State Council* is the main supreme executive body, which means that it has the power to decide how to enforce China's laws. The State Council can also make laws. Its leaders — the *premier* (the head of the government), several vice premiers, and various commissioners — are the next highest-ranking big shots in China after the general secretary of the Communist Party (who doubles as president of China, or head of state). About 50 leaders in the State Council have voices running the administration for the government. The State Council technically reports to the *National Peoples Congress (NPC),* the central government's legislative branch (see the next section).

The ministers and government officials who lead China's 28 ministries and commissions report to the State Council leaders. These officials include such heavyweights as the Minister of Finance, the Minster of Commerce, and the Minister of Foreign Affairs. Others reporting to the State Council include key Chinese organizations such as the Chinese Banking Regulatory Commission, the state-owned Asset Supervision and Administration Commission, and the Xinhua News Agency. (The Xinhua news agency stands for the New China news agency, and it handles all the public relations and government news for the CCP.)

The People's Congress and other lawmakers

The *People's Congresses* are part of the legislative government body. They have many different levels that eventually decide who represents the local people at the national level. China holds elections for local People's Congress representatives. Of course, candidates for the elections must be nominated by the CCP. In reality, the political leaders at the top of the government pick the people they want to move up. The hierarchy works like this:

1. National
2. Provincial
3. Regional/municipal
4. County
5. Township
6. Village

Those who are elected at the highest level get to participate as members of the *National People's Congress* (NPC). The NPC has fewer than 3,000 members who are elected to five-year terms. A *Standing Committee* of the NPC consists of 170 full-time members. Its members draft most of the NPC's laws.

The planning and elections take place every five years. The NPC meets every year in the Great Hall of the People, but the first year that the NPC meets is really the most important — at that time, the members approve the agenda for the next five years and also elect the Central Committee of the Chinese Communist Party (see the earlier section on the CCP). The Central Committee sits above the rest of the NPC (which is called the *General Committee*) and really runs the show — it includes the top ten or so most senior Chinese party officials.

Several other branches of the government have the ability to make or change laws, including the State Council and some of the 28 ministries. Sometimes you encounter conflicts in the law because more than one government body has the right to make laws. The laws do follow some form of hierarchy. For instance, the State Council enacts far more laws than the NPC, but when the NPC passes a law, it's superior to State Council laws. The Supreme Court sorts out these conflicts.

The People's Liberation Army (PLA)

The third branch of the government is the powerful People's Liberation Army (PLA). As the most populated country in the world, China also has the biggest army. The PLA has more than 2 million soldiers! In practice, it's a voluntary army, though registering with the PLA is mandatory for all men when they turn 18 years old.

As the PLA reports into the party, it supports government policy. The PLA technically reports to two military commissions and not the State Council. The heads of the military commissions are civilian members of the CCP. In the end, the PLA reports to the president of China (see "The Chinese Communist Party [CCP]," earlier in this chapter). Here's the main thing you need to understand about the PLA and the government: The Communist Party is in control.

Figuring Out the Chinese Business Scene

The most common types of businesses in China include the following:

- **Companies owned by the government:** China still has many state-owned companies kicking around — they're a product of the old days when the government owned everything. Although they play a lesser role in today's economy, these companies are still significant in China.
- **Privately owned Chinese companies:** Privately owned companies are fast becoming the backbone of the business scene in China. Supporting smaller businesses has become a priority for the Chinese government.
- **Foreign-invested companies:** Foreign investors from nearly every corner of the world — large, brand-name multinationals to small- to medium-sized family-owned companies — continue to flock to China.

The business scene is constantly changing, with a lot of relatively new businesses flourishing while many larger, older, and unprofitable companies bite the dust. All in all, China is teeming with young and old, large and small, and private and state-owned companies. (For more on China's economy, please see Chapter 2.)

Getting state-owned businesses in shape

When China first started down the path to fix its economy, the state owned almost all of China's businesses. In the late 1970s, about 80 percent of China's gross domestic product came from state-owned enterprises (SOEs). The SOEs provided most of the jobs for China's hundreds of millions of workers. The big state companies also gave the workers social and healthcare benefits and a place to live. Unfortunately, many of the SOEs were unprofitable and caused a financial drain on China's government.

The SOEs didn't need to be profitable. After all, China was a planned economy, where the state set production quotas. SOE managers didn't understand market forces, and they weren't supposed to. However, China's leadership recognized that to modernize, they needed to reform the SOEs, which weren't prepared for the socialist market economy China's leaders were creating. So the Chinese leadership made some big changes in SOEs. They chose to keep the good ones and shut down, sell, or auction off the bad ones, which was no easy task. Many of these state-managed companies were the only employers the Chinese workers ever knew. The change was a painful process for companies and workers who were used to the security of lifetime employment.

The Chinese leadership made big bets that certain state-owned companies could compete and prosper against foreign companies. With a little help from protectionist policies, this approach worked well in many industries, including telecommunications, power, and financial-service companies.

Now China has only about 20,000 SOEs operating in the whole of China, down from more than 120,000 in the mid-1990s. The number of SOEs is fast shrinking as the number of new privately owned companies grows by leaps and bounds. Even some foreign companies are buying companies that were SOEs.

Supporting private businesses

As China marches to the beat of a new socialist market economy, it knows it needs to support private businesses in a big way. Supporting privately owned businesses took time for the Chinese. After all, China's a socialist country!

Why the big shift in attitude to allow private businesses to grow and prosper? When China's leaders decided to unload unprofitable SOEs by selling them or shutting them down, it needed to create jobs for the unemployed and the huge number of people entering the workforce. Privately owned businesses are helping create more new jobs, which China needs so it can keep its fast-growing population employed.

The Chinese government is making sure the smaller companies can participate in China's booming economy, too. Small-to-medium enterprises (SMEs) are at a huge disadvantage to the large foreign and domestic companies operating in China. For example, SMEs have more problems getting access to money to invest in their businesses. They're not as powerful as the big companies in terms of influence and *guan xi* (relationships — see Chapter 15). The government helps smaller companies in a variety of ways, including designing special laws and regulations. For instance, under China's SME Promotion Law, the government has set up a credit rating system and offered management training, too.

TECHNICAL STUFF

China has many good reasons to support SMEs: They represent 99 percent of all companies in China! The total number of registered SMEs is around 5 million companies. They contribute more than 60 percent of the total industrial output in China.

Privately owned companies are creating the first wave of really wealthy entrepreneurs in China. This development is significant within China. Many of China's new entrepreneurs have very deep pockets and are formidable competitors for foreign companies.

Growing a small business: From bicycle shop to auto parts powerhouse

The son of a Chinese farmer, Lu Guanqiu, built a modern enterprise called Wanxiang Group (pronounced wan-shang) from a small bicycle repair shop he started in 1969. Today, Lu, the founder and chairman of the company, is one of the richest people in China.

The multinational company, headquartered about 100 miles east of Shanghai, is now the second-largest privately owned firm in China and is aggressively expanding overseas. It's fast becoming one of the major players in U.S.-China trade. Wanxiang is China's largest car parts manufacturer, and it's involved in finance, real estate, import and export, and other interests as well. The company has 40,000 employees worldwide and US$4.2 billion in sales.

China's leadership has made the commitment to support China's globally minded companies through deal financing and risk management, and Wanxiang is a shining example of the type of firm China wants to support. Its humble beginnings as an SME give China's leaders every reason to be proud. If your business in China can provide products, support, or services to these successful homegrown companies, you're in a good position to succeed.

Encouraging foreign investors

The leaders of the country figured out pretty quickly that they needed foreign investors to help China change and grow. The government leaders knew China could attract the biggest and best multinationals from around the world. After all, what multinational company (or any other for that matter) can ignore a market with a population of 1.3 billion people?

The road wasn't easy. Convincing foreign multinationals that the business environment was stable took many years. And some bumps along the way — such as the Tiananmen Square incident — rattled a few foreign investors. But many of the foreign companies that stayed the course in China are very profitable today.

When China began looking more stable, more foreign companies considered going to China. And come they did! Multinational company investment is pouring into China. All the major global companies are making big investments in China. Chinese government authorities say that 480 of the largest 500 companies in the world are already invested in China. Most large globally minded companies see China as a top priority for their business and plan to invest even more in the future.

China has attracted more investment by foreign companies over the past 15 years than any other developing country in the world. The latest figure is that China has received around US$700 billion since it opened its door to foreign investment. China is like a big magnet for foreign investment.

Going forward: Risks on the horizon

According to the World Bank, China is the fourth-largest economy in the world based on gross domestic product (GDP). It's a major player in the global economy. If you adjust for purchasing power differentials, China is already the world's second-largest economy. Growing at a faster clip than any other major nation, it's on course to surpass the United States as the world's largest economy within two decades. But with such heady growth come risks and concerns. Here are some issues that can potentially lead to an economic slowdown:

- The disparity between the haves and the have-nots is growing in modern China. The amount of social unrest is rising, which may destabilize China's economic development.
- The continued debate and uneasiness about China's currency revaluation causes concern in the financial markets. On one hand, if China responds to pressure from other countries to appreciate the RMB (see Chapter 10), but does so too quickly, China's economic growth may slow a good deal. On the other hand, if China appreciates the RMB too slowly, some of China's trading partners (particularly the U.S.) may take protectionist measures, which would also hurt China's economy.
- Although China marches down the path toward a socialist market economy, little political reform is going on in the country.
- China's environmental problems continue to worsen, despite the fact that the central government leaders call the environment a priority.
- Disputes with other governments may lead to disruptions in China's ability to import energy and vital commodities. One such trigger would be a war with Taiwan.

Benefiting from the five-year plan

The *five-year plan* is a roadmap for the Communist leadership to tell the country the direction the Party wants to take. It's also a way for the Party to rally support internally, set targets and future priorities for the country, and determine which industries to encourage foreign investment in.

The government's main priority is to build a "harmonious society" in China. In other words, China doesn't want an imbalance between the haves and the have-nots, instead preferring a growth that benefits a wider group of Chinese people. Here are the main thrusts of the 2006–2010 plan:

- **Improve noncoastal economies:** China doesn't want to have too wide a gap between the wealthy coastal areas and the poorer inland provinces, so it's placing greater emphasis on improving the lives of people in the countryside and developing western China. Infrastructure has been a problem in developing the region.
- **Strengthen service industries and improve industry:** China's leaders want greater balance between industrial growth and the service sector. Therefore, the government will support faster growth particularly in

service industries. As for industrial growth, China's leaders don't think more is better — they want structural upgrades.

- **Save resources:** China wants to save natural resources by reducing its dependency on commodities such as oil, gas, and coal. With soaring energy needs in China, the government wants to explore alternative energy and support conservation. It also needs to deal with water shortages.
- **Become cleaner:** China's government wants to decrease the widespread pollution of the land, water, and air.

Several other important areas in the five-year plan include education, social security and insurance, and healthcare. To find out more about China's five-year plan, go to `english.gov.cn/special/115y_index.htm`.

REMEMBER

As China sets out its priorities in the five-year plan, it's telling you and your business what opportunities lie ahead in China. China has a proven track record of assisting foreign firms that help China realize its goals. If your business happens to be in pollution control, healthcare, agriculture, services, or any one of the sectors highlighted in the plan, you're one step in the right direction already. For more on investment opportunities, go to Chapter 7.

China and the World Trade Organization

In many ways, China's entry into the World Trade Organization (WTO) was a historic event that changed many of the old ways of doing business in China. China's membership defines how China's market will open to foreign competition in both goods and services and sets out a timetable of China's commitments. The agreement not only opens China's market but also puts in place a defined set of rules that'll make foreign investment and trade more predictable in China.

Here are the two biggest impacts of China's entry into the WTO:

- China must adhere to the WTO's rules for doing business.
- China must open up more businesses to foreign involvement.

For more information on the implications of China's membership in the WTO, check out *China and the WTO: Changing China, Changing World Trade* (Wiley). And of course, read on.

Agreeing to play by the WTO rules

The *World Trade Organization* (WTO), an international organization that helps promote global trade and commerce, defines rules that are designed to help all member countries play fairly in the global market. The WTO has 150 members representing most countries in the world.

When members of the WTO don't agree with each other, the WTO acts as the official umpire on trading disagreements. The WTO's mission is to help the global economy go about its business as smoothly as possible. In China, the WTO is trying to make rules for global trade and services clearer for investors and to create a system that's fair to all who are interested in investing there.

Getting the world's most populous country and fastest-growing economy to join the club was a huge breakthrough for world trade. At more than 15 years, China had the longest application process for any member to join the WTO. The country made the bold decision to join in the early 1980s, and the process was finalized on December 11, 2001. In the end, more than 900 pages of legal documents were submitted with China's application.

The U.S. government played a significant role in China's entry into the WTO, though China saw the benefits as well. The Chinese leaders know that they have to play by the WTO rules in order to become a major player in today's global economy.

Changing how China does business

Under the WTO, China agreed to a timetable for changing the way it does its business. The agreement makes changes to key investment areas such as financial services and logistics, China's legal system (including intellectual property rights), and import and export rules (tariffs, quotas, and approvals).

China is under a yearly review process by the WTO authorities. Along the way, China has made some good progress, but there are some concerns about whether the country is making all the required changes.

The first five years as a member of the WTO required China to open up certain protected industries that were off-limits to foreign competition. These industries included banking, telecom, and retail, where some Chinese companies are market leaders. The phase-in period to WTO also expected China to get tougher on enforcing copyright protection to reduce counterfeiting of popular Western consumer brands. China introduced many new laws to clarify its new commitments to the WTO.

China today says it's open for business and is obeying all the rules under its WTO obligations. Some critics — especially the U.S. — say China didn't meet some of the promises made to the WTO and that China's track record is mixed at best. But don't let your business get too caught up in the criticism — these times of noncompliance are likely just bumps in the road as China evolves into a major player on the world economic stage.

Chapter 4

Planning for Success in China

In This Chapter

- Looking at what you need to succeed and making key business decisions
- Doing research
- Working with professional service providers
- Watching out for common planning errors
- Spreading the risk with China plus one

Although the rewards of a good business plan may take a while to become evident, the costs of a bad plan start piling up immediately. Making minor adaptations to your home-country business plan won't usually get you too far in China. Getting your plan right for China may take a lot more time and effort than you think. This chapter isn't about how to write a business plan. Instead, it's about how to adjust your planning process and expectations for China.

To find out how to write a business plan, check out *Business Plans Kit For Dummies,* 2nd Edition, by Steven D. Peterson, Peter E. Jaret, and Barbara Findlay Schenck and *Business Plans For Dummies,* 2nd Edition, by Paul Tiffany and Steven D. Peterson, both published by Wiley.

Setting the Stage

Along with a good business model, the following elements can help your company succeed in China. Some of them may seem self-evident; however, many foreign investors forget them by the time they start getting serious about China — or never knew them at all.

Being in the right state of mind

Avoid having a must-do attitude about China. China isn't the right place for many businesses (see Chapter 1); however, some of them don't find that out until after they've already made the plunge. If you go into your feasibility study thinking that your company absolutely must be in China, then your evaluation process is going to be flawed. You'll almost inevitably conclude that your company will do well in China. When you're operating under this pressure, you may compound the mistake by rushing and cutting corners.

The proper approach is one of cautious optimism. If you think China may have an opportunity for your company, you should investigate it impartially. If your original notions of how to do business there look like they may not work, see whether changing the model works better. Above all else, don't lose objectivity.

Budgeting enough money

China is an expensive place in which to do business. You're going to need to hire good lawyers, accountants, and consultants. Partly because of China's bureaucracy, its developing legal system, and the language issues, these professionals take longer to do their work. No doubt about it — you're going to rack up some serious fees. And don't think you can send these people home after the initial documents are done, either. Having good outside professionals involved on a continuing basis can reduce the very real risks that you have a rogue, noncompliant, or dysfunctional operation, so keep these people on payroll (see Chapters 9 and 17 for more on dysfunction and risks).

You also encounter many hidden costs. See the upcoming "Underestimating costs" section for details.

Garnering strong support from headquarters

Your company's CEO and board should be fully supportive of the China activities. Beyond that, headquarters should have people responsible for liaising with, supporting, and keeping their fingers on the pulse of the China operations. These people should frequently visit China.

Your company also needs to be committed to China for the long haul, which usually requires the full support of the CEO as well as the board of directors. The Chinese judge your company's commitment by your senior management's participation in the China business planning and execution. With a CEO-led market entry, you can show the Chinese officials and business contacts that your company is committed to the China market. Some of the biggest success stories in China today can be attributed to the direct involvement of CEOs.

The China team needs dedicated resources, a sufficient amount of patient capital, and access to decision makers. Therefore, without the full support of your company leadership, the people responsible for executing the plan may not be able to live up to their end of the deals with the Chinese.

Too often, board members don't really understand the China market and as a result have trouble making informed decisions. Therefore, educating the board continually is important. Some forward-looking companies even hold occasional board meetings in China in an effort to provide a setting for members to better understand both the opportunities and challenges.

Think about how you can get your company's board to understand China better. If you plan a board meeting for China, make sure board members see the less modern side of China. Consider taking them outside of Beijing or Shanghai to show them a little bit of rural life so they can better understand the limitations you're dealing with.

Designating the China manager — the earlier, the better

Identify your in-country manager early. His or her involvement in the planning from the beginning can help tremendously. (See Chapter 9 for a discussion of finding management and other employees.) Having longtime employees of your company initially manage the China operation is far better than the alternative.

If you're going to bring somebody in from the outside, identify this person soon so he or she can also spend time at headquarters. This orientation is important because the manager needs to know something about not only your business but also your corporate culture (see Chapter 9). The China manager will also be able to develop important relationships with people at home.

Although having the new general manager (GM) involved in planning and negotiation is great, it's best not to have him or her leading the efforts. Remaining unbiased about the prospects in China is tough when your career is closely tied to going forward with the operation.

Don't send people to China just because you don't like them and/or don't want them around. This move is often a multimillion-dollar mistake!

Staying flexible

Even the best-researched and thought-out business plan becomes inapplicable after a while — particularly in China, where certain things (especially the market) change so quickly. Be ready to use your plan as a guide, but don't be afraid to reevaluate it if circumstances change. Get your top management and board to understand that the plan shouldn't be set in stone.

The CEO support of Hammerin' Hank

Hank Greenberg, the former CEO of American International Group (AIG), provides an excellent example of a successful CEO-led China effort. AIG was actually founded in China in 1919. The business thrived until the foreign capitalists were forced to leave in 1949. Soon after Richard Nixon's historic 1972 visit to China, Greenberg had a vision of reopening AIG there. He made his first trip to the Middle Kingdom in 1975, and by 1980, AIG had one of the first foreign representative offices in China. Greenberg continued to lead AIG's China strategy for many years, making dozens of trips to Beijing and Shanghai. During these trips, he cultivated close relationships with Chinese leaders. Greenberg's involvement has paid off for AIG in many ways, including in 1992 when it received the first insurance license issued to a foreign company in China. In part due to having such an actively-involved CEO, AIG was able to get a head start on its competitors.

Deciding What You Want (and Need)

When doing any business plan, you need to address a lot of questions. The following six considerations are part of any proper plan. However, you need to be aware of some important China twists in order to keep it realistic.

REMEMBER

You obviously need to know what business you're going to do in China. However, you should think a little bit deeper than that. What are your business goals? As you research, consider whether they're realistic.

Where to locate

One of the first questions you need to answer is location. (See Chapter 7 for a general discussion of China's regions.) Your company's location is vital to its ability to find qualified office staff. You don't necessarily have to be in a top-tier city (for instance, Beijing or Shanghai) to tap into a solid talent pool. Many second- and third-tier cities (such as Hangzhou and Chongqing) have good worker bases. If you're going to be manufacturing in China, be careful not to fall into the trap of focusing on incentives. Being near suppliers, customers, and reliable utilities is more important. See Chapter 13 for more information on factory site selection.

TIP

The governments in large, first-tier cities are generally more transparent and reliable. However, unless you're a major investor, they're unlikely to guide you through the various approval processes. Cities that are hungrier for investment may be more willing to help you through the red tape, but the potential for bad surprises is greater.

Staffing and worker requirements

Be a little aggressive in your assumptions about the number of office staff you need. As you can read in Chapter 9, Chinese employees have certain strengths and weaknesses compared to their Western counterparts. In general, you may need a slightly greater number of workers in China than you would in the West. Most Chinese workers aren't as good about wearing multiple hats as Westerners are, so you may need to have a bit more staff.

We can name two other caveats about staff planning. Figuring out what the appropriate wages are is really difficult. In many of China's booming cities, wages for well-qualified office workers are inflating rapidly. When forecasting your financials, be a bit aggressive on the wage and wage inflation rate. Another issue is that office staff turnover is very high — especially in hot markets. Plan for significantly greater turnover than you'd expect in the West.

One of the big misconceptions that companies have about China is that the factory labor saving is substantial. In many cases, your per-unit labor costs will be about the same as they are in the West. Yes, Chinese wages are much lower than in the West; however, most products don't have that high of a labor component, anyway. In addition, Chinese laborers aren't usually as productive as Western workers. You therefore need more workers for the same task than in the West. See Chapter 13 for more on factory labor.

TIP: If you're wondering whether it's a myth that you're able to produce in China for less, it isn't. In Chapter 13, we explain that the cost savings in China are lower utility and input costs, as well as efficiencies gained by using newer manufacturing models.

Building up: Whether to walk or run

Your company can get its feet wet by setting up an office in China just to do some sourcing (see Chapter 12). Maybe your goal is to manufacture in China for your U.S. customers today and sell in China tomorrow. Or perhaps you're going right after the Chinese consumer with your own sales network (see Chapter 14).

The slower you build up in China, the less costly your mistakes (which you'll inevitably make) will be. You're also less likely to leak proprietary intellectual property (see Chapter 17). On the other hand, regardless of whether you leak IP, you're likely to see the competition develop quickly. Part III of this book can talk you through the major factors in this decision.

How to sell in China

If you're looking to sell consumer products in China, be aware that distribution is very difficult. As we discuss in Chapter 14 on selling in China, third-party distribution isn't usually a good long-term plan. Doing a joint venture with a Chinese company has drawbacks, too. Usually, for long-term success, you have to build a sales force on your own.

After you figure out how you want to distribute, you have to decide whether to go into multiple markets at once (beating out competitors but possibly making costly mistakes) or start with one market and then scale (mistakes will be cheaper, but competitors can beat you to the new markets). One thing is certain: If you don't have your distribution in place before you start selling, you're destined to fail.

Perhaps you're thinking of selling services in China. In that case, you have to be ready to educate customers on your offering. If you're going to sell to businesses, you may have to deal with both state-owned enterprises (SOEs), which make purchasing decisions by committee, and privately owned Chinese companies, in which the owner decides all.

How to maintain competitive advantages

As we discuss in Chapter 2, after you taste some success in China, you should expect competition to come at you from all sides. You have to think long and hard about how you'll maintain your competitive position. You should be prepared for a scenario in which the competition is able to quickly commoditize your early offerings. Some ways to develop and protect competitive advantages include

- Building your brand (see Chapter 14)
- Protecting intellectual property (see Chapter 17)
- Doing your own distribution (see Chapter 14)

How to finance the venture

Chapter 10 is a must-read for anybody thinking of setting up an office in China. China's currency, the RMB, isn't fully convertible. In other words, getting money into China is easier than getting it out. Consider using shareholder loans, intellectual property licenses, and consulting agreements to get money out of China (in addition to paying dividends when permitted to by law).

Doing Your Homework

Hands-down, the best way to begin to understand China is to spend serious time on the ground there. This idea is a test of your company's patience and commitment. Is it willing to send people to China without very clear agendas? Ideally, at least one person can go to China several times for a few weeks at a time.

Of course, you need to do plenty of research before you step foot on China's shore. This section tells you a bit about the research process and how people and published resources can help you find what you need.

Continuing research as you develop your plan

Planning and research are iterative processes. In other words, you come up with a plan. You research it and find out what the issues are. Then you go back to the drawing board to adjust your plan. You then research the revised plan, and so on and so forth. Going through the process once or twice would be nice, but that's unrealistic. You encounter so many moving parts and surprises when setting up in China. Being able to accept a lengthy iterative process without becoming frustrated is important.

Be realistic about your company's resources and commitment. If your company can't make the full plunge, you can pursue China opportunities in alternative ways. Assuming you want to move forward, start with your company's goal or idea (for instance, you want to manufacture widgets in China for export to Europe).

After you have your basic idea, look into Chinese law. As we discuss in Chapter 7, a host of legal barriers take place in various industries. Sometimes, foreigners are completely prohibited from doing certain businesses; other times, there's a requirement to form a joint venture (JV) with a Chinese company.

If you're allowed to have a wholly foreign-owned enterprise (WFOE), then think strategically about whether you want a WFOE or a JV. (Chapter 7 covers the tradeoffs of JVs; Chapter 14 discusses using a JV to sell in China.) If you're not able to have a WFOE, then you need to think about whether you can tweak the idea so that it's permissible.

After you have a sense of the broad outlines of your plan, you can move on to some real, detailed research. Your research will lead you back to your plan and then to more research.

Networking

Before sending someone over, your company's employees should scour their networks for contacts they have in China. Hopefully, the person going to China can establish contact with these people and set up meetings before heading over. When that person does head over, he or she should hit trade shows, interview consultants and other professionals, and attend the myriad networking events found in major cities (see Chapter 15).

Somebody in this role ideally has good networking skills, knows your business well, and is able to ask good questions. Chinese language is a plus but not essential at this point. The overriding goal should be to meet other Western businesspeople who can give advice and potentially refer your company to good consultants and other advisors.

TIP

Especially in the planning stage, the best people to try to meet are people in similar businesses or industries. Also, people who are just six months to a year ahead of you can be excellent resources because their startup lessons are fresh in their minds.

Unfortunately, this somewhat primitive and costly process is the best way to approach China. One of the reasons networking is so important in China is that getting good information is hard. A lot of information is out there on China, and a lot of people are loudly advertising their advice. Much of the information and many of the contacts are of low quality. One telltale sign that someone can't really help you is that he or she drops a lot of names or brags about connections. Another sign is constantly telling you how difficult and mysterious China is.

You may be thinking that you can shortcut some of the on-the-ground research process by going right to internationally recognized consultants and the like. That may not be a good idea. Many multinational service firms have good China operations; however, the quality isn't nearly as consistent as in the West. Networking can lead you to the right people. We discuss working with consultants and other professionals later in "Hiring Consultants, Lawyers, and Accountants."

WARNING!

Don't give too much weight to what any single person advises. You can speak to two very successful old China hands on the same issue and get radically different opinions. You want to understand their logic and then see which view you think works best for you. The more sources you meet, the better.

Reading up

Numerous Web sites, articles, and books — including this one — can help you conduct your research from home. The problem is knowing the quality of the source. We've read pieces from Ivy League business professors on some aspects of doing business in China that we think are completely wrong. Similarly, pieces written by many consultants make China out to be much more mysterious than it really is (the reason, of course, is that the writers are trying to sell you their services). You can't really know how accurate your information is unless you confirm it firsthand. Nonetheless, you can improve your chances of getting good information. When evaluating a source, consider the following:

- **Author experience:** Author credentials can be very iffy; however, an author based in China is more likely to be accurate than someone who just paid a visit to China.
- **Where it's published:** Publications focused on China tend to have a better picture of what's going on — even when compared to major international news sources. Academic journals sometimes have useful information, but we find that writings from businesspeople and practitioners usually contain better information and are more practical than academic writings. *The China Business Review* (`www.chinabusinessreview.com`) is generally very good. Your country's chamber of commerce in China may have published a number of good articles and circulars on doing business in China.
- **Date of publication:** Information can quickly become outdated. In the West, three years may not be that ancient, but China changes so quickly that three years in China can equal a lifetime in the West.
- **Tone and objectivity:** Popular media frequently tend to be either ebullient or nightmarish in their portrayals of China; finding well-balanced reports from these sources is hard. Look for neutral language and balanced coverage, and check whether the author uses evidence to support the claims.
- **Content:** Even when you come across a good piece on doing business in China, it may not be applicable to the part of China you want to do business in. China is very diverse, so look for info that pertains to you.

Reaching out to organizations

Many governments have agencies and affiliates that specialize in helping smaller companies with research and planning. Here are the major organizations in Australia, Canada, the U.K., and the U.S.:

- **Australia:** Australia China Business Council (`www.acbc.com.au`)
- **Canada:** Canada China Business Council (`www.ccbc.com/home`)

- **United Kingdom:** China-Britain Business Council (www.cbbc.org); U.K. government's trade and investment site (www.ukinvest.gov.uk/gateway/index.html)
- **United States:** US-China Business Council (www.uschina.org); U.S. Government Export Portal (www.export.gov/china); U.S. Commercial Service China (www.buyusa.gov/china/en); American Chambers of Commerce (Amcham) in Beijing (www.amcham-china.org.cn) and Shanghai (www.amcham-shanghai.org/AmchamPortal)

Some of these organizations specialize in providing export services to small companies. Many are staffed with experienced people who've been doing business in China for many years. Check with your government's commercial service sector to look for support for your China business. They provide valuable services, with competitive fees, to companies seeking to enter the Chinese market. Many countries also have chambers of commerce in China that provide referrals and valuable information, as well as networking opportunities.

Hiring Consultants, Lawyers, and Accountants

Starting to use *quality* consultants, accountants, lawyers, and other professionals early in the planning process is a good idea. The following is a list of some professionals you may want to engage during the planning process:

- **IP lawyers:** As we discuss in Chapter 17, one of the first things you want to do is protect your intellectual property in China. That usually means applying for Chinese patents and trademarks. Also, you should get a non-compete/non-disclosure agreement drawn up for any discussions with potential partners.
- **Corporate lawyers:** Your corporate lawyers advise you on structuring issues. Knowing from the beginning how the laws will affect where and how you set up your companies for the China venture is essential. You may choose to use the same firm that does your IP work.
- **Tax consultants:** Some law firms have in-house tax experts who can help in the structuring advisory stage. If your law firm doesn't, consult somebody in this field as you plan the structure. You want to make sure that the structure your lawyers propose works from a tax perspective.
- **Market consultants:** If you're going to be selling in China, you would do well to have consultants research the potential markets for your product or service.
- **Site selection consultants:** If your company is going to manufacture, you want to start looking at sites right off the bat, because your location can affect your tax status, which may affect your corporate structure. See Chapter 13 for more on picking site-selection consultants.

The challenge is that you first have to find good professionals. You can't always rely on multinational service providers' brands in China, so you need to get referrals from people you trust. Of course, when you do get a referral, don't blindly follow it. Interview the candidate thoroughly. Following in this section are factors to consider when evaluating professionals.

Doing more than asking questions is hard when evaluating potential professional service providers. Even bad professionals have good answers to some of these questions. So listen to your gut when hearing their responses. If you think something is off, trust the feeling. Interviewing the professionals in person is best so you can read them better. Plus, you may get a glimpse of their operation.

Many of the professionals will actually be working in teams. You want to understand these answers as they apply to the *teams,* not just the individual you're speaking with.

China (and Western) experience

Usually, the best teams have a good mixture of experience in China and the West. Those with experience in the West should understand your expectations well. They're also likely to be better practitioners than the people who've spent most of their careers in Asia. The people heavy on China experience are just as vital because China has certain unique elements that the team needs to be attuned to.

Teamwork

If you'll indeed be hiring a team from a given service provider, meet with the entire team during the evaluation and observe them in the meeting. If only the leader seems to be doing the talking, you may want to assume that you have less of a team than an individual. Although the other team members will no doubt perform work, they may not have much influence on the most important strategic advice. In that case, you're placing a bigger bet on the team leader. It's not time to run for the exits, but be aware.

Information flows

Because China changes so quickly and radically, your professionals must be able to keep pace. You should develop a line of questioning about how they keep current on developments, share information within the firm, and pass information along to clients.

Too much information

Professionals need more than mass e-mails to stay up-to-date on important issues in China. One foreign lawyer in China groused about the daily e-mails she receives on new laws, regulations, and circulars. To begin with, she usually has dozens of e-mails to sift through each morning. The legal update e-mails are usually several pages of text, discussing numerous items. Unfortunately, important legal developments are often buried among developments in areas such as the sale of leopard bones, corpse handling, and mooncake standards. She confesses to not always reading the updates.

The initial responses to your questions aren't likely to reveal much — everybody will say that he or she gets regular updates from various sources and disseminates information via e-mail and meetings. You should ask a lot of follow-up questions based on the professionals' answers. You're trying to figure out how effective their systems truly are — the communication does no good if nobody reads the e-mails they send out.

To better understand why communication and information sharing within a firm in China is such an issue, see Chapter 9. In China, communication can easily break down among coworkers — in an information intensive business, the clients can get hurt badly.

Specific experience

Industry experience may or may not be important, depending on the type of service and what your business is. For example, if you want to manufacturer screwdrivers, it's probably not that important for your lawyers or accountants to have worked with tool manufacturers before. On the other hand, if you're getting into an area with a lot of regulation or an area that's new in China, such as media, having even one or two similar projects under the provider's belt can be a big help. Industry experience is most important in selecting market and strategy consultants.

With lawyers, the important part of their experience is usually with similar business structures rather than businesses. Manufacturing wholly foreign-owned enterprises (WFOEs) are extremely common, so your attorney likely has ample experience in this area. The qualifications get trickier when you're in the joint venture (JV) realm, though. If you already have a sense of any special features you want in a JV — especially in the control and corporate governance areas — an attorney experienced with similar features can be a big help. If you're at the point where you don't know what kinds of features you want or are available, ask the attorney to describe what he or she has done before to help clients with similar goals.

When evaluating accountants' experience, make sure they have a good deal of experience working with your home accounting standards. Also, they should have done a number of engagements with businesses that have similar work processes, such as inventory-management processes. Above all, though, they should have ample experience working with foreign-invested enterprises (FIEs).

If the people you're evaluating tell you little more than "China is very different from the West," watch out. China *is* different, but some professionals make a good living by convincing clients that China is so complicated that the clients can't possibly take a breath of air without the professional's help (although having the help of an air filter when taking breaths in China may not be a bad idea). You're sure to need help in certain areas but not in all aspects. Not only are the professionals who work hard to shroud China in mystery hard-sellers, but very often, they have little substance to offer. If you engage someone like this, you'll often find yourself on the receiving end of the excuse "you don't understand China" because the professional messed something up.

Being Aware of Common Planning Mistakes

Several mistakes are common to first-time investors in China. Try to keep this section in mind during your planning. When you've almost finished your plan, you may want to reread this section to see whether you've possibly committed one or more of these errors.

Overestimating revenue

Over-optimism is the biggest mistake that foreign investors make when planning for China. Assumptions tend to be a bit optimistic because consultants and soon-to-be China managers have an interest in selling the project. Some companies looking to sell to China are naïve enough to think that China is a market of 1.3 billion consumers. Hopefully, your company understands that only a small percentage of Chinese people have disposable income. Companies also commonly overestimate sales because they don't fully account for distribution difficulties, competitive onslaught, and consumers' purchasing power.

Underestimating costs

Companies tend to experience higher operating costs than they expect. For one, China is a more expensive place to do business than you're used to. Another issue is that China has a number of hidden costs, such as employee turnover, utility shortages, and supply bottlenecks.

Another reason companies underestimate costs is that they assume timelines for getting off the ground that aren't realistic. If you're manufacturing in China, for instance, expect that your per-unit costs will be the same as in the West for your first two or three years of operations.

Rushing the process

If you feel beholden to a timeline, you're bound to make mistakes. "Good things come to those who wait" is doubly true in China. Don't look for shortcuts and ways to cut corners. Common examples of such shortcuts include doing a joint venture when you have reservations about the partner just because you want to get things moving. It's also common to screw up in negotiations because your team has flown thousands of miles for a negotiation and there's pressure to make the trip seem worthwhile. When something comes up in the meetings, your team may gloss over it, deciding that it can be worked out later, in order to move closer to signing. Build plenty of extra time into your schedule.

Not accounting for the X-factor

In a literal sense, you can't plan for the unknowable. But you should know that the unknowable will happen to your company and that you normally won't be pleased. You shouldn't operate the company so close to the bone that it can't withstand the X-factor. Moreover, you should have contingency plans in place for various emergencies.

Throughout the book, you can read about a number of companies that got hit by the X-factor in one form or another. Don't take their stories too much to heart, though, or you'll find yourself preparing to fight the previous war. However, one event that should be in your contingency plans is a major health epidemic, such as SARS or the bird flu. Have a plan in place in case of a sudden outbreak where nobody shows up to work. You may also want to educate your workers on public health issues and push them to get flu vaccines yearly.

Mistaking Chinese language for China

Short-sighted firms believe that if they hire someone with Chinese language skills back at headquarters, he or she will be the right fit to work with the China business — either from headquarters or in China. Too often, Western companies think that language skills are the key to unlocking the Chinese market. Unfortunately, this method isn't the way to go about it. Doing business in China involves more than speaking Chinese.

We thought they *wanted* to work

One company was in negotiations to purchase a Chinese-owned company. The Chinese company's payroll was a bit bloated. Part of the negotiations dealt with whether the buyers could lay off some employees. The sellers agreed to layoffs, provided that the buyers paid severance and guaranteed the pension obligations to those workers. This provision seemed fair enough, and the sale of the company went through. Shortly after the workers found out that some workers were going to be let go with severance and a guaranteed pension, the remaining workers immediately went on strike. They wanted to get laid off, too!

TIP

Hire people for their business skills. Interpreters and translators (see Chapter 2) can help your team deal with any language issues.

Losing sight of what you know

Throughout all phases of doing business in China, you should remember that you already know a lot about your own business. Language barriers, overzealous consultants, job applicants, and widely reported incidents of Western companies meeting with business disaster can easily intimidate you into thinking that you don't know what you're doing in China.

You know a lot more than you may realize. Good business practices are good business practices. They can be transferred. Odds are that many aspects of your business model can be transferred, too, but don't take this advice as a license to be stubborn or arrogant. You're going to need to be flexible in some areas. We're just trying to give you some backbone to stand up to the (often self-interested) people who're inevitably going to try to convince you that you don't know what you're doing.

TIP

As a general rule, your internal management practices — particularly your corporate culture — are mostly applicable in China (see Chapter 9). If you're going to make adjustments, they're most likely going to be made to marketing and distribution models.

WARNING!

Your respect for ethics and legal compliance is 100 percent applicable in China. Never compromise these principles in the belief that you have to play by special rules in China. Some of your Chinese competitors may play by different rules, but an FIE should never do so. Make sure part of the culture you instill reflects your company's ethical practices. See Chapter 17 for safeguarding against some compliance-related risks.

Putting Some Eggs in Another Basket

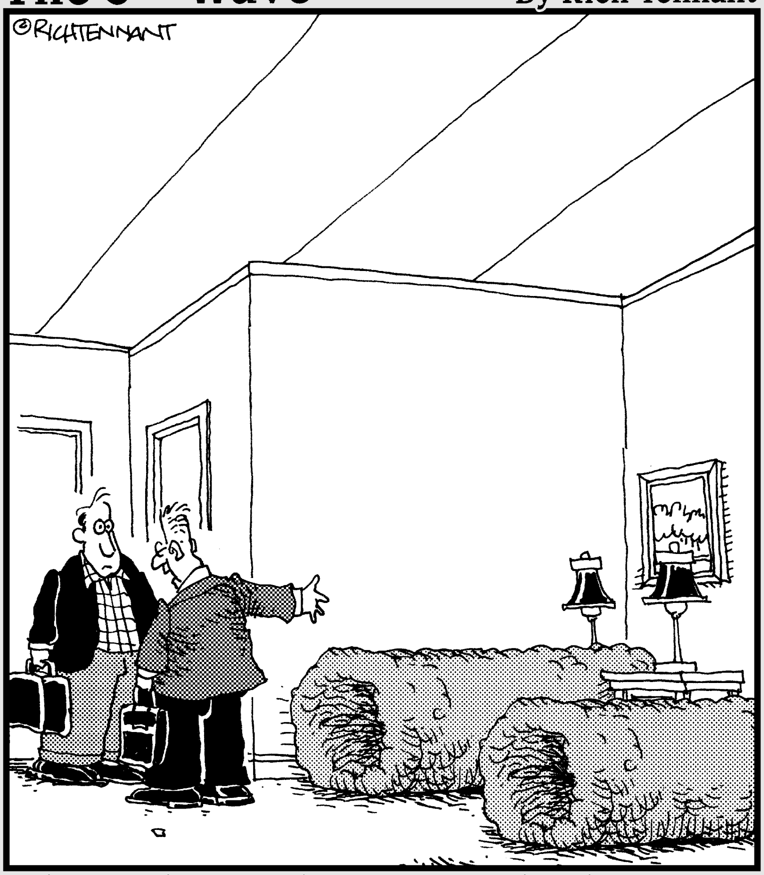
The China plus one strategy, or plus one, is gathering attention in the business world. Some businesspeople fear that their companies may be overconcentrating in China. So instead of putting all your eggs in the China basket, *China plus one* says you should consider somewhere to invest in addition to China.

Although China is attractive to many companies around the world, diversifying is always a good risk management tool. It's especially significant for the manufacturing sector, where some multinationals have a very high concentration of investment in China. As a result, many companies are becoming more cautious about adding any future investment in China. Some big companies are considering investments elsewhere in Asia, such as Vietnam and Malaysia.

As you may appreciate, some of the multinationals have billions of dollars of investment in China. Therefore, they have a good reason to be concerned about their company's future approach to investment in China. If you're a smaller company, you may want to keep China plus one in mind for the future.

Part II
Starting Up in China

The 5th Wave By Rich Tennant



"This is why you shouldn't use the Chinese you picked up in restaurants when making a hotel reservation. We've got a room with two twin size eggrolls."

In this part . . .

This part helps you figure out the most appropriate way for your business to operate in China. We share the common restrictions facing foreign investors and help you understand the choices of possible locations for your company. We put the government role in business in perspective and point out the best ways to work with government officials.

Also in this part, we give you plenty of practical information about getting around China, getting money, and just plain getting by. We talk about what to expect when managing people in China — figuring out what motivates Chinese workers and how to build a strong team in China. Finally, we give you a clear picture of financial matters, particularly China's currency, the renminbi.

Chapter 5

Traveling to and around China

In This Chapter

- Figuring out how to travel to China
- Getting around and about
- Finding what you need
- Staying safe and healthy

This chapter tells you all about traveling to, from, and around China. Getting to China is now easier than ever with direct flights from several major cities. After you arrive, though, finding your way around can be a challenge. Whether you travel by train, bus, ferry, or plane, we guide you as you make your way into China's vast country.

This chapter also explains how to get through the basics Westerners often take for granted at home. We fill you in on the best way to get local currency. We also give you tips on finding money, staying healthy and safe, and more.

REMEMBER

Prices and exchange rates vary. To find the exchange rate between Chinese yuan (renminbi, or RMB) and your home currency, go to `finance.yahoo.com/currency`.

Getting the Necessary Documents and Vaccines

This section goes through the permissions, paperwork, and other preparation you need to take care of before you head to China.

Passport

You need a valid passport to travel to China. Go to your government's Web site for details on the application process. The process can take up to two months, but you can generally expedite the process by paying an additional fee.

If you already have a passport, it must be valid for six months prior to the expiration of your visa for a single-entry visa (see the upcoming "Visa" section). For a double- or multiple-entry visa, you need your passport to be good for at least nine months before the expiration of your visa. The Chinese embassy or consulate won't issue you an entry visa if your passport doesn't meet the requirements. The passport also needs to have at least one blank page.

Business invitation to China

As a business visitor, you require a formal, paper invitation from Chinese business contacts saying that you'll be visiting China for business purposes. You can ask your Chinese host to fax you a letter of invitation. You must include this letter when you apply for your China business visa at the Chinese embassy or consulate. Your invitation letter should be from a company or organization based in China. (For a sample letter, go to `www.visarite.com/bizinvitation.htm`.)

Alternatively, if you don't have contacts in China yet, you can submit a business letter addressed to the Consulate General with your visa application. (Visit `www.visarite.com/bizletter.htm` for a sample.)

On official company letterhead, the invitation should include the following:

- The visitor's name and position
- The company name(s)
- The dates and purpose of the trip
- A statement that your company is covering expenses

Visa

Most people entering China for business purposes need *business (F) visas.* Business visas are valid for up to six months, but they allow the holder to stay in the country for only up to 30 days. Business visas are available in single-, double-, and multiple-entry options. To be sure you get the right visa, check with your travel agent.

China has two Special Administrative Regions (SARs): Hong Kong and Macao. These two regions have separate and different visa and entry requirements. Your Chinese visa is not valid for entry into Hong Kong and Macao. For many travelers, however, visits to Hong Kong and Macao don't require visas. Hong Kong and Macau allow visitors from certain countries to visit for short periods of time without a visa. Check (`www.immd.gov.hk/ehtml/hkvisas_4.htm`) for Hong Kong requirements and (`www.gov.mo/egi/Portal/rkw/`

public/view/showcomp.jsp?id=InfoShowTemp&docid=c373e909dd97940b8f7ad00d226ced8b) for Macau requirements.

If you plan to spend considerable time (90 days or more for some visitors) in China, you may be subject to personal income tax. Check with your tax advisor back home to find out the maximum number of days you're allowed to travel to China without incurring any tax liability. (It varies by country and depends whether your country has a tax treaty with China.)

Paying attention to processing time

Check with your travel agent and/or nearest Chinese consulate to determine what the local processing time will likely be. Generally, you need up to seven days to obtain a visa in person at a Chinese embassy or consulate. Make sure you allow additional time over the holidays. The Chinese consulates are often closed for Chinese national holidays — usually in January or February, May, and October. This is in addition to observing the holidays of the host country.

You can get your visa from the Chinese embassy or consulate more quickly if you're willing to pay a higher price. Check with the Chinese embassy or consulate to determine your best option. In the U.S., single-entry visas start at US$50. A multiple-entry visa that's good for 12 months and lets you stay for 60 to 90 days is US$180.

You may want to consider using a passport or visa express service company. For a modest additional fee for handling and shipping, you can avoid the hassle of getting your Chinese visa. It saves you time, lets you avoid long lines, and gets the job done right the first time.

Applying for a visa

You can get your visa from the Chinese consulate or Chinese embassy in your local area. Visas are also available via a travel agent or visa service. To obtain a single-entry, double-entry, or multiple-entry business visa for a 6-month or 12- to 24-month period, you need

- An application form
- One passport-sized photo
- A formal letter of invitation from your Chinese business contact (or a letter to your consulate — see the earlier section on letters of invitation)

The single-entry visa is valid for travel to China for 90 days from the date of issue; in other words, you need to begin your travel within 90 days of getting your visa.

If you believe you'll be headed to China more than once over the coming months or year, consider getting a multiple-entry visa. That way, you don't have to get a single-entry visa every time you go there. The added costs of a multiple-entry visa may be worth avoiding the hassle of getting a new visa for every trip you make.

See the earlier "Passport" section for info on passport requirements.

Considering your visa when you're in China

You can usually extend or even change your visa when you're in China. To do so, go to the Public Security Bureau. The visas that you obtain or extend in China are usually more flexible than the ones you can get in your home country. Work with a local travel agent or get help at the hotel where you're staying to get everything done correctly.

Make sure you leave China the day before your visa expires — not on the day it expires. Staying in China beyond the expiration date of your visa earns you monetary penalties of 300 RMB a day.

Vaccines and health requirements

The Chinese authorities don't require vaccines for travel to China, but you should consult your doctor and relevant government agencies in your home country to determine what vaccinations may be appropriate for you. At least make sure your tetanus and hepatitis A vaccines are up-to-date.

Plan to get inoculated within a sufficient amount of time to allow the vaccine to take effect. Check with your doctor to be sure to get everything in order before your trip, and keep your vaccination records in a safe place so you know when to update them in the future.

If you're not sure what vaccinations are recommended for traveling to China, you can check sources such as the Centers for Disease Control and Prevention (`www.cdc.gov/travel/eastasia.htm`).

Health may be a concern as your company decides whom to send overseas. China won't issue visas to people with the following conditions:

- Certain mental disorders
- Contagious tuberculosis
- AIDS
- Venereal diseases
- Similar infectious diseases

Making Flight and Hotel Arrangements

Getting to and from China is a lot easier than most people think. Because China has such a large land mass, you can choose from multiple points of entry. Not only can you fly internationally on many foreign airlines or Chinese airlines, but you can also take advantage of the incredible number of domestic flights to and from Hong Kong, which serves as a gateway to the rest of China. (For info on domestic flights within China, see "Taking flight in the Middle Kingdom," later in this chapter.)

In a booming travel market like China, full airline cabins and overbooked flights can be a problem. Therefore, we strongly recommend that you make your flight arrangements about a month in advance of your departure date.

Airport fees and fuel surcharges apply. The airport tax for international travelers into China is 90 RMB, and it's included in the ticket price.

If you're coming from North America, you'll arrive in China the day after your departure date because you'll cross the International Date Line. Therefore, you need to build this change into your busy schedule. Many businesspeople who travel to China arrive on a Sunday to allow time to get over jet lag. If your schedule allows, consider departing for China on Saturday.

Flying directly into mainland China

The most popular way to get to China is a direct nonstop flight from a major international city. Almost every such city in the world has a direct flight to China these days, saving travelers both time and hassle. This section discusses the airports in the most common Chinese destinations for business travelers: Beijing, Shanghai, and Guangzhou.

Many airlines — including United Airlines, Air Canada, Northwest, Air China, China Eastern, and China Southern — fly directly to China from North America. In the U.S., flights depart from Los Angeles, New York, San Francisco, Chicago, and Washington, D.C., and the list continues to grow. If you're departing from Canada, you can fly nonstop to Beijing from Vancouver or to Shanghai from Toronto.

From Europe, you can travel from major cities such as Amsterdam, Frankfurt, Copenhagen, London, Milan, Paris, and Zurich. KLM Royal Dutch Airlines, Air China, SAS Scandinavian Airlines, Lufthansa, British Airways, Virgin, Alitalia, Air France, China Eastern, and Swiss Air all fly nonstop to China.

Beijing, a growing gateway to the East

Beijing made many improvements to its infrastructure in the run-up to the 2008 Olympics, and the government there is adding more and more international air routes that connect to China's bustling cities. This allows more foreign airlines and domestic carriers to serve additional Chinese cities that are growing in popularity, such as Tianjin, Qingdao, and Hangzhou. Check with your travel agent for a direct flight to the city you're traveling to. If one isn't available, you can travel to Beijing (or the nearest large city) and take a connecting domestic flight to your final destination.

Beijing

Beijing, in the northern part of the country, is one of the most popular entry points in China. The Beijing Capital International Airport is conveniently located 25.35 kilometers (15 miles) from the center of the city. The airport has two terminals servicing 66 domestic and foreign airline companies.

From the airport, you can take a bus (60 minutes) for 16 RMB on four different routes in the city. Taxis take 40 to 60 minutes and are the preferred way to travel. The cost by taxi is 60 to 120 RMB, depending on the destination and the traffic.

Shanghai

A city of 18 million people, Shanghai is a popular gateway to China for foreign businesspeople. Its Pudong International Airport has two terminals.

From Pudong International, you can take a bus (five routes), taxi, or the Maglev train for the 19-mile ride into Shanghai. Depending on traffic and where you're staying, a taxi ride should take 25 minutes to an hour and cost 100 to 150 RMB.

Taking the Maglev is definitely the most exciting option. This train, which runs on magnetic levitation, takes a mere 8 minutes and goes at speeds up to 430 kilometers per hour (267 miles per hour). Beware that the Maglev stop in Shanghai is several miles out of the way and requires a taxi ride or a subway transfer to your final destination. A number of reports say that taxi drivers at the Maglev station often require customers to pay fares substantially higher than the meter rates. Such behavior is generally isolated to pickups from the Maglev station and otherwise very rarely occurs in Shanghai.

Guangzhou

The city of Guangzhou (population 10 million) is located in the south of China. Guangzhou is a busy commercial center for visiting businesspeople in China. The Guangzhou Baiyun International Airport opened in late 2004, and the second phase of construction is scheduled to finish in 2009. You can grab a taxi for the 28-kilometer (17.4-mile) ride into the city.

Guangzhou has an enormous international trade fair (among other fairs) each October and April. Hotels fill up fast for the trade fair, so plan accordingly.

Flying into Hong Kong first

An option for many people is to fly to Hong Kong and take other transportation to the mainland. The Hong Kong International Airport — which is actually on an island — is one of the best, most interesting airports in the world. While at the airport, you can take advantage of its free Internet access and wide range of shopping and dining outlets. The flight procedures are the same as at other international destinations — go through quarantine, customs, and then to baggage claim (check out "Navigating the Airport after You Land," coming up).

You have many choices of flights from Hong Kong to most of the popular destinations on the mainland (though flying directly into China is generally cheaper). Or you can take the Airport Express train for a maximum of HK$100 (US$12) (price depends on location), use one of six bus routes into the city, or use a taxi to get to and from the airport. If you get a taxi, get a red one — they specifically serve the urban area.

Another option is to travel from Hong Kong to the Chinese city of Shenzhen by one of the high-speed ferry companies that call at the Hong Kong International Airport. The ferry is a convenient way to get to southern China if you're doing business there.

And if you prefer to travel by train, you can travel from Hong Kong via the Kowloon Canton Railway (KCR) to Lo Wu in southern China. From Lo Wu, you walk across the border into the mainland into Shenzhen. This option is relatively easy, fast, and low-cost. You can also reach other southern Chinese cities using the railway.

For more information on the Kowloon Canton Railway route system and ticketing, go to `www.kcrc.com`. Booking a ticket directly with the Kowloon Canton Railway Corporation (KCRC) is easy by calling + 852 2947 7888.

Finding a good hotel

You can stay in one of many quality hotels in China. The hotels range from luxury five-star hotel chains that you'd find at home to three-star economy hotels. Try to select a hotel that's near your appointments while in China.

Most international hotel chains are well represented in China's major cities, and many good Asian regional hotel chains operate in China. One of the best represented foreign luxury hotel brands in China is Shangri-La. Some Chinese-owned hotels can be an option as well. Generally, the Chinese-owned hotels are not comparable to foreign hotels of the same star rating, but your travel agent can find you a suitable place to stay.

Business centers are common in many hotels in China's major cities but less so in Chinese-owned hotels. Check with the hotel ahead of time to confirm that you'll have access to a fax, express mail, broadband Internet, and a meeting room if you need one. International calling is also available.

When checking into a Chinese hotel, you need to present your passport as identification. Use the hotel's safety deposit box, or if you're lucky enough, an in-room safe, to store your valuables and passport. When checking out of the hotel, service fees and possibly a construction fee for the city that you're visiting will also be on your bill.

Navigating the Airport after You Land

Chinese airports tend to be very crowded. They can be confusing to foreign travelers, even though most signs are written in both English and Chinese. Some newer Chinese airports are very large, so pay attention to where you're going and leave yourself adequate time to get to and from your gate.

Boarding and exiting a plane in China can be quite an experience. Don't be surprised if you see people pushing their way through a crowd of people. The best advice is to just go with the flow. Note that airline personnel don't call seating by rows or sections as they do in the United States. People just start boarding the plane all at once.

In this section, we explain what you have to take care of after you get off the plane.

Health and quarantine

You need to complete a health declaration form upon arrival in China. You get this form on the plane, and the Chinese collect this document from you.

Under the law, China reserves the right to health inspections on passengers who arrive or depart. Foreigners suffering from certain types of mental or infectious diseases aren't allowed to enter China. And like most other countries, China doesn't allow certain products, such as fruit, that may cause a health risk in China. Check with your local Chinese embassy or consulate if you have any specific questions.

Immigration

To pass through immigration, you need to complete the right paperwork, including an entry card for foreign visitors, which provides basic arrival information. You receive the entry card on your flight to China. As you enter China, officials inspect this entry card and your other documents and do the usual stamp on your passport. Given the increased security around the world, Chinese authorities may interview visitors upon arrival in China.

Baggage claim

After health and quarantine and immigration, head to the baggage claim. In the unlikely event that your luggage goes missing, find the airline ticket agent and show him or her your baggage receipt. Tell the agent the name of the hotel where you're staying, and the agent can arrange for your luggage to be sent there.

Customs

You need to complete a customs form before arriving. If you have nothing to declare, just follow the green lane and pass right through customs. If you do have to declare something, you need to go through the red channel and deal with the customs officials. You're expected to pay duty on any items in excess of the amounts allowed to be brought into China. Here's what you're allowed duty-free:

- **Alcohol and tobacco:** Four hundred cigarettes, 100 hundred cigars, and two bottles of liquor (up to 1.5 liters for each bottle)
- **Electronics:** A laptop, camera, video camera, and tape recorder for personal use
- **Money:** Foreign currency up to US$5,000
- **Precious metals:** Gold and silver up to 50 grams

WARNING!

Any content — including film, picture, and video — that's detrimental to China is not allowed to be brought into the country, so don't bring anything into China that may be considered offensive.

When you leave China, you can take 6,000 RMB in cash with you. Of course, you can use Chinese money only inside the country. It's not convertible outside of China except for in Hong Kong. China also has some strict laws about the exportation of cultural relics. Make sure you have customs approval to export any antiques before leaving China. Customs officials attach a small red seal to antiques that can be legally taken out of China.

Getting from the airport to your hotel

After you get your luggage, your next destination is the hotel. Some high-end hotels can offer you car service. Make such arrangements in advance. Most foreign businesspeople go to the taxi stand at the airport and head to their next destination.

WARNING!

At the airport, you often see private cars offering rides to visitors. Just ignore them — going by a metered taxi is cheaper and safer.

Around and About: Traveling within China

Traveling within the vast country of China can be a little trickier than getting to China. China's transportation infrastructure is being built at a frantic pace. New airports, high-speed trains, and new expressways are always popping up. (China had no expressways until the late 1980s.) Sometimes your travels in China go really well — and sometimes they don't.

Although getting around China by yourself is possible, the language barrier makes it somewhat difficult. Outside of the major cities, English isn't very common. Even within major cities, don't expect taxi drivers to understand English.

Many visitors to China rely on their local Chinese business contacts to help them get around. Using an interpreter can also help you with travel arrangements. (For more information on using an interpreter, go to Chapter 2.) After you've traveled to China a few times and have experienced the transportation systems, getting around shouldn't be too much of a problem.

For information on paying for transportation, see the upcoming sections titled "Considering a travel card" and "Finding money."

TIP

A little help from Chinese travel agents

For planning travel within China, including making hotel reservations, using a reliable travel agent that's based in China is best. Intra-China airfares are usually lower when purchased in China, and travel agents based outside of China often use China-based travel agencies to book hotels and tours in China, anyway.

Many travel agents are in China, but one of the biggest is China International Travel Service (`www.cits.net`). If you have somebody in China who can make payment and take delivery of air tickets or hotel vouchers, you can use the Chinese travel portals eLong (`www.elong.net`) or Ctrip (`english.ctrip.com`). Both offer English sites. For arranging business and higher-end personal services in Shanghai and other major cities, Black Card Life (`www.blackcardlife.com`) is a good bet.

Taking flight in the Middle Kingdom

China's domestic airlines serve approximately 80 Chinese cities. Air China alone has over 240 domestic routes, and more routes and services are being added. China's local airlines have purchased a newer fleet of European- and American-built airplanes. Generally, foreign business visitors get around China pretty easily using the local Chinese air carriers. However, the quality of some domestic airports isn't as high as that of the international ones.

The airport tax is 50 RMB for domestic flights. The domestic flight fee is labeled as an "Airport Construction Fee" and is included in the sale of all plane tickets.

Taxiing

Taxis are the best way to get around China's cities without the hassle of packing yourself in amongst subway or bus commuters. The cabs are usually reasonably clean and of varying comfort, and tipping isn't expected. Some taxis are air conditioned and others are not. But when you really need one, you take what you can get!

Taxis technically aren't allowed to stop except in designated areas, but most taxis rarely follow the rules. Hotels and large commercial buildings generally have a taxi stand where people wait in line for the next available taxi. Outside such common places, you hail a taxi by holding your arm outstretched and parallel to the ground. Needless to say, competition for taxis is common in the large cities in China.

Here are some points to remember about taxi travel:

- Many taxi drivers in major cities don't originally hail from those cities, so they may not know their way around well. Unfortunately, they don't always tell you this before driving! Always have a mobile phone with you in case the driver gets lost.
- Make sure to have your destination written in Chinese for your driver, or at least have a printed copy of the name and address of the hotel or business you're visiting.
- Opt for one of the larger taxi fleets, which generally have better service. In Shanghai, the larger taxi companies go by colors: yellow, turquoise, light green, white, and blue.
- Use only taxis that have meters.
- The taxis seem to disappear in rain or extreme heat. Picking up a taxi at the hotel is an easy method — the hotel doorman can tell the driver where you need to go.
- Don't be surprised when you find a lot of traffic and congestion in most Chinese cities. You need to plan your time carefully to make sure you arrive at your appointments on time.
- Taxis don't accept credit cards, so you have to pay in cash or with your transportation card (see "Considering a travel card," later in this chapter).
- Always get a receipt from the driver. Getting a receipt is especially useful if you happen to forget your belongings in a taxi.

Taking the subways

For the first-time visitor or the infrequent visitor to China, taking on the busy subway system probably isn't a good idea. But if you're game, using the subway, or Metro, can be a great, cheap way to get around and explore. Many of the large Chinese cities have existing subways that continue to expand, and about a dozen other cities are planning or building new subways. For example, Shanghai's subway can whisk you from the financial district in Pudong to the Bund in just a few minutes. And the signs are in English, too. However, the stops aren't the most convenient for business visitors. Still, you can take the subway to the closest stop and then take a cab to your final destination, avoiding the crazy traffic jams that are part of modern daily life in China.

To use the Metro in most cities, you need to purchase a single-journey ticket or transportation card at the Metro station. Most cards can be refilled at both stations and various merchants, such as convenience stores. The fare for a subway ride depends on your destination, with fares ranging from 3 to 5 RMB. Be sure to hang onto your card after you get on the train — you need to put it in the machine in order to exit the station.

You could watch three trains pass by before one has room for you to get on, so don't be afraid to push a little bit to get a spot on the train! Some people may push onto the train before waiting for people to get off. Avoiding subways around rush hour can save you some of this hassle.

Busing around

Although you don't see too many foreigners on buses, these vehicles can be a reliable source of transportation. Beijing alone has more than 700 bus routes. However, taking buses in China is not for the fainthearted. Even the locals can get confused about which buses go where. Still, the newer, climate-controlled busses are worth a try if you're adventurous.

The bus fare in Beijing depends on your destination, as well as the vehicle itself (the nicer the bus, the more expensive the ride). For an air-conditioned bus, the trip costs 2 RMB for less than 10 kilometers (6.25 miles) and another 2 RMB per additional 10 kilometers. If you don't get air-conditioning, the cost is 1 RMB per 10 kilometers.

When you get on the bus, you don't pay as you board. Instead, a bus attendant comes to you, asks where you're going, and tells you the fee. Clearly writing down your destination to show the attendant is a good idea. After paying the fare, the attendant usually gives you a receipt. Be sure to pay attention to the bus stops and ring the bell before yours so you can get out.

In Shanghai, the fare doesn't depend on distance. Instead, either you touch your transportation card to the reader by the driver's seat (see the upcoming "Considering a travel card" section) or an attendant comes to you after you've boarded to collect the set fare. As in Beijing, prices are slightly more expensive for air-conditioning.

Riding the rails to and fro

China's extensive rail system links most of the country. It's upgrading rapidly and even includes some high-speed trains, similar to those in Europe and Japan. Depending on the type of train, riding the rails may or may not be a good way to travel between cities.

You need to purchase tickets in advance, which your hotel should be able to arrange for you. Ticket prices vary by route and type of train — they're quite affordable, though. Most trains have a "soft class," which is highly recommended over "hard class."

Avoid taking trains around the week-long holidays (January/February, May, and October) because the trains are so jammed with people that passengers stand in hard class for up to 36 hours at a time!

Considering a travel card

In Shanghai, the Shanghai Public Transportation Card (SPTC) gives you easy access to the buses, Metro, ferries, taxis, and Airport Maglev. You can purchase a card at Metro stations. Besides being a convenient touch card, the SPTC also allows you to take an overdraft if you run out of money on your card. Taxis don't provide receipts when you use the card, because you receive a receipt when purchasing the card.

Watch out for taxi drivers who give back another card without much money on it. You may want to mark your card in a way that you can easily identify it, even when you're in a dark cab.

The Standard card has a refundable deposit of 30 RMB; other cards can't be refunded, but a Mini card has a lower deposit (20 RMB). The cards can be reloaded in multiples of 10 RMB at deposit stations throughout Shanghai or in multiples of 50 RMB in many local Metro stations. The balance is noted every time you scan through an entry/exit at a Metro station.

Hong Kong's Octopus card is good not only for paying for public transportation but also for payment at convenience stores, supermarkets, fast-food restaurants, and more. After purchasing the card at an MTR (Mass Transit Railway) station, you can refill it at an MTR station or at a merchant that accepts the Octopus as payment. The most overdraft an Octopus card will take is HK$35 (US$4.50). An adult Octopus card costs HK$150 (US$19.20).

Beijing has a Yikatong card (formally known as the Beijing Municipal Administration and Communications Card) that you can use for public transportation. The system was recently expanded and continues to grow. You can purchase bus, subway, and combined bus/subway cards for a monthly fee.

If you're in Guangzhou, get a Yang Cheng Tong card for the bus, Metro, taxis, and ferries. A standard card costs 80 RMB.

Shenzhen's card — the Shenzhen Transcard — works for the Shenzhen Metro and buses.

Getting through the Basics of Daily Life

Finding money, staying healthy, and generally getting by in your home country is usually pretty easy. In China, these basics can be easy, too. In this section, we talk about how these fundamentals work in China.

Finding money

For now, cash is king in China. You can find ATMs in all the big cities. Credit cards aren't widely used or accepted except at businesses catering to foreigners.

China's currency is called the renminbi (RMB), meaning *the people's money.* Its basic unit is called the *yuan.* Some people also refer to the yuan as kuai. Here are the main denominations:

- 100 RMB note (currently a red color — older versions are purple)
- 50 RMB note (green-blue)
- 20 RMB note (brown)
- 10 RMB note (blue)
- 5 RMB note (brown)
- 2 RMB note (green)
- 1 RMB note (purple brown) and coin

Other smaller bills and coins, called *jiao* and *fen,* are also in circulation.

You should convert your personal foreign currency into China's local currency. You can do so at a bank in China, at the airport, or at your hotel. Generally, you get a better deal at the bank. Look carefully at the rates and fees to make sure you're getting a fair deal. If you expect to exchange currency at the end of your trip, save your exchange receipts. If you don't have the receipts, you can't convert the money back into your original foreign currency. (For information on avoiding counterfeit money, see "Staying clear of counterfeits," near the end of the chapter.)

Using ATMs

The Bank of China (`www.bank-of-china.com/en/static/index.html`) is China's main bank. Bank of China's ATMs are linked to Plus, Amex, Cirrus, Maestro, and Diners Club International networks. Bank of China's ATM network is quite good in most medium and large Chinese cities. The Bank of

Communications (`www.bankcomm.com/jh/en/index.jsp`) is another large Chinese bank where you can access an ATM. Some good quality hotels also have ATMs that are hooked up to international networks.

Withdrawing money from an ATM in China is no different from drawing money out of your ATM at home. Just follow directions, which are in English, and you can convert money from your foreign bank account into RMB. (***Note:*** You can't withdraw foreign currency from ATMs — only Chinese money.)

To be safe, use ATMs during the day at the larger bank branches or at your hotel.

Using credit and debit cards

Traditionally, credit cards haven't been widely accepted in China, but this is fast changing as the government is supporting the use of credit cards in China. The government wants a bigger credit card network for the 2008 Olympics in Beijing. Foreigners use debit cards from domestic and foreign accounts all the time.

You can use international credit cards in large department stores, popular restaurants, and hotels in medium and large Chinese cities. Credit cards are also accepted in the Western-style markets in Beijing and Shanghai. Taxis do not accept credit card payments. Note that most U.S. card issuers take on 2 to 3 percent "conversion fees" for all foreign currency transactions. This is true of debit cards as well.

If you need to get a cash advance using your credit card, you need to go to a major bank. Of course, they charge you a commission.

TIP

Call your card company before you leave to alert them that you're traveling to China. The company can then expect to see China-related transactions on your account without concerns about your spending. You don't want to have your card blocked while you're in China.

Using traveler's cheques

You can pay by traveler's cheque in China, or any hotel or major bank can convert your foreign traveler's cheques into cash. However, most people find using the Chinese ATM to get cash and using credit cards for major expenses to be more convenient.

Staying healthy

Nothing's worse than getting sick or injured in a foreign country. Most people who travel to China don't have any problems. The most common ailment for foreign visitors to China seems to be an upset stomach probably caused by lower local standards of hygiene.

Getting smoked, Chinese style

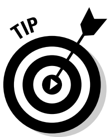
The Chinese are really heavy smokers. More than 350 million Chinese smoke cigarettes, and the number of new smokers is growing by about 3 million a year. More than 50 percent of men smoke. Greetings between males usually involve offering a cigarette. As you may have guessed, you can find plenty of ashtrays around.

In China, smoking in front of others is still socially acceptable. If you're sensitive to smoking, you may have some problems in China. Smoking bans are in place in some public places, but smokers largely ignore them, even smoking right in front of the Do Not Smoke signs! People rarely complain about the smoking.

Generally, business visitors to China stay in the medium and large cities where hygiene standards are better. Steer clear of poultry markets and rural areas to avoid any possibility of avian flu exposure. With this and a few other simple precautions — which we discuss in this section — you can stay healthy during your visit to China.

Understanding hygiene in China

Hygiene standards in China are likely very different from what you're used to back home. For instance, spitting is common there (although some cities are trying to crack down on it). Beijing seems to be making some progress tackling the spitting problem, but outside of the capital city, there's still a lot of spitting going on.



With overcrowded cities, people start living in closer proximity, encouraging the spread of germs. As a result, you may become mildly ill during a visit to China. However, here are some preventive measures you can take:

- **Take greater care of your hygiene while you're there.** Wash your hands a lot. Don't be surprised when you don't find hot water or soap while visiting restaurants and other places. A bottle of hand sanitizer can be one of your best friends in China.
- **Plan on using the bathrooms at your hotel, your office, or the factory you visit.** The public bathrooms in China were really meant to serve the masses, so take advantage of a clean bathroom whenever you can.
- **If you cut yourself while shaving or whatever, immediately sterilize it.** Here's an application for antibacterial gel. Peroxide is even better if you take it with you. Bacteria levels are so high everywhere that open cuts have a really high rate of infection.
- **Consider wiping down dining ware with a clean cloth napkin or hot tea if things don't look very clean.** Bring packs of two-ply tissues everywhere, just in case.

Watching what you drink

Here's the main rule about drinking water in China: Don't drink from the tap. Use only bottled or filtered water. Some people prefer to use the bottled water to brush their teeth, too. Many medium- to higher-end restaurants in the major cities serve filtered water; however, if you're unsure, just assume that it's not filtered. Outside of the major cities, also avoid using ice with your drinks, because the water may not be filtered. Make sure you stay hydrated in China, especially in the summer.

The Chinese love to drink tea. Take advantage of the great variety of teas and enjoy the local custom during your visit. In most situations, tea should be a safe alternative because the water has been boiled. Drinking tea is more than just a tradition — it's a safe way to enjoy a pleasant beverage!

As in most cultures, drinking alcohol with a meal is common in China. Be careful about how much alcohol you consume. Some types of Chinese liquor can be extremely strong and may leave you with a throbbing head the next morning. Because you're traveling on business, often trying to get over jet lag while negotiating with the Chinese, drink only in moderation.

Minding what you eat

Hopefully, the Chinese food sits well with you during your visit. Enjoying the Chinese cuisine can be one of the highlights of visiting China.

Some people have trouble adjusting to the amount of oil in Chinese cooking. Others have a particular sensitivity to MSG (monosodium glutamate). Also known as *Chinese restaurant syndrome,* sensitivity to MSG can cause symptoms such as a headache and drowsiness. Unfortunately, you can't do much to avoid MSG during a visit to China, because almost all Chinese restaurants use it. If MSG becomes a problem, seek out non-Chinese food restaurants.

If you have food allergies or intolerances, watch out for some of the following, which are common in Chinese cooking:

- Fish and shellfish
- Soy, which is present in tofu, soy sauce, salty black beans, and edamame
- Wheat (gluten), which may be in noodles, dumplings, bread, and pancakes

Even if you don't usually have a sensitive stomach, you should bring some remedies, especially for diarrhea. Most Western remedies are generally available, but consider bringing your favorite brand with you to China so you can avoid taking counterfeit medicine.

As delicious as the food may smell, stay away from anything sold by street vendors. The hygiene standards are less than ideal.

Finding healthcare when you need it

For general ailments, your best choice is to visit a Western-operated clinic. Western-run clinics usually have decent English-speaking capability. In addition, they're less likely to have arbitrary pricing or to recommend unnecessary tests. You can choose from several of them in Beijing and Shanghai. Some higher-end Chinese hospitals also have VIP clinics that offer foreigners a higher level of service.

In the case of something more severe, look for Western-operated hospitals in the larger Chinese cities. You may seriously consider traveling to Hong Kong for healthcare services. If time and conditions allow, just head back home.

If you're not feeling well before a planned trip to China, do the right thing and cancel or postpone your visit. You're much better off getting over your sickness at home.

You can obtain some recommendations of the healthcare facilities available in your city by contacting your home country's embassy or consulate. Or your hotel should be able to tell you what the options are. Otherwise, look for Western clinics and hospitals in major cities through the Internet and in advertisements in the free expatriate magazines at Western bars and restaurants.

Prices for quality healthcare in China are high, and they may be somewhat unpredictable. You can expect to pay higher costs for healthcare as a foreign visitor. Generally, your health insurance should cover your usual and customary medical expenses while in China. Insurance providers usually reimburse you after you return home. In Chinese-run clinics and hospitals, you may have to provide a deposit for your treatment; therefore, if you're short on cash, you may want to have your hotel confirm whether the clinic will take a credit card for payment.

To better understand how your coverage works, check with your healthcare provider before you make your trip. Make sure you bring your insurance card with you to China.

Be careful about taking any prescriptions or antibiotics that a Chinese doctor provides you. Certain prescriptions in China may not be what you'd expect them to be. Over-the-counter products may not be authentic. The best recommendation is to bring what you may need in terms of over-the-counter remedies — especially anti-diarrhea medicine. Eye drops for irritation due to pollution may be a good idea, too.

Weathering China

Because the country is so large, you can be in a subtropical zone one day and frigid plains the next. Some places in the very south of China don't even have a winter. To the north, some regions don't have a summer — the winters are very cold, so be prepared. Most of the country has blazing hot weather and humidity in the summer. (For men, wearing blue shirts in the warm months is not recommended. If you're prone to perspire, you'll look like a wet dish rag in a blue shirt!)

The most pleasant months to visit China are April, May, September, and October. During this time, the weather is generally comfortable across China.

Check on the local weather conditions before you go to China. Don't be fooled into believing that being on the same latitude means that the temperatures are the same as elsewhere in the world. Find out what the local conditions are like in China before you start packing. Bring a variety of clothes that can keep you comfortable for the places you'll visit in China.

Preparing for crowding and noise

With the rise of China's economic prowess, more people have migrated to the cities in China. They're seeking better jobs that offer better pay than what's offered in the countryside. As a result, life in China's cities is crowded. With a population of 1.3 billion, this statement may be a little obvious, but once you get there, you realize what "crowded" really means. Beijing's population is more than 11 million, Shanghai's tops 18 million, and Guangzhou has 11 million people. While you're there, forget about personal space, and get to know your new neighbors.

Noise levels in China are high — you deal with city noise, construction noise, factory noise, people noise, and all sorts of other noise. China has noise pollution laws, but enforcement is still a work in progress. You often hear Chinese shouting into cellphones, talking during musical concerts, and jabbering loudly over a meal. The level of noise can be high in public places such as restaurants and factories and even on airplanes. You soon learn to take this in stride.

Dealing with pollution

China's burst on the scene as the world's factory has had both positive and negative results. On the downside, many of China's bustling cities are incredibly polluted, tainting their rivers and streams. Don't be surprised by factories that pour toxic chemicals down manholes, people using the road as a trash disposal, and a blanket of haze where a sunny blue sky should be. Sometimes the pollution can be so bad that your eyes begin to sting. Although the Chinese authorities have installed plans to improve the overall situation, there's been little short-term progress in the way of improvement.

Most of the time you'll be indoors, so pollution shouldn't have too much of an effect on you, but be prepared. You may want to bring some eyewash with you when you visit China if you're sensitive to air pollution. Also, if you have a respiratory condition, such as asthma, be sure to pack medications to avoid flare-ups.

Staying Out of Trouble

This section goes through some of what you can do to protect yourself from scams, crime, and legal problems.

Contacting your embassy or consulate

If your travel plans include staying at a place other than an international, standard tourist hotel, registering with your nearest embassy or consulate — before you need assistance — may be a good idea. Many embassies and consulates in China have registration procedures for visitors. In the event of an emergency, the embassy or consulate knows where to contact you.

If you need any help in China, contact your embassy or consulate as soon as you can. Keep the contact details of the embassy or consulate with you when you travel to China. Most European, North American, and some Asian countries have consulates in Beijing, Shanghai, Guangzhou, Hong Kong, and other places in China.

Protecting yourself against crime

Researchers estimate that the transient population in China is over 120 million people, representing almost 10 percent of China's population. Most of the transient population has flocked from the countryside to China's booming cities in search of jobs. With such a large number of people on the move, it's not surprising that crime is on the rise. Many people are out of work as China's "iron rice bowl" (employment and benefits guaranteed by the government) no longer applies, and desperation can move some people to illegal actions.

Take the usual precautions while in China. The best advice is to be alert at all times. Here are some other tips:

- Try to keep only a minimum amount of cash with you at all times.
- Be mindful that expensive jewelry, watches, personal digital assistants (PDAs), and laptops are attractive targets for thieves.
- Walking the street at night in the larger cites is usually no problem, but try to stick to high-traffic areas and avoid poorly lit side streets.

China can be a safe place for visiting foreigners; however, crime does occur. Pickpocketing and theft are the most common types of crimes against foreign visitors. The pickpockets and thieves may work in gangs, so be aware that more than one person may be looking to take advantage of you. China's pickpockets can be extremely skillful, so take nothing for granted.

Generally, crime against foreigners takes place in tourist areas, bar areas at night, street markets, airport areas, and so on. Beggars often work in gangs using young children as bait to get you to give them money. Sometimes, people may try to force business flyers or cards into your pockets with intent to pick your pocket.

Shenzhen and Guangzhou, to the south, have higher incidence rates of petty and occasionally violent crimes against foreigners. Sometimes foreigners are forced to withdraw cash from an ATM. Although these incidents aren't very common, you should be especially careful at night in these and other southern Chinese cities. If you're the victim of a crime, contact the police as soon as possible. Keep the police report in the event that your loss is covered by insurance.

Foiling scam attempts

Avoid people who approach you on the street to offer you sightseeing or shopping tours. Tour scams are particularly common in China. Guides may approach you at tourist places, offer special tours at inflated prices, and then make stops at factories, restaurants, and stores to try to get you to buy goods at inflated prices. If you do take a tour, often the best approach is to refuse to participate in the shopping stops by enjoying a brief rest rather than feeling pressured to spend money.

Staying clear of counterfeits

Fake currency is a major concern in China. It usually involves the 50 and 100 RMB bills, so use smaller bills to pay for whatever you buy in the local markets. This is a safe way to avoid having someone's fake currency passed to you during the purchase.

Identifying a counterfeit bill can be quite challenging for foreigners. Like most fake currency, the forged bills in China contain images that aren't as clear as the real notes. Other than carefully checking your bills, you can do little about it. If you do get a bogus note, you can do what most people do: Just try to pass it off on somebody else later (doing this in dark places is easiest)!

Don't exchange money on the street, at tourist destinations, or anywhere else. Exchanging currency at unauthorized places in China is against the law. The rates of exchange will likely not be in your favor, and you may wind up with counterfeit money.

Fake or counterfeit goods are also a problem in China. If someone offers to sell you something below the expected price, be very wary. Bootleg DVDs are commonly sold on the street.

Avoid buying from the street vendors while in China. Buying fake merchandise is against the law in China, and it's often an infringement on worldwide copyrights. The risk of getting into trouble at customs isn't worth the discount you got for fake goods.

Keeping out of restricted areas

Most businesspeople travel to China for the more popular cities along the coast or those just inland a few hundred miles. More than 1,000 Chinese cities are open to foreign visitors, but that's obviously not the whole country. Some remote and sensitive areas are closed to foreigners.

The restricted or closed areas are usually in remote areas in China. Generally, most businesspeople wouldn't travel to these areas, anyway. If you have any questions, contact the Chinese embassy or consulate before you start your trip to China.

Avoiding legal problems

Be on your best behavior in China by respecting the local laws and customs, and you won't have any problems. The best rule is to act responsibly and use common sense — go about your business as you would in your home country. Be sure to deal with people who are reputable and are acting within the law. Avoid areas where any illegal activity may be taking place, and keep clear of any activities related to the military or political activities while you're in China. (For information on Chinese business laws, check out Chapter 8.)

Chapter 6

Getting Business Going through Successful Negotiation

In This Chapter

- Getting a handle on what the Chinese are thinking
- Understanding Chinese negotiating tactics
- Playing the game your way
- Negotiating after you've made the deal
- Ending on the right note

To be sure, the Chinese are difficult and shrewd negotiators — after all, they've been haggling for the last 5,000 years! The Chinese seem to hammer away at you until you agree to do business the "Chinese way." Therefore, you need to be ready for negotiations that are very relationship-based and ready for meetings and discussions that are very formal.

Make no mistake: Negotiating will test your limits! The Chinese seem to have unlimited time to negotiate with foreigners. Sometimes, you may think to yourself, "Don't these people have anything else to do?" Meanwhile, your boss back at headquarters expects some good news soon about signing a contract with the Chinese.

Although negotiating with the Chinese is a challenge, it certainly can be worthwhile in the end. We hope you find that the Chinese make great business partners. This chapter can help you and your company better understand how negotiations really work in China and the strategies and tactics that the Chinese use. ***Note:*** Although this chapter focuses on negotiating specific business deals, the general advice here holds true for most negotiations with the Chinese.

Preparing for the Process

Negotiating with the Chinese can be hard enough — you don't want to make it any harder by not being prepared. Getting your team together beforehand to prepare for the negotiations is sure to improve your chances of success.

Most people going to China from outside Southeast Asia are very jetlagged when they arrive. We recommend that you don't get involved in important negotiations during your first few days in China. Also, plan to stay long enough during your trips to China. You need more time to get things done the Chinese way.

Organizing your team

TIP

Here are some aspects to consider when deciding who should be involved in negotiations:

- **Leadership:** The Chinese like to deal with a single leader, so have the most senior person from your company represent you as the leader at the negotiating table. He or she should have authority to make decisions. (For more information on Chinese business meetings, go to Chapter 11.)
- **Head count and role call:** Bringing the right skills to the table is highly important. In the beginning of discussions, your technical people need to be at your side. Also, being underrepresented may give the Chinese the impression that you're not serious, so be sure that you bring along other experienced team members as well.
- **Consistency:** The Chinese don't like changes in your negotiating team. You may need some technical representatives for part of the discussions, but having a core team that represents your company through it all is best. Try to have the same company leader from start to finish.

  At least one of your company representatives needs to be at all the meetings so that one or more people know the history of the entire negotiation. This move protects your company from any false claims from the Chinese that you agreed to something previously.

TIP

Assemble your team before any meeting takes place. Go over the progress so far and goals for the meeting. You can also discuss what concessions you're willing to trade off. And remember to discuss what trade-offs are absolutely nonnegotiable with your team.

Developing trust and then doing your bargaining

Through all the negotiating, the Chinese are still trying to figure out whether they want to do business with you and your company. You need to convince the Chinese that you and your company are committed to the Chinese market and to working with them as a trusted partner. Demonstrate that you're open and honest, and take the time to get to know the representatives from the Chinese side on a personal level.

Reputation is extremely important, so you need to prove to the Chinese that you and your firm are reputable. Give real-world examples where your firm has lived up to its commitments, and allow the Chinese to check out your existing business relationships so they can get a good idea of how your firm does business. Better yet, if you're lucky enough to already have some successful relationships in China or Asia, use these contacts as references.

You can also build trust by hosting a small group of your Chinese counterparts at your company's headquarters or arranging for the Chinese to visit your place of business back home. The Chinese generally like overseas business travel and are impressed that you think highly enough of the relationship to invite them. Obtaining a visa for visiting Chinese can sometimes be problematic in certain countries, so plan accordingly. U.S. companies that belong to an American chamber of commerce in China may be able to take advantage of a program to expedite visas for their Chinese guests.

Considering how best to divide the pie

A Chinese CEO of one of the largest privately held Chinese companies recommends that foreign businesspeople not negotiate with the Chinese. In his mind, "negotiation" implies a zero sum mentality — that in order for you to win, the Chinese side must lose. Instead, he suggests that you consider how to divide the pie with them so that both sides win. In other words, think about how best to distribute the benefits of a commercial relationship with the Chinese. The Chinese certainly do expect their fair share. (For more on mutual benefit, go to Chapter 11.)

Finding out what the other side needs the most makes negotiating a lot easier. Here's a list of Chinese counterparts and what they may be looking for:

- **Government officials:** They normally want benefits for their city or region. They want new factories that produce new jobs and more taxes.
- **Businesses:** They're typically looking for new technologies that can improve their position in their home market or export market.

Appealing to SOEs and private companies

State-owned enterprises (SOEs) and private Chinese companies often look for different benefits. You have to adjust your negotiating style (and possibly business plan) for each group:

- SOEs are often focused on protecting or creating jobs, so in many cases, they're not that interested in efficiency. They also like to do deals that help them achieve political business goals (such as "green development").
- Private Chinese companies are very bottom-line focused, and they value many of the same things that their Western counterparts do — profits, efficiency, and so on.

SOEs have a tough negotiating style for two reasons. First, they possess many of the country's best assets — and they know it, so they're aware of their leverage. Many of them also take their charge to protect the value of those assets very seriously, so they proceed cautiously to make sure that they're not getting a bad deal. This process often involves a good deal of internal approvals. Because private companies haven't had access to those prized assets, they're much more efficient — including in negotiations. Their decision-making is usually centralized with the largest shareholder. Unlike SOEs, the owner/largest shareholder can usually approve a deal with a good deal of speed, if he or she is so inclined.

- **Service industries:** They're looking for know-how from the West so they can be more competitive in a quickly deregulating business environment.

REMEMBER

The Chinese take a lot of pride in their country, so they like to be assured that your relationship will not only bring business benefits to them but also do something good for China. For example, if you're acquiring a poorly performing company in China and taking on pension liabilities, you can emphasize that your company will guarantee to honor future benefits for retirees, which is something the current owners may not be able to do.

Practicing the Chinese Art of Negotiating

Negotiating with the Chinese is a combination of hard-nosed bargaining, relationship building, and banqueting. When negotiating with the Chinese, being polite, understanding, and respectful of the cultural differences is extremely important; however, you also need to be a skilled negotiator to keep up with your potential new partners.

Although your Chinese hosts are incredibly hospitable, you can expect your counterparts to be very smart and demanding at the negotiating table. This section explains how the Chinese think and act when dealing with foreigners.

After many attempts to get to an agreement, you may find that you can't conclude a satisfactory deal. Don't be afraid to walk away from a bad deal. If you've been negotiating for about a year, you're probably at the end of your rope. Make sure you let the Chinese know from the beginning that you're responsible for looking out for the best interests of your company — even if that means not reaching a negotiated agreement with them.

Thinking like the Chinese

Thinking like the Chinese is a good way to get an understanding of their negotiating strategies. This section explains some Chinese perspectives.

Developing a relationship is most important

Many Westerners negotiating in China emphasize getting a contract signed; however, the Chinese believe that developing a relationship is the primary objective of any negotiation. Foreign businesspeople tend not to fully understand the importance that the Chinese place on relationship building.

First, the Chinese need to be satisfied that a good long-term relationship with your company is possible. They consider criteria such as

- The people who represent your company
- The way you conduct business
- Whether you do what you say you're going to do
- The success of your company in the international market
- Your company's reputation

Only then do they ask themselves, "Are you the right partner? Can I do business with you over the long term?" (For more about relationships, go to Chapter 15.)

Sometimes you may feel like the Chinese don't trust you. Some people say the suspicion has to do with the past abuses by foreign powers in China (see Chapter 3 for details). Whatever the cause, the Chinese need to be comfortable in dealing with you before they begin any discussions "Developing trust and then doing your bargaining," earlier in the chapter).

The Chinese often don't believe that the signed contract defines the agreement. Many times, they think that the contract is just a snapshot of what was agreed to then and there. (For more on contracts, go to Chapter 18.) Be prepared to hold the Chinese feet to the fire if they don't perform their obligations according to the contract.

Sometimes the Chinese try to have it both ways. When the snapshot view benefits them, they may tell you it's only a snapshot. However, if you try to play the game the same way, don't be surprised if they expect you to adhere to the letter of the contract! For info on strategies, see the upcoming section titled "Navigating Chinese negotiation tactics."

Haggling is expected — and kind of fun

The Chinese like to haggle about everything — it's part of their culture. They bargain over the price of fish in the market. They squabble over the discount on the purchase of a washing machine. In their daily lives, they wrangle over most everything they buy. So don't be surprised when the Chinese want to negotiate all the nitty-gritty details of the deal with you.

Navigating Chinese negotiation tactics

The Chinese use some common tactics in negotiations. We explain some of these tactics so you're ready to negotiate from a position of strength.

TIP

The Chinese like to take their time when starting up negotiations, so don't get down to business right away. Take your time by making small talk for a while. (For more information about business meetings, go to Chapter 11.)

The setup: Accusing you of violating the guiding principles

The Chinese usually open negotiations by thoroughly explaining broad guidelines for the discussion — its *guiding principles.* For instance, the Chinese often emphasize that "mutual benefit" will be one of the guiding principles. In this way, they set up the expectation that any negotiated agreement will be fair to the Chinese side.

TIP

Pay careful attention to what the Chinese tell you during the start of any negotiations. They explain to you at length what their expectations are. They often use broadly worded statements that give the Chinese flexibility in interpreting them the way they want. Later, they continually refer back to these principles and try and use them to their advantage.

After setting the stage, the Chinese finally get to the details. At some point, they don't like what your side proposes. They say what you've suggested violates the spirit of the guiding principles that they so carefully explained to you in the beginning. You're not living up to your end of the deal.

Shame on you for trying to pull a fast one on the Chinese! Now you've created a problem, and you have to fix it. This Chinese negotiating tactic is classic: They try to make you feel guilty about how you're negotiating with them. Their hope is that this tactic triggers the response they're looking for. You guessed it: concessions from your side! You need to remind them that "mutual benefit" (or any of their other open-ended principles) is a two-way street.

You, too, can play the game the Chinese way. If they lay out their guiding principles, you can do the same. The Chinese should get the idea that the discussions need to be more balanced.

The demand: Asking for the moon

A favorite Chinese tactic is to make outrageous demands. The Chinese can put on quite a performance. With a straight face, they ask you to pay for all the business insurance costs because the Chinese say they're not necessary. Or they ask to be your exclusive distributor in perpetuity. Or they want you to pay for all expenses involving expatriate costs. Their attitude seems to be that there's no harm in asking.

When the Chinese do make an outrageous request, they generally see a slim chance of getting what they're asking for. By setting the bar so high, the Chinese have more room to negotiate a better deal for themselves. The Chinese put an obligation on you to come up with something closer to what they've asked for — not a bad negotiating tactic if you can get away with it.

Leave yourself some wiggle room in your position in case you need to make some concessions. But after you reach your bottom line, say no (see "Saying no the Chinese way," later in this chapter). And maybe say it several more times! If you don't, you can expect the Chinese to ask you to cough up even more concessions.

The better offer: Threatening to go to one of your competitors

The Chinese like to create competition for their business by negotiating with several foreign companies at once. The message is that if the Chinese can't work out a deal with you, they'll go to one of your big competitors, often in Germany or Japan.

Talk to several potential Chinese business partners about possible cooperation, and the people you're negotiating with will have to compete for your business as well. Bargaining in China is difficult, and reaching a negotiated agreement can be highly unpredictable. You have plenty of partners to choose from, so make sure you take the time to find the right one.

Divide and conquer: Pointing out your inconsistencies

One negotiating tactic is to try to divide and conquer the visiting foreign negotiators. The Chinese look for inconsistent messages or points of view from your negotiating team. If you're giving mixed signals to the Chinese by offering multiple approaches or proposals, the Chinese may seek to exploit them to their full advantage. Therefore, careful cooperation and teamwork are necessary. If one of your subordinates makes a misstep in judgment, your leaders can tell the Chinese that the employee didn't know what he or she was talking about. However, this tactic causes your subordinate to lose face to the Chinese, which you should consider before acting.

Look for the same openings the Chinese do. If you find contradictions from the Chinese side, try to use them to your company's advantage.

The clock: Outlasting your patience or citing deadlines

When the Chinese take their time explaining the broad principles guiding the discussion, you may start to grow restless. You start looking at your watch. Your flight home leaves in two days, and you feel like the discussions have just started to move forward. Whenever you begin to push things along and get into the details, the Chinese circle back and continue to talk about their expectations.

The Chinese often use the clock as a negotiating tool. To them, most foreigners seem to be in a rush to get a contract signed or a deal done, so the Chinese deliberately try to control the timing and progress of the negotiations. The waiting game that the Chinese play really wears down most foreign businesspeople, and your counterparts know it. Negotiating a complex agreement in China may take as long as a year.

The Chinese also may pressure your company into making concessions by rushing you. They inform you of a deadline — sometimes just a week away. They insist that the agreement be completed by a certain date. Often, they say that the government officials who'll be signing the agreement are available to do so only on a particular day. For visiting foreign businesspeople, knowing whether the Chinese message is fact or fiction is difficult.

Here are some tips for working with the clock:

- Leave plenty of time in your schedule for negotiations, and never reveal any internal deadlines your company may have on any China-related project.
- Set deadlines with the Chinese, and keep trying to push things along. Tell your Chinese counterparts that your company has a certain number of days to work on this very important project.
- Organize the agenda in a way that addresses the important issues early.
- Gain a home-field advantage by having the Chinese negotiate at your headquarters.
- A potential partner who abuses the clock in negotiations may be quite difficult to work with throughout your relationship. In that situation, consider looking for a new partner.

Taking the time to get it right

Some people say that negotiations in China have a beginning, a middle, and never seem to end! As we discuss in Chapter 11, both sides need patience when doing business in China. Here's why your Chinese counterparts may be taking their time:

- They're using the time wisely to make sure the deal is done the correct way, even though you keep checking your watch — and calendar! They're willing to go slowly in the beginning to ensure that everything will work out in the long term.
- They're concerned about losing face (for more about face, go to Chapter 11). They don't want to risk getting embarrassed by putting together a bad deal, so the Chinese negotiators take every precaution — including as much time as they need — to make sure the deal is a good one.
- The person you're dealing with doesn't have the power to make a decision on a particular matter and needs to seek approval from someone else. This is often the case with SOEs, which use a decision-by-committee process. As a result, internal approval at SOEs often takes more time than it does with private companies.
- The Chinese are using the delay as a negotiating tool (see the preceding section).
- The Chinese side is sorting out internal issues among themselves. (For more on Chinese style of consensus management, see Chapter 11.)

  When the Chinese specifically say there's no problem with the way you want to proceed, there usually is one. When you hear the expression *mei wenti* (pronounced may one-tee), which means *no problem,* dive deeper into a discussion to look for any problems.

Although deal-making usually takes longer in China, negotiations can also speed up unexpectedly at times. Perhaps one of the Chinese government officials wants to conclude the deal by a certain date to look good with the big boss. If you're pleasantly surprised with the pace of the negotiations, keep the momentum going on your side, too.

If the businesspeople you're dealing with in China really want to do things in a hurry, trouble may be lurking around the corner. Be careful that you're not exposing your company to some scam. China doesn't have a lot of transparency concerning company information, so use every source at your disposal to thoroughly check out your business partner before agreeing to anything. For more on due diligence, please see Chapter 17.

Exchanging information

Often, impatient foreign negotiators reveal their hand before the Chinese show any cards. Don't give any specific information to the Chinese side about your company's negotiating position, and don't provide any detailed proposals to the Chinese in hopes of jump-starting the negotiations. Don't tell them what the venture, deal, or arrangements can or should look like. And don't let down your guard under pressure to explain your proposal.

You can give the Chinese side information about your business — as long as you don't give away any proprietary or confidential information. For example, you can tell them how your company is structured and the types of products you make. You simply don't want to go into details of what makes up your product. For example, you don't want to tell them the secret formula for your line of soap products. And don't give them samples of your products if you think reverse engineering them is possible.

The Chinese expect you to give away a lot of information. They ask for detailed explanations as if they know nothing about your business. But in the beginning of negotiations, they're not usually very willing to tell you much from their end. If the negotiations go well from a Chinese perspective, they'll begin to share appropriate information with you. As a general rule, expect them to provide you with as much information as you provided them. Before the start of negotiations, you can gain more information about the company and its business from the marketplace. See the upcoming "Using intermediaries effectively" section for advice on how to find information the right way.

Keeping track of all the details

Capturing the details of what goes on in all your negotiations with the Chinese is a must, so take detailed notes. You'll likely need to bring up past discussions during the later stages of negotiating. The Chinese keep very accurate records of conversations at your meetings, and they'll be sure to recall any significant statement your company makes — especially where they find inconsistencies in what your team suggested.

Note-taking is also a good signal to the Chinese that you're as serious about the negotiations as they are and that you're not losing sight of what's important. Of course, you need to take notes only at formal business meetings.

Also consider taking a timeout when negotiating with the Chinese — simply pause to reinforce what's been agreed to so far. That way, you can avoid covering old ground in the future and avoid possible deal-breaking misunderstandings.

TIP

Have the points that have been agreed to so far put in English and Chinese right away. Get both sides to agree to them in writing. You can then move on to the next stage of discussions.

Saying no the Chinese way

Because the Chinese are very concerned about causing anyone (on either side) to lose face, they don't like to use the word *no* during negotiations. (For more about face, please go to Chapter 11.) The Chinese are worried that they may offend you by sounding too negative, so they say no indirectly — "this may be a bit difficult" or "this could be a problem for us." Foreigners sometimes assume they're making progress when the Chinese are really rejecting the idea. You need to appreciate that hinting at a *no* is a refusal.

TIP

Don't be afraid to say no to the Chinese — they're used to hearing foreigners respond this way — but try softening the tone a bit by making it more polite and subdued. Perhaps the best way to say it is "this may be difficult." They'll respect you more if you deliver the message less directly.

Treating anger appropriately

Chinese negotiators used to rarely display anger — it's a violation of Confucian principle. In those situations, foreigners would've done well to be similarly reserved. However, like many cultural rules, this provision was a bit more relaxed for foreigners. Today, Chinese negotiators commonly make a show — at least one time — of losing their tempers. This idea is particularly true when you're dealing with the owner of a private company.

REMEMBER

If the Chinese side shows anger, the chances are that it's as much for theatrical value as anything else. The key is to keep your composure. Don't worry that you may have gravely insulted Mr. Zhu in a way that's never happened before. Try to show a little concern, but don't fall for any suggestion that you have to work hard to make it up to him.

If the need arises, you can show your temper as well. Because the anger display has more significance in Chinese culture (again, being contrary to Confucian teachings), you want to save it for when it counts. But when you really want to make a point — especially if you're genuinely angry — don't be afraid to show anger. Try not to go overboard for the context, though. If your counterparty seems to be more reserved, don't lay in too much. If he or she is a bit more mercurial, you have greater license.

WARNING!

When showing your temper, don't make it personal and cause somebody to lose face. In other words, avoid using *you* too much. Use phrases such as *we were told* rather than *you said.* However, you can make an exception if you're personally insulted. For example, if somebody on the other side constantly interrupts you or essentially tells you that you don't know what you're talking about, such actions would rise to the level of a personal insult worthy of a personal response.

In general, you want to stay away from getting drawn into mind games of when to show anger — it only complicates the discussions. Although a display of anger can be part of the process, make sure you and your team remain professional in your dealings with the Chinese. Don't spend time deciding when and how to get angry.

Using intermediaries effectively

Using intermediaries can be a constructive way to communicate with your Chinese counterparts. It's not as common in China today as it once was, but when you're dealing with the government and/or government businesses, using an intermediary does have its advantages. The intermediary often works behind the scenes after the most recent formal negotiating session is complete.

The Chinese sometimes use intermediaries to get important messages to you. They may prefer to have someone else ask you a difficult question, or they may not feel comfortable speaking to you directly on something because they don't know you well enough yet. After the relationship is more developed, you likely won't need to use an intermediary as much. The intermediary usually delivers any messages to your side's senior leadership in a face-to-face private meeting.

Sometimes, using an intermediary can provide you with information that the Chinese side hasn't revealed. Intermediaries can help you figure out what the Chinese negotiating position may be. The intermediary can also signal your intentions to the Chinese.

TIP

Consider using an appropriate person whom both sides know well as the go-between during your negotiations with the Chinese. If you were first introduced to the Chinese company through a personal connection, whoever made that introduction may be useful as an intermediary with your potential partner.

WARNING!

Don't trust an intermediary too much. If anything, he or she is likely to favor the Chinese side. Therefore, don't let the intermediary know your bottom line. Also, take certain things the intermediate says with a grain of salt — particularly if he or she is communicating a ridiculous demand from the other side and telling you it's the only way to get the deal done.

Making concessions

The Chinese expect you to make significant concessions for the opportunity to work with them. They insist that they're willing to make concessions, too.

This statement is usually just a way for the Chinese to get your side to make further concessions, not to favor your company in any way.

Your company can play the tit-for-tat game, too. You should have plenty of minor concessions you can give the Chinese in return. For example, you may agree to have the Chinese language version of an agreement appear first, with the English version second. (Note that this concession doesn't refer to controlling language, which we discuss in Chapter 18.)

The deals that the Chinese offer are usually small and not very meaningful. But they like to tell you that these concessions are significant. Like your side, they have a laundry list of giveaways, too.

TIP

Unless your main concern is the amount of the economics you're entitled to in a joint venture (JV), "control" is an issue where you can usually make concessions. If you'll have over 50 percent of the equity and board members, going to war over exactly how much equity you'll have usually isn't worth the effort. As we discuss in Chapter 7, by law certain critical decisions need unanimous board approval.

Banqueting as part of the deal making

The Chinese use entertaining as part of relationship building. It's really part of the negotiating game, too. On one hand, they're trying to soften you up by being extremely gracious hosts during the elaborate Chinese banquets. They're also sizing you up, trying to see who the key influencers are, and getting to better understand the leadership structure and personalities within your company.

You banquet often during the various stages of negotiations with the Chinese (though you don't actually conduct business at the banquet itself). Expect to be on the banqueting circuit every time you visit China. See Chapter 16 for more on dining.

WARNING!

Banqueting in China generally involves lots of drinking and socializing with your Chinese negotiators. Your negotiating team will be included in all the banquets. The Chinese have a reputation of getting foreign visitors to drink pretty hard the night before key negotiations are to begin. Also, the alcohol served at banquets tends to produce nasty hangovers. Don't fall into this trap: Be sure to minimize your intake of alcohol when you're in China to negotiate on behalf of your company.

Earning Approvals in China: Understanding the Bureaucracy

The Chinese bureaucracy is extremely large and complex. It stretches from the central government in Beijing all the way to the local village in the countryside. Fortunately, the Chinese government is giving more autonomy to the local government officials. Nowadays, only the mega deals or projects involving sensitive industries need to be approved by the central government. For most small- to medium-sized businesses, you likely need to deal only with the local government bureaucracy.

Getting approvals in China is hard work. Usually, the smaller the deal, the fewer approvals you need. However, you need lots of time to get those required approvals, permits, signatures, and chops (stamps) from the local government officials. Most foreign businesspeople underestimate the amount of time to get approval in China. You can expect some approvals to take up to several months. (For more on the approval process, see Chapter 7; also see Chapter 13 for manufacturing approvals.)

Unlike in the West, local government officials in China have much more influence on daily business activities. For example, the mayor of a city may have leverage to help you in a dispute with a Chinese company in his or her city. Therefore, having good relationships with the right government officials makes getting the required approvals easier.

Local officials can make the difference in how quickly you can get established and up and running in China. You need their support for a wide variety of business activities. They may decide whether your factory gets more or less electricity, help you get the right permits to expand your local factory, and approve your business license to operate in China. Know who the local officials are, develop solid relationships with them, and stay on their good side (see Chapter 8 for details). Try to find a channel to get introduced to them — a Chinese intermediary may be able to do the job.

Negotiating after the Deal

After numerous rounds of negotiations, countless hours of explaining your position to the Chinese, and too many toasts at evening banquets, you believe you're closer to getting the deal done. But just when you think the negotiations are over and you have a signed contract in hand, the Chinese start renegotiating with you. Negotiating with the Chinese seems to be endless. This is one of the cruelest lessons for foreigners who are new to dealing with the Chinese.

The Chinese believe that when circumstances change in business, they can count on you to work together to fix the problem. They believe that the relationship that they've built with your company, not what the contract says, is what counts. And now that things have changed, the Chinese fully expect to discuss the terms and conditions of the contract again. Although your first reaction may be "This can't be happening," it happens every day in China. So take a deep breath and sit down to discuss the situation with your Chinese partner.

Unfortunately, reopening negotiations isn't a two-way street. When a change negatively impacts the Chinese, they expect you to help fix the problem; when you're in a similar situation, don't expect a warm reception from the Chinese. They look at it as your problem, not theirs.

At Long Last: Telling the Public and Celebrating the Deal

Although most of the hard work is behind you now, you still need to get a few very important details right. You'll be working very closely with your new Chinese partner in figuring out how to deal with the news of your new venture, preparing for the formal signing ceremony, and last but not least, celebrating the new relationship. In this section, we show you how to wrap things up the Chinese way.

Announcing the news

If the Chinese agree to an announcement, you need to negotiate the wording in both Chinese and English. The last remaining detail is to agree on when and where to simultaneously release the announcement. Usually, the press releases are announced simultaneously in China and your home country. To be polite, consider letting the Chinese side announce it just before you do.

WARNING!

Make sure you've obtained all government approvals for your company to operate in China. The last thing you want is to announce the deal before the government has finally approved it.

Chinese and foreign companies often sign a letter of intent before full negotiations have finished. The letter of intent can be announced before the negotiations and approval process are finished, but you still need to get your Chinese partner's approval before you make anything public.

WARNING!

Never release any announcement without getting permission from your Chinese partners first. Sometimes, the Chinese don't want too much fanfare or publicity around business deals. For example, a local government official may not want the sale of a state-owned enterprise (SOE) to be announced because he or she fears the price was too low and doesn't want to risk getting criticized. To respect the government officials' wishes, no press release or public statement would be made.

Showing off for the cameras at the signing ceremony

For deals that the Chinese want to publicize, they really do like to make a big splash. Formal signing ceremonies are very common in China. You and your Chinese counterparts need to work together carefully to organize this event.

Usually, these events take place in ballrooms of flashy five-star hotels in China. Signs announcing the deal are in the background in English and Chinese and sometimes other languages. Everyone wears his or her best attire. Senior management from each company wears boutonnieres or corsages. Sometimes, flags representing each country are on display on the table. Beautiful flower arrangements adorn the podiums and tables.

Each company brings in several senior officers to the ceremony, and each side generally makes a speech congratulating the other on the venture. You do lots of clapping, and both sides are all smiles. It's the perfect photo op and a testament that you and your Chinese partner have entered into a new phase of your relationship.

Celebrating the venture

The Chinese like to celebrate their newly formed partnerships with foreigners through one large, elaborate, and expensive banquet. (See Chapter 16 for more on banqueting in China.) The guests include the important relationships from both sides, including selected government officials. The guest list for the Chinese side is usually larger than yours, if only because they have a greater number of relationships in China.

The banquet is usually hosted jointly by both companies. You need to come to an agreement on who pays for it. Generally, the hosts share the costs equally.

For very large companies that are celebrating a major deal, having several hundred guests to celebrate the venture is not uncommon. For smaller companies, a celebratory banquet is likely to include two dozen people. After your long negotiations with the Chinese, you're ready to celebrate your new commercial relationship in style.

Chapter 7

Setting Up Shop

In This Chapter

- Understanding features of business structures in China
- Navigating restrictions on foreign investment
- Deciding on a business location
- Setting up your company

Good things come to those who wait. Keep this idea in mind as you go through the process of setting up your company in China. It's important not just because you need to deal with a lot of paperwork (you do) but also because you need a lot of time to analyze your various decisions.

This chapter primes you for some of the basic issues you have to deal with when establishing a business in China. We look at the business structures available, examine issues related to restrictions and approvals, and provide insight into the various locations in China for establishing a business.

Choosing the Right Business Structure

Setting up shop in China unfortunately isn't as easy as incorporating a company and opening your doors. You have two overall choices:

- Representative office
- Foreign-invested enterprise (FIE), operated as either
    - A joint venture (JV)
    - A wholly foreign-owned enterprise (WFOE)

Whether you should set up a rep office or an FIE partially depends on whether your company will be collecting money in China. Sending money offshore can be challenging. When you receive money from customers inside of China, getting it out is harder than what you're probably used to. Your customers may have a hard time sending money to your foreign bank account, too! (To understand these issues better, read this chapter closely with Chapter 10.)

If you need to collect money from businesses or others inside of China, select one of the FIE options. If not, opt for the representative office, which is an easier entity to establish.

Representative offices

A *representative office* (rep office) is technically not a company in China; it's considered an extension of your offshore company. The representative office isn't directly doing business in China — rather, it's doing indirect business such as consulting, sourcing, support, and liaison activities. To set up a rep office, you need to already have a company set up in another country (offshore).

The main advantage of a representative office is that it's usually easier to set up than an actual company. Rep offices don't require registered capital (see the next section on foreign-invested enterprises).

China hasn't made clear what a "direct" business activity is, but the government generally considers producing and selling to be direct. Therefore, a rep office wouldn't work for a manufacturing operation. On the other hand, in some highly regulated industries (such as legal services), foreign investors are allowed only to use rep offices.

The most important feature is that rep offices can receive payment only to accounts outside of China for their activities within China. Therefore, your customers must pay you in your foreign currency and send the payment to your offshore account. (To understand more about paying money offshore, see Chapter 10.) You therefore have to send revenue back into your China accounts if you want to use such accounts to pay bills in China.

Setting up a rep office

The requirements to set up a rep office vary depending on location, but the procedure tends to be straightforward and transparent. To make things easy, hire a Chinese company that specializes in business services such as setting up rep offices. Try searching online to find sponsor service companies, contacting a local foreign chamber of commerce for referrals, or even asking the local Ministry of Commerce/Commission of Foreign Trade and Economic Cooperation (MOFCOM/COFTEC) branch for names (see "China, may I? Getting business approvals," later in this chapter). One relatively large sponsor service company in Shanghai is Shanghai Corporate Consulting Co. (`www.haizhixin.com`).

In Shanghai and many cities in China, you can also hire the Foreign Enterprise Service Company (FESCO — discussed shortly) to set up your rep office. If you hire a service firm, the all-in cost is usually in the ballpark of $1,000 to $4,000. You need about two to three months to set up.

Many local approval authorities require that a company have at least some operating history before it can set up a rep office. If you set up a company overseas and then immediately try to set up your rep office in China, you may be rejected. Also, rep offices don't have limited liability — the company establishing the office is liable for its debts and liabilities. Finally, a rep office's business should stay within the parent company's scope of business in its home-country incorporation documents.

Hiring through employment service companies

Because rep offices can't directly do business in China, they can't directly hire Chinese employees. Instead, rep offices need to use government appointed employment service companies, such as the Foreign Enterprise Service Company (FESCO) or the China International Intellectech Corporation (CIIC). Each company has its own standard form of labor supply contract, which is negotiable to some extent. Even when you directly recruit your Chinese employees (including those who have permanent foreign residence), they technically need to work for this type of company. You still determine the terms of employment, though.

You can hire *foreign* employees without going through an employment service company. They can usually sign employment contracts with either your foreign parent or local rep office.

Looking at rep office taxes

The weirdest aspect of the indirect business feature of rep offices is taxation. Because rep offices technically aren't doing business in China, they shouldn't have profits or taxable income, right? Nope — the Chinese know that a foreign investor must have a rep office for a reason.

In most cases, the government taxes rep offices on "deemed profits." In most locations, that means that a rep office pays taxes of about 10 percent of its business expenses. If the rep office keeps accurate records of income and expenses, it may be able to qualify for taxes based on actual profits. In isolated cases, rep office taxes may be lower in some special economic zones (SEZs). You should hire a local accounting firm to assist your rep office with accounting and tax matters. For more on taxes, see Chapter 10.

Foreign-invested enterprises

Any company that's at least 25 percent owned by foreign investors is considered a *foreign-invested enterprise* (FIE). The FIE distinction is important because the government tries to guide where and how FIEs invest, meaning that FIEs may receive additional incentives in some industries; they may be prohibited from investing in others.

With FIEs, you have a few decisions to make:

- What kind of FIE is better for your business: wholly foreign-owned enterprise (WFOE) or joint venture (JV)?
- If you choose joint venture, what kind of joint venture is better in your circumstances: equity JV (EJV) or cooperative JV (CJV)?
- What type of incorporation do you want: limited liability company (LLC) or joint stock company?

If you're feeling a little confused right now, don't worry. We step you through your FIE options in this section.

Choosing a wholly foreign-owned enterprise

An FIE that's owned only by one or more foreign investors is called a *wholly foreign-owned enterprise* (WFOE, although you sometimes see it as WOFE). WFOE is usually pronounced *woofie.* Having a WFOE ensures that you maintain control of management and can more closely guard intellectual property.

When China first opened up to foreign investment in the 1980s, WFOEs weren't permitted. WFOEs were created in the 1990s, and then they could operate only in a few industries. The government has since opened up many more industries to WFOE investors. Many investors aren't willing to accept the trade-offs of JVs — particularly regarding control and cultural issues. As a result, many foreign investors are looking to buy out their JV partners and convert to WFOEs, especially when they've operated in China long enough to feel comfortable about proceeding without their partners' relationships and knowledge.

Choosing a joint venture

A *joint venture* (JV) is a company that your company (or you) co-owns with another company (or person). In this book, when we discuss JVs, we're referring to Sino-foreign JVs, in which at least one Chinese party owns registered capital.

Having a JV with a Chinese party presents a number of pros and cons. On the positive side, a JV can give you established sales channels, a trained workforce, and facilities (such as a factory or land). Your JV partner may also be able to walk you through the approvals, making it faster to get the operation off the ground than it would be with a WFOE. On the other hand, a JV means that you won't necessarily have management control of the business. Having a JV may also increase the risk that you'll lose control of intellectual property (IP). In the end, though, you may have no choice but to form a JV. Some industries require foreign investors to form JVs with Chinese companies in order to do business (see the upcoming section titled "Checking out the catalog").

You see two types of JV in China:

- **Equity JV (EJV):** EJVs are fairly straightforward. Each party receives a share of the profits and risks in proportion to the amount of registered capital it owns. Board representation doesn't have to be proportional to capital, but by law the minority shareholder is usually entitled to at least one seat.
- **Cooperative JV (CJV):** The CJV allows the parties to set the benefits in a way that's not proportional to their ownership of registered capital. People generally use CJVs in businesses in which one party receives most or all the profits from the business's operations for a certain period; at the end of the term, the other party receives most or all the assets. This type of arrangement has been most popular in infrastructure and real estate projects.

Forming a JV: Contracts and Chinese law

To form a JV, you and your partner(s) need to sign a JV contract. A well-written JV contract has no substitute, though the contract still follows a relatively standard "approvable" JV contract template that many Western lawyers may consider sparse.

WARNING!

Make sure the Articles of Association (AOA) are written in a way that reflects your understanding of the agreement and does not contradict the JV contract; if the two conflict, the JV contract is binding. The *AOA* is the foundational document of all Chinese corporations (see the upcoming "Incorporating your FIE: Limited liability companies" section). In other countries, it's commonly called the *charter* or the *constitution.* You almost certainly want a lawyer to help you with the contract and the AOA. See Chapter 4 for more on selecting attorneys and other service providers.

If you set up a CJV, your CJV contract needs to discuss who owns what assets at expiration of the JV — again, that's because a CJV's benefits and risks may differ from the parties' shares of the registered capital.

TIP

Include an arbitration clause in the JV contract. Having a properly written arbitration clause means that any dispute will be settled by an arbitration panel instead of by Chinese court. Depending on the arbitration body selected, this move should decrease the chances of favoritism and hopefully guarantee that a capable body will hear the dispute. For more on arbitration clauses and arbitration bodies, see Chapters 17 and 18.

Chinese law is very protective of minority shareholders, so don't waste time and energy arguing over whether your company will have a majority versus supermajority of board seats. Most critical decisions require unanimity, so a supermajority often doesn't mean anything. In fact, you may want to pause before getting into a heated discussion about having a majority versus minority of control. As a minority shareholder, you can veto a lot.

Three barriers to Chinese-foreign cooperation

Rick Wang is the CEO of RetailCo, Inc. (`www.retailcoinc.com`), a company that specializes in apparel and food and beverage retailing. Through his work in franchising, he's identified what he calls the *three barriers* that affect Western and Chinese cooperation in business. They apply to JVs, franchising, and many other forms of long-term arrangements. If both sides don't fully get past those barriers, then your relationship will likely sour eventually. In a JV, bad partner relations cost money. Carefully consider whether you and the Chinese side can surmount the barriers:

- **Mind:** The barrier of the mind is a question of commitment to the relationship. You have to be willing to transfer money, valuable know-how, and skills. The Chinese side also needs to understand that the assets and workers it pledges to the JV will belong to the JV. The Chinese side has to commit to putting as much effort into the JV as it puts into its wholly-owned businesses.
- **Trust:** To be successful, both sides must truly trust one another. On the Western side, you hear stories about unscrupulous JV partners all the time, which can make Chinese partners seem guilty until proven innocent. Of course, good partners rarely make news. Chinese investors need to trust that you won't push them aside as soon as the business is off the ground and you're comfortable in China. Take your time to decide whether to JV and who your partner will be; then place a lot of trust in them. If you don't, your lack of trust will show; and, if you can't, don't JV.
- **Discipline:** The barrier of discipline is more of an issue on the Chinese side. It refers to the Chinese propensity to search for ways to do things more quickly, cheaply, easily, and so on. In many respects, China doesn't place the emphasis on quality that Western countries do, so there's a real tendency to *"cha bu duo"* things, a term that literally means *more or less.* This tendency is a problem when you're contributing technical and management know-how to the venture. You may discover the Chinese side has broken from your system. When you point out the changes, don't be surprised if they tell you their way is *cha bu duo* what you taught them. You need to help them get past this barrier by insisting at the beginning that if you're contributing technical expertise and management know-how, they stick to it. And if you see the Chinese side *cha bu duo*ing things, tell them they need to fix the problem. Of course, you should be open to suggestions for improvement.

In almost all cases, the law requires that your local partner have at least one seat on the board, regardless of how small its share is. Therefore, your partner will have the legal right to veto certain major decisions. These rights include amending the AOA, terminating the JV, increasing or reducing the JV's registered capital, and merging or selling the JV.

As a result, JVs sometimes go into deadlock, which may prevent them from continuing to operate. If that happens, you may have to go to court in order to wind up the business. You can address some of these issues in the AOA and JV contract. Also, JV partners may delay your sale of all or part of your interest onshore because Chinese law gives the partner a right of first refusal — a provision that gives your partner the potential to abuse this right.

Expiration and termination of JV contracts

When the JV contract is about to expire (or does expire), you and your partner(s) can choose to either extend the JV or wind it up. Either decision needs approval from the original approval authority (that is, the original MOFCOM/COFTEC).

After the owners receive approval to liquidate the JV, the JV has to follow China's liquidation procedures. These procedures are essentially similar to those in many other countries. The company has to give notice and time for creditors to come forward. After satisfying its debts, it may divide the proceeds and assets among the shareholders. From the time a JV (or other LLC) receives approval to liquidate, liquidation usually takes several months to fulfill.

If you and your partner(s) decide to terminate the JV early, the winding up process is the same: Seek approval and then follow the liquidation procedures. Depending on where the JV is located, this approval may be difficult to obtain. The termination can be a bit of a political issue in that the local government is losing foreign investment and jobs. If one partner wants to liquidate but the others don't, then the partner who wants to liquidate has to petition the court to order the dissolution and liquidation. Petitioning is not a fun process, and succeeding may be difficult.

Incorporating your FIE: Limited liability companies

Regardless of whether you choose a joint venture or wholly foreign-owned enterprise, you can incorporate in China in one of two ways:

- **An LLC:** Most FIEs in China are set up as limited liability companies (LLCs). The *LLC* is similar to the standard form of corporation found in many countries: Your personal liability is limited to the amount of money you invest. (Don't confuse the Chinese LLC with the U.S. LLC, which is a hybrid of a partnership and a corporation.) The following sections discuss the characteristics of LLCs.
- **A joint stock company:** The joint stock company isn't common for FIEs and is fairly technical, so we don't cover it here. But we do want you to at least be aware of the option. If you really want to know more, have your lawyers look at Chinese law texts.

Ownership and registered capital

An LLC doesn't issue shares — instead, investors own percentages of the LLC's registered capital. (***Note:*** "Registered capital owners" is kind of a mouthful, so we call the investors *shareholders,* anyway.) Whenever you set up an LLC, you're required to contribute some money or assets as registered capital. Different industries and local governments may require varying amounts of registered capital. In some cases, the required amount isn't that high, say $10,000. In other cases, the required amount may be over $100,000. You can contribute assets, such as machinery or technology, instead of cash for part of the contribution.

TIP

Planning ahead with offshore holding companies

If you think you may sell your company (or go public outside of China), you may want to set up an offshore company to hold your interest in the FIE. That way, when somebody wants to buy all or part of your ownership, the buyer can just buy equity in the holding company. Assuming that you set up your holding company in one of the usual places (such as Hong Kong, the Cayman Islands, or the U.S.), you don't need to go through an approval process to sell the holding company. Otherwise, if you want to sell your interest in the FIE directly, you have to go through a somewhat lengthy application and approval process with the Chinese authorities. If you consider setting up an offshore holding company, consult a tax expert who can help you choose a suitable country — China has tax treaties with many countries that may affect your decision.

Note: If you're going to set up an offshore holding company and will have a JV, your Chinese partner may want to own its share at the offshore level, too, either directly or through offshore companies it controls. The Chinese government usually doesn't like this type of arrangement. Make sure you consult a lawyer who can determine whether your Chinese partner has received the necessary approvals to join you offshore. The Chinese government may revoke the FIE's foreign exchange license if your partner doesn't have the proper approvals.

The Chinese authorities have to verify the value of assets you contribute. Fortunately, you don't have to contribute all your registered capital upfront. By law, you need to contribute only 20 percent of your capital within 60 days of receiving your business license (see "China, may I? Getting business approvals," later in this chapter, for more on the business license), and then contribute the remaining 80 percent within two months of receiving the license. Some localities allow you even more time to make the contributions.

After you make your contributions (in cash or assets), you need to have an authorized Chinese accounting firm verify to the government that you've made them. The other good news is that as soon as you have your contribution verified, you're free to use the contribution however you want — China has no requirement that you maintain or replenish cash contributed as registered capital.

WARNING!

If you don't make and verify your registered capital contributions, the government may eventually force your company to liquidate.

Limited life and government approval

An LLC must have a specified life, such as 30 years. You're usually not allowed to set up a company with an indefinite term. An LLC may apply to extend its term, though. Such applications are usually approved.

Most other major company matters — including establishing, selling or transferring ownership (even if partial), and winding up — likewise need approval from the government. Also, because of the approval processes for onshore transfers, many foreign investors set up foreign holding companies to own their onshore interests — see the sidebar titled "Planning ahead with offshore holding companies" for details.

Decision-making

Board members — not the shareholders — make all the LLC's decisions. The company's charter, called the *Articles of Association* (AOA), can specify the board approval requirements for certain decisions (for example, unanimous approval). Keep in mind that Chinese law requires unanimous approval for certain major decisions. The law will always trump the AOA! Voting rights and requirements are a crucial factor in deciding whether to JV.

Getting money out

An LLC can pay dividends to shareholders; however, China does have restrictions in place. For one, an LLC can usually pay dividends only if it's been profitable for that year.

You can also get your money out of an LLC by using licensing/consulting/loan agreements with offshore companies that you own (see Chapter 10). Another option is getting money back when you wind up the company.

Expansion

When you register an LLC in China, you have to provide your company's legal address. Your company can't then automatically open up a factory or office outside the immediate area of your legal address. Your company has to go through the application procedures to open *branches* anywhere else you want to have a presence. This process usually isn't too complicated, but the branches can't have scopes of business that are different from the LLC's.

If you want to do something outside of the scope of business, you have to set up a new company (or rep office). When you have multiple companies in China, they usually each need their own administration. In other words, you see a good deal of duplication because each company has many of the same internal functions — human resources, selling, and so on. In certain circumstances, you can set up onshore special holding companies that handle these administrative duties for your various companies, but the legal requirements make this choice hard for all but very large businesses.

Considering Location Variations

Choosing where to start your business is obviously a crucial decision. In the end, the type of business you want determines which factors to consider. If most of your sales are in China, you obviously want to put convenience to customers at the top of your list. But regardless of where your customers are located, you need to keep some overarching considerations in mind. Just as in any country, you see variations in laws and resources from region to region. This section discusses some common factors to keep in mind as you look at various locations.

Many people classify cities in terms of development. *First-tier cities* are the large and most-developed cities. *Second-tier cities* are cities that are roughly as wealthy as places like Shanghai and Beijing but are smaller, or they're large cities that are rapidly catching up to the first-tier cities. *Third-tier cities* are smaller cities that are in earlier phases of economic growth and expansion, and they're a good deal behind first- and second-tier cities.

Finding good infrastructure

China's infrastructure is strongest near the coast. However, its major waterways (particularly the Yangtze and the Yellow rivers) do provide good outlets from parts of the interior. The highway system is second only to the U.S.'s in terms of the number of miles laid. China is also rapidly adding to its roadways to make getting to the interior easier.

Railways aren't the best way of transporting freight because freight trains share tracks with passenger trains. Passenger trains have the right of way. Freight trains can take much longer than they should to reach their destinations. China is adding more track, though, to alleviate this problem.

Consider how close you'll be to suppliers or to customers (see Chapter 13). Even though infrastructure in certain parts of China is excellent, logistics is highly fragmented, so shipping can take a lot of time. In this area, the Pearl River Delta, which has almost every type of manufacturing supplier and customer under the sun, is difficult to beat. The Pearl River Delta isn't an absolute advantage, though — you may want to set up your business in another area of the country that specializes in your field.

Locating your labor force

The supply of managerial and technical workers who are qualified (especially in terms of English ability) to work in FIEs is pretty tight. Finding these employees in the first-tier economy cities of Beijing, Shanghai, and Guangzhou is easiest.

However, luring this talent away from first-tier cities to second- and third-tier cities is fairly difficult, even though many such cities are quite prosperous. If you're thinking about trying to attract employees away from the first-tier cities, be prepared to pay hardship premiums. Fortunately, the smaller cities in the Pearl and Yangtze River deltas, the Bohai Rim in northeastern China, and Chengdu and Chongqing are developing their own talent bases. The situation in those cities is rapidly evolving, so it really pays off to do thorough research on the labor supply there before making a move (for more info on the labor force, see Chapter 9).

Skilled workers (equipment operators and office support) are also in high demand. Fortunately, they're less tied to first-tier cities. You can find them in most growing second- and third-tier cities, especially in the Yangtze and Pearl deltas. Many companies hire skilled workers from two-year technical schools, so you may want to look for locations near some technical schools. You may also be able to get skilled employees who have been laid-off from state-owned enterprises (SOEs).

You can find unskilled workers almost anywhere you see factories or construction projects, but they're most concentrated in the Pearl Delta. Western companies often find unskilled laborers without much of a problem because they enjoy a reputation for good working conditions and pay.

Seeking government incentives

To find out what local governments have to offer, speak with the officials there. Incentives can mean big renminbi (RMB) for your business. You find incentives for foreign investors most often in special economic zones (SEZs — see Chapter 10 for details). If you locate in the right SEZ, you can receive a significant discount on your company's income taxes. Within some SEZs are special export processing zones (EPZs). If you locate within EPZs, your company may enjoy reduced tariffs on imports and exports.

If a local government is really hungry for your investment (either because it's relatively big and/or officials are just beginning to attract foreign investment), they may be willing to provide your business with additional subsidies. These subsidies can be tax subsidies or ways of defraying some of your company's costs — for example, assistance with your factory's construction costs. (As we explain later in "Landing your land," you should stay away from any incentive that seems like a subsidy to purchase land-use rights!)

TIP

If your company is going to receive a decent amount of incentives or subsidies, you may want to see whether the local government will sign an investment contract with you. This contract should clearly explain all incentives your company is to receive and give you a way to enforce them. As with JV contracts, your investment contract should contain a binding arbitration clause. An attorney experienced in foreign direct investment (FDI) in China should be able to draft your investment contract.

WARNING!

Incentives are a common fixation. Make sure the location you're looking at takes care of your business's basic needs before worrying about the incentives.

Looking for experience with foreign investors

Whether a local government has experience with foreign investors can be an important factor for your business. Without experience, the government may not understand that foreign investors like consistency, transparency, and predictability. This situation may come out when you ask the government to sign an investment contract to guarantee your company's incentives. The government may be willing to go along with signing a contract but not realize that you fully intend that they honor the letter of the contract.

If you suspect that the officials you're dealing with don't fully understand what they're promising, find a way to make them understand sooner rather than later. Speak in a way that doesn't make it obvious you know they don't understand. Simple phrases such as "as I'm sure you know . . ." can help.

Of course, the more experience a local government has with foreign investors, the less likely the government is to give you special incentives. Perhaps you'd be better off as a bigger fish in a smaller pond by dealing with a government that doesn't have many other foreign investors to welcome. If you do end up dealing with a government that hasn't done much business with foreigners, clearly explain your expectations to them.

Touring the Mainland Regions

This section gives you an overview of opportunities, strengths, and challenges of China's various regions.

If you're looking for a specific type of opportunity, you may want to consult the U.S. Commercial Service China Web site (`www.buyusa.gov/china/en`). The site provides comprehensive information on a number of Chinese cities as well as updated trade leads showing opportunities to participate in various projects or businesses. The Chinese government also provides some provincial and city information at `www.fdi.gov.cn`. Another way of finding specific opportunities is to go to any of the many, many industry and regional trade fairs that take place in China.

Northeastern China

Here we discuss four areas in northeastern China: Manchuria, Tianjin, Shandong, and Beijing.

Manchuria

Manchuria contains the northeastern-most three provinces in China: Liaoning, Jilin, and Heilongjiang. Parts of Manchuria are next to North Korea and Russia. The area has a little over 100 million people, and it's the heartland of China's heavy industry state-owned enterprises (SOEs).

This area is actually a top development priority for the government, and a lot of money's floating around these three provinces for economic development projects. The governments of the area are emphasizing development of the information technology, telecommunications, environmental technology, automobile parts, and tourism industries.

Harbin, which is the capital of Heilongjiang, ranks among China's top three cities in academic, scientific, and technological skill, which may make it a good place for research and development. Dalian, which is in Liaoning, has the largest deep-water port in northeast China and is one of the largest oil refinery bases in China. It has a good number of workers who speak Japanese or Russian.

Tianjin

Tianjin province is between Beijing and the Bohai Bay. It's at the crossroads of two major railway lines: Beijing-Shanxi and Beijing-Shanghai. Tianjin's port has the biggest container dock in China. Because of Tianjin's location near Beijing, it's a major logistics center. It also attracts a good deal of investment in manufacturing — particularly in electronic products and biochemicals. Motorola and Samsung Electronics are among the biggest investors in the area.

Shandong

Shandong is both a province and a peninsula in northeastern China. Shandong is China's third-largest manufacturing base. It also has large mineral and oil deposits. Qingdao, which is on the southern part of the peninsula, is one of China's five major ports and is also a major tourist attraction.

Beijing

Beijing is hosting the 2008 Olympics, and it's made enormous investments in infrastructure to prepare for the event.

Beijing is one of four cities in China that enjoy provincial-level status. In addition to being China's government capital and home to over 12 million people, it's China's academic capital. Beijing has 475 research centers and over 60 colleges and universities, including the country's two most prestigious, Peking University and Tsinghua (pronounced ching-hwa) University. As a result, Beijing has a very well-educated workforce that provides it with a solid base for services.

The city also produces large amounts of chemicals, cars and car parts, textiles, garments, and appliances.

The Yangtze River Delta

The Yangtze River Delta includes the provinces of Zhejiang, Anhui, and Jiangsu. It also includes Shanghai, which is a provincial-level city. The Yangtze River Delta is one of China's two most economically powerful regions.

Zhejiang and Jiangsu are much bigger economically than Anhui (although Anhui's capital, Hefei, is developing nicely these days). The most important cities in Zhejiang and Jiangsu are Nanjing (in Jiangsu), Hangzhou, and Ningbo (both in Zhejiang). The region has a large heavy manufacturing base but also excels in high-tech and biotech products. Zhejiang and Jiangsu have excellent ports, airports, and roads.

Shanghai itself makes up 5 percent of China's gross domestic product, even though it contains only 1 percent of the population (although it's one of the world's largest cities at about 18 million people). It's China's commercial center with numerous factories on its outskirts, a port that processes about 25 percent of China's exports, and numerous Chinese and foreign banks.

Shanghai is easier to do business in and more transparent than most other parts of China. By the end of the decade, it hopes to become the high technology center of China.

Shanghai will also host the 2010 World Expo, and it's investing billions of dollars in infrastructure to prepare.

The Pearl River Delta

The Pearl River Delta in Guangdong Province in the south of China is China's most prosperous region. It was the first part of the country opened up to foreign investment, and it benefited greatly from money and technology from Hong Kong.

The major commercial cities are Guangzhou (the capital of the province) and Shenzhen. Zhuhai is a smaller city, but it's important commercially because it was one of China's original special economic zones (SEZs).

The region has several major ports and extensive road networks. However, the density of people and factories has created some bottlenecks moving people and goods. The government is working on building more infrastructure.

The Pearl River Delta is China's technology manufacturing heartland (although as we mention in the preceding section, Shanghai hopes to wrest that title away). Unfortunately, the area has paid a high environmental price for its prosperity. Air pollution from Guangdong factories is even a hot-button issue in Hong Kong.

The wild, wild west

Some pockets of the west are developing well — in particular, the cities of Chongqing, Chengdu, and Kunming are booming. Xi'an is also attracting a lot of foreign technology investors. If you look at a map, these cities appear to be more central than western; however, given China's heavy bias toward coastal development, almost every inland province can be considered western.

The central government is on a well-publicized drive to develop the west. With the exception of the few pockets of prosperity we just mentioned, it may be too early to say whether the west offers much opportunity. In general, costs should be extremely low, and you should see a lot of incentives.

The underdeveloped parts of the west have a tough time competing with many coastal areas in business environment transparency, the rule of law, and infrastructure. But smart people are trying hard to change this situation, so if you're willing to take a bigger risk, you may be rewarded.

Weighing Hong Kong's Offerings

Hong Kong is connected to the mainland, with its border at the southern Chinese boomtown of Shenzhen in Guangdong province. Hong Kong used to be the business and investment gateway to China, often serving as a transit point for mainland-made goods. As China has opened up to foreign direct investment (FDI), Hong Kong's role has evolved.

Today, Hong Kong is a major financial and services hub for China as well as all of East Asia. It's also the single largest foreign direct investor on the mainland. Hong Kong has its own vibrant economy, with real estate, banking, and retail, among other industries, playing major roles. Luckily for you, Hong Kong may be able to save you time and hassle.

Hong Kong's special status: The SAR (it's not something you catch)

Until 1997, Hong Kong was a British colony. In 1997, the British returned Hong Kong to China but only after China pledged to retain Hong Kong's capitalist system for at least 50 years. Hong Kong is now officially called the Hong Kong Special Administrative Region (SAR) of the People's Republic of China.

Hong Kong has its own quasi-constitution called the *Basic Law.* Basic Law provides for a legal system that's different and much more open than the mainland's. Hong Kong has its own laws and courts, currency (the Hong Kong dollar — see Chapter 10), and customs and immigration policies.

Decolonization: The Brits give back to China

Hong Kong consists of two main land masses: the Kowloon Peninsula, which connects to the mainland at Shenzhen, and Hong Kong Island, which is just across Victoria Harbor from the Kowloon Peninsula. Great Britain received Hong Kong Island by treaty in 1842 at the end of the First Opium War. At the conclusion of the Second Opium War in 1860, China ceded to Great Britain the part of the Kowloon Peninsula closest to Hong Kong Island. In 1898, Great Britain leased the remainder of the Kowloon Peninsula (called the *New Territories*), for 99 years.

The Brits were not exactly keen to return Hong Kong to China. By the 1970s, Hong Kong had developed a large manufacturing industry, most of which was based in the New Territories. Many of Hong Kong's banks made loans to finance those businesses and other projects in the New Territories.

By the 1980s, people started to realize a looming problem with Britain's lease on the New Territories, which was to run out in 1997. The Chinese clearly weren't willing to re-lease or cede the New Territories, and Great Britain realized that partitioning Hong Kong would be disastrous. The two sides compromised in 1984, with Great Britain agreeing to return all of Hong Kong and the Chinese agreeing to preserve the capitalist system for 50 years after the handover. The handover officially took place at midnight on July 1, 1997.

Although Hong Kong has a lot of autonomy, China is still in charge of all foreign affairs and selects part of Hong Kong's government. Hence, China is one country with two systems.

TECHNICAL STUFF

In 1999, China also reclaimed Macau, a former Portuguese colony. Macau is a short ferry ride away from Hong Kong, and it also has a more open system than the mainland. We don't otherwise discuss Macau in this book because aside from a booming gaming industry, it's not a major business destination.

Perks of investing in Hong Kong

Depending on your business, Hong Kong can be a better base than somewhere on the mainland (see the earlier "Touring the Mainland Regions" section). This section explains some of the perks Hong Kong offers.

Open economy, low taxes, and free trade agreements

The biggest advantage is Hong Kong's open economy. It usually ranks at the top of the *Economic Freedom in the World Report* and the *Index of Economic Freedom.* In other words, Hong Kong has strong rule of law with little corruption, low barriers to trade and business, and a strong market-based economy. Business is undoubtedly more efficient and transparent in Hong Kong than on the mainland.

CEPA stands for the Closer Economic Partnership Agreement between Hong Kong, Macau, and the mainland. It's a free trade agreement between those three parts of China. Under CEPA, China doesn't impose duties on imports from Hong Kong (and vice versa if the products are made in China). This idea is important if you're considering an international trading business. Also, CEPA allows Hong Kong–based companies better and sooner access to some restricted industries.

REMEMBER

Before you rush to incorporate a company in Hong Kong to get around the mainland's restrictions on foreign investment, keep in mind that in most cases, the company has to really be a Hong Kong company. In other words, Hong Kong residents own a certain minimum percentage of the company or you have certain minimum levels of Hong Kong residents as employees. It may also require some operating history in Hong Kong. The bottom line is that CEPA is one useful way to get around mainland restrictions, but you should work with an experienced attorney to understand how it can help you.

Hong Kong also has very low corporate and individual tax rates. Its tax agreement with the mainland may also give you creative ways to structure a hybrid mainland/Hong Kong business to save taxes (see Chapter 10 for more info on taxes).

English language and workforce training

Hong Kong has a fairly high English proficiency. You can do business with the government in English — and in much less time than you'd need on the mainland. And much of Hong Kong's white-collar workforce is likewise fluent in English. Hong Kong's workforce is also better trained in many services, including marketing, finance, and information technology.

Quality of life

Hong Kong may be easier for most Westerners to live in. The city's very clean, modern, and easy to get around. Western goods, services, food, and entertainment are everywhere. Hong Kong also has a lively social and arts scene. However, in recent years, many expatriates have been complaining about the increasing levels of air pollution.

Location

Hong Kong has a great location, especially for regional businesses. Getting into the heart of China's southern manufacturing heartland takes only one to two hours by car, bus, train, or ferry (see Chapter 5). A lot of people commute daily to the mainland from Hong Kong.

Hong Kong also has one of the best (if not the best) airports in the world, with numerous flights to different parts of the mainland, as well as all over Asia (and the world). Shanghai is about two and a half hours away by plane, and Beijing is about three and a half hours. Most Asian countries are within a five-hour flight of Hong Kong.

Currency

The Hong Kong dollar, usually pegged to the U.S. dollar, is convertible into foreign currency, and unlike the Chinese renminbi, there are no restrictions on remitting money overseas from Hong Kong (see Chapter 10 for details). Of course, if you have a rep office in China, your bank account may be in Hong Kong, anyway, which would provide you with most of these benefits.

Hong Kong hang-ups

Hong Kong has some disadvantages, too. This section goes over some of the most significant drawbacks.

Cost

The biggest issue with setting up in Hong Kong is cost. Make no mistake: Hong Kong is expensive! Your Hong Kong employee may have more skills than your mainland worker, but you have to pay up — white-collar employees in Hong Kong earn roughly the same salaries that their counterparts in Western countries do. In most cases, you'd be crazy to manufacture in Hong Kong instead of the mainland.

Real estate prices are also quite high in Hong Kong — sometimes they're comparable to those of New York City. Hong Kong is also one of the world's most expensive cities to live in.

Bad Mandarin

Hong Kong's main language is Cantonese, a dialect spoken in Hong Kong and Guangdong province. It shares the same written language as Mandarin, but the two sound nothing alike. Most Hong Kong Chinese speak at least a little Mandarin, but in many cases, their Mandarin isn't good enough to do business on the mainland (aside from in Guangdong, where they can slide by with Cantonese). Also, people from Hong Kong and the mainland have some cultural differences that can occasionally create tensions between the two.

Classifying Your Company and Reckoning with Restrictions

Although China is robust with business opportunities, you have to maneuver through more than a few restrictions. China has reasons for such limits:

- China is still transitioning from a command-type economy, and it still likes to have a lot of control. This idea is particularly true as China tries to balance economic development with social stability.

- China is trying to gradually expose its companies to foreign competition. The government hopes bringing in foreign competition more slowly will allow Chinese companies to strengthen and be able to compete.
- China considers certain industries to be essential for national security, so it restricts foreign investment.

At the same time, China is actively looking for foreign investors in a number of industries, especially export-oriented ones. China also encourages foreign investment in certain industries because it wants to discover how to do those businesses or use a particular technology.

This section discusses industry regulations that have to do with your scope of business. To find out how the Chinese feel about foreign investment in your industry, consult the foreign investment catalog discussed in the next section.

Checking out the catalog

Any serious consideration of doing business in China should begin with the *Catalogue for the Guidance of Foreign Investment Industries* (the foreign investment catalog). Type the name of the catalog in your search engine or visit `www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51089` for an unofficial English version of the catalog.

The catalog breaks down industries into three categories:

- **Encouraged:** You want to be in the encouraged category if possible. Encouraged companies may receive tax preferences and incentives. The incentives vary by industry and location, so you have to analyze possible benefits thoroughly. Most encouraged industries allow WFOEs (see "Choosing a wholly foreign-owned enterprise," earlier in this chapter).
- **Restricted:** When an industry is restricted, foreigners usually may not own more than a certain percentage of a company in that industry. The percentages vary, but a 49 percent cap is common.
- **Prohibited:** As the name suggests, prohibited industries are closed to foreign investment, regardless of how little registered capital foreign investors own.

When an industry isn't listed in the catalog (which is the case with most industries), it's generally considered to be permitted — neither encouraged nor discouraged.

For your application for business approval, you have to submit your Articles of Association (AOA). The AOA contains your scope of business (see the upcoming "Getting MOFCOM and the AIC to approve your scope of business" section).

Sometimes, you need a thorough study of the catalog (fortunately it's not that long) to finesse your company's business into a more favorable category. If you're going for encouraged status, the scope of business needs to match or include items from the encouraged part of the catalog. If you're trying to avoid restricted or prohibited, your scope of business should avoid sounding too much like the items under the restricted/prohibited sections of the catalog. The scope of business is not a mere formality though — your company's actual business must be within the scope of business!

Identifying highly regulated industries

The foreign investment catalog (see the preceding section) can be a little confusing because similar-sounding activities in the same industry can be classified in two wholly different categories (usually as restricted and prohibited). But this ambiguity can also be your opportunity to get a more favorable classification — possibly by making some hopefully small adjustments to your business model.

Although a number of businesses are restricted or prohibited for one policy or another, you should know that some industries bring a lot of restrictions:

- **Media:** As a one-party state, China doesn't trust foreigners to disseminate much information. Operating in media (which can include Internet businesses) can be frustrating because your company is expected to know what topics are off-limits with little guidance. These limits have been particularly hard for companies such as Google and Yahoo!, which have had issues with bloggers posting information that the government considers sensitive.
- **Real estate:** Real estate development is often a highly regulated area, too. In a socialist country, land ownership and use — especially by foreigners — is a touchy subject (see the later section titled "Landing your land").
- **Finance:** Another difficult (but not impossible) industry is finance. This category includes insurance, investments, and banking. Finance is a key sector in any economy, and China wants to allow its financial institutions room to develop so they can compete with foreign companies.

Establishing Your Business

We wish we could say that establishing your company will be quick and painless, but we'd be lying. You will get frustrated at times. This section — and your legal team — can help you out. Remember that finally receiving your business license will be a fantastic feeling.

China, may I? Getting business approvals

When setting up a limited liability company (LLC) or a rep office, you generally deal with two main approval authorities: the Ministry of Commerce (MOFCOM) and the State Administration of Industry and Commerce (SAIC) — or their local branches. The terminology and process is a little different with rep offices than with LLCs, but the idea is the same in terms of receiving an approval to set up shop and then registering the business and receiving your business license.

This section mostly discusses getting approval for an FIE LLC from MOFCOM and SAIC. For certain industries, particularly restricted ones, the approval process is more complicated and can involve other ministries.

Introducing your friendly neighborhood approval authorities

MOFCOM and SAIC are actually the acronyms for the national-level organs. Unless you're making a very large investment or investing in a sensitive industry, you'll be dealing with their local branches. Local MOFCOM branches are often called COFTEC (Commission of Foreign Trade and Economic Cooperation). SAIC's local branches are usually referred to as [city or province name] AIC (Administration of Industry and Commerce) — for example, Qingdao AIC.

Keep in mind that local practices at the approval authorities can vary quite a bit. Different MOFCOM and AIC branches usually use different forms. In addition, some branches may require certain formalities that others do not. For example, some branches may want a little more documentation from the country in which the parent is incorporated.

TIP

Find a trustworthy local business services company or attorney where you're going to set up. If you're more comfortable with providers that aren't local, that's fine. Just be ready to have some patience as they run into differences in local practice that require them to redo some forms and signatures.

Getting your approval certificate from MOFCOM/COFTEC

Here's how the approval process works:

1. **Go to the Administration of Industry (AIC) to do a name search and get pre-approval for the Chinese name you want to use (see Chapter 16 for a discussion of choosing Chinese names).**

   Name pre-approval isn't a lengthy process, though the time varies by location — it may be a few days or a week or two.

2. **Submit your application packet to MOFCOM/COFTEC.**

   After you receive your pre-approval, you begin the major part of your application by going to MOFCOM (or COFTEC). You give MOFCOM your wholly foreign-owned enterprise (WFOE) or joint venture (JV) application packet. This packet consists of a number of items, including

  - Information on your directors, shareholders, and finances
  - A feasibility study
  - The Articles of Association, or AOA (see the next section)

  Much of the packet must be in Chinese. Your service company or attorney can provide the proper forms for these documents, although you do have to supply information.

3. **If your company is approved, you receive an approval certificate, along with a statement of encouraged status, if applicable.**

   By law, MOFCOM should decide on your application within 90 days of receiving it. In some locales, the actual time varies. Note that the AIC still needs to also sign off on your scope of business language, which may affect your encouraged status (see the next section for details).

According to the letter of Chinese law, you're also supposed to seek approval for your project from the State Development and Reform Commission (SDRC) around the time that you go for MOFCOM approval (the law is unclear as to the relative timing). Most projects seem not to actually need this approval, but if your project is subject to central-level MOFCOM approval, you'll likely need SDRC approval as well.

Getting MOFCOM and the AIC to approve your scope of business

The Articles of Association (AOA) in your application packet lists your scope of business. The scope of business must be pretty specific, and both the Ministry of Commerce (MOFCOM) and the Administration of Industry and Commerce (AIC) separately scrutinize it to see whether your proposed investment is in line with the foreign investment catalog (see the earlier "Checking out the catalog" section).

In some cases, MOFCOM approves the scope of business as it is, but the AIC rewrites or rejects it. If this happens, you can't yet start your business or you don't get the status you want.

Size can be a factor in getting the approval you want — a smaller company may be able to use its nimbleness to find a creative way to do the business it wants to do while receiving favorable status; a large, famous company is usually likely to get more deference, though.

Talk with both approval authorities as you write your scope of business. That way, you can get informal pre-approval of your scope. You can always apply down the road to change your scope of business.

Your company should never deviate from its approved scope of business. Doing so can get you in serious trouble with the government: revocation of your business license.

Taking it in the chops

As you go through the approvals process, you'll notice that government agencies and private companies stamp a lot of documents. These stamps, called *chops,* usually contain the agency or company's name. China is big on chops — most documents aren't official until someone chops them. After your company is established, you go to a licensed chops maker to get your own set.

Treat your company's chops with care. Not only do they act as an official company endorsement of a document, but you may not be able to do some business without them. For instance, Winston Zhao, the partner-in-charge of Jones Day's Shanghai office, tells the story of a foreign client who owned a manufacturing company in China. The foreign investor had appointed a local Chinese person to be the chief representative of the company. As often is the case, the chief representative was made the signatory on the company's bank accounts. After several years, the foreign investor wanted to make a change and fired the chief representative. The fired individual had access to all the company's chops, though, and took them with him on his way out. The bank wouldn't change the signatory on the accounts because the company no longer had its chops — even though the investor had all the paperwork to prove that it was the rightful owner of the account! Eventually, the investor had a to pay a ransom to get its chops back.

Getting your business license from the AIC

Assuming your company is approved, you next go to the AIC for your business license. You must apply for your business license within 30 days of receiving your MOFCOM approval certificate. The business license application should include the following:

- An application form
- The AOA
- The MOFCOM approval certificate
- A copy of the parent's certificate of incorporation
- A letter from a bank attesting to the parent's good standing
- A list of the FIE's directors, supervisors, and the general manager
- The name pre-approval notice
- Other documents required by the local AIC

WARNING!

If you wait more than 30 days to apply for your business license, your approval certificate will automatically become invalid.

If all is in order, the AIC issues your company's business license within a few weeks. The date your company receives the business license is its birthday. It starts the clock running on a number of important timelines, such as your required registered capital contributions (see "Ownership and registered capital," earlier in this chapter). Now you're ready to start doing business!

Getting post-formation approvals

After you receive your license, you've formed your company. Here's where to go from there:

- Register with the tax bureau and the Quality and Technology Supervision Bureau.
- You may need to deal with the State Administration of Foreign Exchange (SAFE, discussed in detail in Chapter 10) and the customs authorities.
- You may need approval from additional approval authorities if you're going to do business in certain industries. For example, if you're going to set up a coal-mining business, you also need approval from the Ministry of State Land and Resources and the State Development and Reform Commission (SDRC).

Landing your land

Land is becoming a hot-button issue in China. The state owns all land in China, but it sells land-use rights to companies. *Land-use rights* are basically long-term leases, usually good at least for several decades.

The central government has become concerned that in order to attract investment, local governments have been selling land-use on the cheap to investors. As a result, land use is an area where the law is changing rapidly. One recent change is that the central government has made clear that it won't tolerate any more bargain land sales or land subsidies. Beijing has now specified minimum land-use right sale prices for most parts of the country.

WARNING!

Local governments aren't generally happy about Beijing's increasing regulation of land-use rights sales. However, the central government seems serious about cracking down in this area, so be skeptical of local governments that seem willing to give you a discount on the land price or a land subsidy.

REMEMBER

Knowing your land-use rights

You need to know about three types of land-use rights:

- **Granted:** You want granted land-use rights because they're the only rights that are transferable to other buyers.
- **Allocated:** Allocated land-use rights are not transferable, and they're typically the type of rights that state-owned enterprises have.

- **Collective:** You have to worry about collective-use rights only if you're purchasing land from a party other than the government. Collective-use rights are for use only by village or township cooperative enterprises. They can't be transferred legally to investors — the government must first repossess the rights (usually paying compensation to the collective rights owners). Then it can turn around and grant the rights.

Law requires you to begin building on the land within one year; if you don't begin within two years of purchase, you lose your land-use rights!

If you're getting your land-use rights from the government, you sign a land-use rights grant contract with the local land bureau. The bureaus usually have their own contract. Your advisors should be able to tell you whether the contract is a standard form they're used to seeing. If it isn't, you may be able to use your advisor's form instead; which form you use is something you have to negotiate (see Chapter 6 for tips on negotiating).

Considering options to expand

Land options are contracts that allow you to buy land at a fixed (or not-so-fixed, as we explain later) price in the future. Land options executed between two private parties are enforceable. However, some investors sign land options with land bureaus. Usually, this happens when the investor is setting up a facility and wants the ability to expand if all goes well. In these situations, investors often purchase land rights for one parcel of land and get an option on an adjacent parcel.

Whether options signed with land bureaus are enforceable isn't clear under Chinese law. Some land bureaus may require you to pay for the option. Don't be surprised if the price you're asked to pay when you exercise your option is higher than the price agreed to in the option — especially with the pressure on local governments to get full prices for land.

Options are also complicated by the one- and two-year construction requirements for the land (see the preceding section) because Chinese officials can argue that you've tied up the land without using it. At best, the area of options is murky.

Visas: Getting yourself and your expatriate employees to China

Fortunately, getting yourself, your expatriate employees, and their families residence permit visas and working permits isn't too hard. (***Note:*** Spouses' residence permits don't allow spouses to work unless they change the visa after they find employment.) Here's how the process works:

1. **Your employees take an invitation letter from your company (or your rep office's sponsor) to their closest Chinese consulate or embassy and apply for a single-entry 30-day Z visa (see Chapter 5).**
2. **Upon arrival, they to go to the nearest police station and complete a household registration form for themselves and each family member.**

   This step usually takes no more than ten minutes.
3. **They complete a health examination within the 30-day period.**
4. **They go to the local labor bureau with a copy of your company's business license or rep office registration certificate and some other documents to receive their employment certificates within 15 days of entering China.**
5. **After getting the employment certificate, they go to the local Public Security Bureau to apply for residence permits.**

As soon as employees have residence permits, they can import their personal belongings. Unfortunately, furniture, home appliances, and electronic equipment are still subject to duty or tax.

Chapter 8

Understanding Government Relations with Your Business

In This Chapter

- Understanding how the government can work with your business
- Identifying your current and desired government relations
- Reaching out to government officials
- Understanding how the structure can work for your business
- Gaining approvals from government officials

Chinese government officials can have a lot of clout, especially in foreign business circles. For instance, the mayor of a good-sized city often plays a more important role in business than his or her counterpart in Europe or North America. A Chinese mayor may be able to get the authorities to speed up the investment approval process or help fix a problem that a foreign investor is facing.

Also, the Chinese government often plays multiple roles. For example, it can be an investor and regulator at the same time, blurring the relationship between business and the government. Therefore, you really need to understand how to deal with Chinese officials.

In this chapter, you find out how the government looks at foreign investment, which can help your company put government relations into perspective. The chapter also shows you how to determine which Chinese government organizations you should get to know. It discusses how you can access government officials, too. And after you've managed to get to know officials better, you discover how you can maximize the benefits of your relationships with them.

When you work with the government, you also deal with the Chinese Communist Party. See Chapter 3 for info on government structure and the CCP.

Knowing Why You Want to Connect with the Chinese Government

The Chinese government's formal policy is to welcome new foreign investment with open arms. Under the surface, the reality is sometimes different. Government officials are under a lot of pressure to give Chinese companies more attention.

Your Chinese competitors are trying to influence behaviors from government officials. They're attempting to strengthen their position and/or weaken yours. Therefore, you really need to develop and manage key influencers within the Chinese government. In this section, we explain what the government can do for you and point out some resources available to you.

REMEMBER

Government relations can be more important in certain industries, including highly regulated ones, those using newer technologies, or those offering nontraditional selling mechanisms. For example, financial services, Internet companies, and telecommunications companies come under much closer government scrutiny. If you're in these industries, you need to spend a lot more time staying on top of your government relations.

Getting official assistance

The Chinese are trying pretty hard to make investing in China easier for foreigners. Here's how:

- China's Ministry of Commerce (MOFCOM) has set up a division called the Investment Promotion Agency to cater to foreign investors.
- Provincial governments have special services to assist foreign investors. For instance, Sichuan Province has set up the Sichuan Provincial Investment Promotion Bureau (SIPB).
- China has created special zones to attract foreign companies through incentives. For example, the Tianjin Export Processing Zone (TEPZ) waives import duties on machinery that'll eventually be used for manufacturing products for export from the zone.
- Trade shows and fairs routinely take place throughout the country. Many Chinese cities even send trade and investment representatives on missions overseas to drum up new investment.

  The largest and most famous Chinese trade fair — the China Import and Export Fair — has kept going for more than 50 years. Sponsored by the Chinese government, this so-called Canton Fair is held in Guangzhou in the south of China twice a year, in spring and the fall.

For more information on agencies, trade shows, and other government services related to investment, visit www.fdi.gov.cn.

Gaining guidance and support

Often, government officials can guide you well. They can help you set up your company and keep your business running smoothly. For example, they may be able to help you get more electricity to keep you going 24 hours a day. Government officials often have the final say in approving your business venture or approving your new building site, so cultivating relationships with officials can help these processes along. In addition, many local governments also are the decision-makers when giving out incentives to set up shop in their city.

TIP

Don't let government relations drive your business strategy. Sometimes foreign companies get so awestruck about the potential opportunity in China that they place too much emphasis on what government officials tell them. But you shouldn't, for example, choose the location of your factory based solely on incentives offered by local officials. Don't get fooled into believing that government officials can make all your problems go away. Decide for yourself what's best for your business.

WARNING!

Some government officials can talk a good game and make certain promises when they're courting a foreign company. Before you make any commitments, check around with other foreign companies that recently may or may not have made an investment there. (Of course, you may not want to contact your competition while checking around!) That way, you can check the local government's reputation before you make any plans.

Mapping the Bureaucracy to Plan Your Network

The Chinese bureaucracy is massive. It extends far and wide, with layers upon layers of officialdom. Smart companies understand that developing a systematic approach to government and relationship management can make a difference. It involves getting an understanding of who's doing what inside the government. By understanding what government units, and who within those units, can possibly help you, you'll have a better chance of getting ahead with your plans for China and may be able to save your company some hassles later on. You may even create new opportunities for your company along the way.

Identifying key government organizations

Getting a handle on what government organizations should be on your radar screen is an important first step in getting your government relations program organized. You need to identify each and every Chinese government organization you'll likely be involved with. You want to find out the following:

- Who regulates the industry and at what level in the central government
- How the central ministry relates to the provincial and city level
- Which Chinese government think tanks or government agencies may influence your business
- Names of other government units involved in the business
- Names of other organizations or specific individuals who may have a say in your business
- Which government-related organizations from your own country you should work with
- Which nongovernmental trade or business groups can help you

Embassies, consulates, and export agencies of foreign governments are excellent resources for such information, especially for small- and medium-sized companies with a limited budget. Many companies supplement the info they get from their home government agencies or embassies with information they develop themselves by making contacts within the industry in China. Some larger companies choose to use external consultants. For more information about foreign government organizations that may assist you, go to Chapter 4.

When your company begins to hire people locally, your people on the ground should know which local officials to contact on any approval or permit. So if you're expanding your factory, adding workers and needing training permits, or performing other activities that require government approval, your locally hired senior plant manager should know whom to call on within the local government.

Identifying the key influencers

After you identify the government organizations that'll likely influence your business, determine who the key players are within those organizations. Make contacts in China with people who know the structure and who the players are. You can find such contacts within the following:

- The Chinese government itself as you get to know the officials
- Your industry business circles
- The commercial services provided by your government

Your list of influencers may include many people within the same government unit. It may take you across China's provincial borders as well. Don't forget to include key influencers from your own country, such as your ambassador to China and commercial officers at your embassy and/or consulate. And remember to include other China-related business or trade organizations, such as the US-China Chamber of Commerce or the Canadian-China Chamber of Commerce.

For small businesses, you can usually figure out pretty quickly who the key players are — your list may include no more than local government officials if you're investing only in a local area. Although your dealings with the government may be minimal, understanding the dynamics of the local government structure and people is worthwhile. When you work with and get to know the local officials, you figure out the pecking order and who does what within the government structure. As your relationship grows, the local officials may become useful contacts for you.

If your company has more ambitious plans across China, you need relationships with the local government in each and every location where you plan to do business. Laws and some regulations can vary quite a bit from one place to another.

Make sure you have more than one relationship inside the government section or unit so that if one contact gets promoted, you have someone else in the department who knows your company.

Government officials move from job to job frequently. Generally, when an official leaves a post for another job, any commitments he or she made to you or your company leaves, too. Don't be surprised if you find yourself in a position of restarting discussions with a new official who has no commitment to any promises made by his or her predecessor.

Protect yourself through contracts. If, for example, the vice mayor offers you tax incentives if your company builds a new factory, execute an investment contract with the local government in which it commits to providing these benefits. For more on investment contracts/agreements, see Chapters 7 and 18.

Tracking key relationships

After you identify the organizations and key players you need to get alongside, you can begin to track your Chinese relationships. You can do this step informally instead of creating an actual map, or you can make a graphic representation of the government organizations and officials that are or should be part of your network. This map can be a good visual for your senior executives so they can better understand the government organization and the Chinese officials who are key contacts for your organization. Your map will likely include Chinese organizations such as

- One or more Chinese regulatory commissions
- Several key Chinese ministries
- National, provincial, and local government leaders and their key staff
- Government think tanks
- University research centers
- Embassy and/or consulate government officials

This mapping exercise is especially useful for mid-tier or large companies that are planning or operating multiple investments in China across multiple provinces while dealing with multiple governmental organizations. But it can be easily adapted on a smaller scale for other firms setting up in China. Here's how the process works:

1. **Identify the Chinese relationships you've developed and indicate how strong these relationships are.**
2. **Get your China team to agree on who's responsible to lead the relationships.**

   This person is responsible for nurturing and growing the relationships. Everyone needs to know who this person is.
3. **Look for holes in your Chinese network.**
4. **Focus on finding and developing these new contacts.**

   You can leverage your key relationships by using one relationship to give you access to another official — especially across provincial borders if they're strong enough. You may sometimes encounter situations in which government organizations seem to have overlapping responsibilities. Your map can define where these overlaps occur and help identify who the right contacts may be to make your deal work out. Your completed map can guide you to other important government-related organizations as well.

   TIP

   Get to know the officials' levels of seniority. By mapping your senior executives with equivalent-ranking Chinese officials, you can make introductions at the appropriate level of seniority.
5. **Update your map to reflect the frequent organizational changes that happen within the government.**

   Updating enables your company to track the transfers of officials from one government job to the next.

Contact: Working Your Network

Getting access to government officials can be challenging at times, but this section provides you with several good approaches. You can use one or all of the suggested methods.

Getting your Chinese employees to make connections

Most senior Chinese business executives know the right way to get access to Chinese government officials. They know how to build a network of relationships that can help support your business activities. They also understand the right way to go about using Chinese protocol to gain access to certain officials. Relying on your local senior management team to build the right relationships is a good approach to bettering your government relations.

Calling in company big shots to access senior officials

Sometimes, due to their relative position within the company, your senior Chinese executives may be unable to gain access to specific government officials. Chinese companies view hierarchy as very important, so only people at certain levels can talk formally to the same level of person at another company or organization. Often, your company can gain access to more senior Chinese officials by wheeling in your company's C-level people (CEOs, CFOs, COOs, and so on).

TIP

If you plan to get your company's C-level executives to meet Chinese officials, start planning the visit well in advance. We recommended that you start at least two months ahead of time. And don't be surprised to get confirmation of the meeting just weeks or possibly days before the meeting.

WARNING!

If your company executive suite looks more like a revolving door these days, bringing in your senior executives to help you in China can backfire. The Chinese value consistency, so you need to have a stable management within your company for this approach to work.

Connecting executives with your Chinese network

Get your company's senior executives directly involved in the government relations process so they can understand how things really work in China. Sometimes, senior executives presume that if something can't be done, it's because your China team doesn't know how to do it. Some executives at your headquarters may challenge you on the amount of effort that's being put into government relationships.

Developing government contacts at the local (never mind provincial or national) level takes a lot of time and effort. This idea is especially true for your local senior Chinese executives, who may need to spend considerable time networking with Chinese officials. And then your business has to deal with the additional time and expense of sending company executives from headquarters. They, too, should be actively engaged in developing relationships with Chinese government officials.

Depending on your Chinese partner

Assuming your relationship is a good one, consider getting assistance from your Chinese partner. Visiting your targeted government officials with your Chinese business partner gives your company more respect in the eyes of the government officials. You're showing the government officials that your Chinese business partner is important to your business.

This approach to government relations works well for firms that are planning or are involved in joint ventures with the Chinese — especially with China's privately owned companies. Using the strengths of your Chinese partner's relationships, you get the benefit of their political connections. This perk is especially useful when you're attempting to get approvals from government officials. (Again, this method works only when your joint venture is a real partnership and the relationship is going well.) Usually, the foreign company complements the relationship with technical expertise, and the Chinese company has the local market operating knowledge and relationships to make business deals happen.

TIP

Although your Chinese partner may have the relationships to get an approval, they may be in a rush to get the paperwork done at the expense of getting the details right. So be sure to stay engaged in the process so that any paperwork submitted to the authorities reflects what's best for your company. For example, you want to make sure you're submitting a proper description of your company's proposed scope of business activity (see Chapter 7).

WARNING!

Using the relationships that your partner has with officials can be advantageous, but it's important that you build your own government relations, too. You want some insurance in case something goes wrong with your Chinese partner.

Turning to consultants

Some firms use business consultants, retired Chinese officials, or retired diplomatic personnel to get an audience with certain officials. Consultants may have not only some strong relationships in government circles but also deep insights in a particular industry. You may use consultants successfully if they truly have key relationships and can deliver on their promises. (For more on consultants, go to Chapter 4.)

Although many people see this approach as a good option, it's not the preferred method for most businesses. The best way forward is for your company to build your own government relationships (or build them in conjunction with your Chinese partner). After all, your company should be capable of developing, managing, and controlling its own network of business and government contacts. Your firm can reap the benefits directly this way instead of relying on some middleman to make it all happen. (For more on building relationships in China, go to Chapter 15.)

Plenty of consultants in China promise to introduce your company to the most connected government contacts. The best advice is to go very slowly with people making such a promise. Just be sure to check out any local consultant's background, references, and success with other companies.

Aligning Your Government Relationships

One of the most challenging notions for foreign companies to grasp is the need to manage your network of government relationships. For small companies, it's pretty easy to manage. For mid-tier and larger companies, this is no easy task. But don't get too hung up on the complexities of it all. This section can help you understand the way you need to operate at certain levels within government circles.

Taking the bottom-up approach for smaller firms

For a small foreign company that's likely operating in one location, take a bottom-up approach to developing relationships with government officials. You'll likely be working with more junior people in the government ranks when you first get started in China. Over time, you eventually want to make connections to the highest level of the local government. Usually, this highest level is the mayor of the city or town where you're establishing your business. Meeting the local officials and getting alongside them is the right thing to do.

TIP

You're likely not obliged to follow the formal protocols you'd likely find at the higher levels of the Chinese government, so be sure your team on the ground makes an effort to socialize with these contacts outside of the usual business activities. This activity may be banqueting or a night out drinking with your Chinese government contacts. In some places in China today, it may even be a round of golf.

Meeting in the middle: Managing multiple levels of government

If you're a medium- or large-scale company doing business in China in more than one geographic area, you'll likely be managing multiple levels of relationships with government officials. You need to have the right government support in the geographic area where you plan to operate. You may need assistance at the national, provincial, city, or even township level.

The big picture for your company in China may look something like this: Your business is regulated by a central ministry in Beijing that exerts considerable power over national policy in your industry. The ministry is influenced by the government's leading think tank that reports to the State Council. The regulatory officials also have local representation in the province and city where you operate your local businesses. Your biggest Chinese competitor has good government contacts at the national level. Your nimblest local competitor is tight with the provincial governmental leadership. But another Chinese government institution — yet another government-supported think tank — also advises the regulatory commission for your industry in Beijing. It so happens that your biggest foreign competitors are trying to influence industry developments with this think tank by financially supporting an independent study of regulation of the industry. As you can see, your company and your competitors can be quite active within many different levels of the Chinese government.

Joining the top to the bottom

If you have to deal with multiple levels of government, a good approach is to make the top meet the bottom. This idea doesn't mean that that senior officials from one level of government need to meet other officials. What it means is that you may need to connect your network of government officials in a way that maximizes your chances to push through an approval. Pull the right government levers by using upper-level connections to help you while respecting the position of more local government officials. After all, local government officials don't necessarily like being told what to do — especially if it reduces their influence or power. Therefore, you need to strike a balance by managing the mandate coming from the top officials with the need to stay onsides and work with the local government officials. This idea is especially true when your company is seeking approvals from government officials that cross geographic boundaries in China.

Make as many contacts as possible so you can cover the wide base of relationships that you may need to call upon to get the job done. The more-senior government contacts your company knows may have some influence over provincial and other local officials, but even senior officials from the central government can't get everything lined up for your company at the provincial or local level. And often the provincial and local government leaders can't get things completely organized for you up the government chain of command.

Lining up the levels

REMEMBER

One of the most important activities for foreign companies operating across China is to align the interests of both the local government and the provincial or central government. The trick is to serve all these masters well.

Your local team can extend your Chinese network to reach the right relationships with multiple levels of government officials — from local and provincial leaders and possibly national, too. That way, your company can make contacts and gain influence not only up and down but across the Chinese government structures that manage, regulate, or impact your industry. Without having the right relationships in place at various levels in the Chinese government, you'll find that getting things done across provincial borders is much more difficult.

TIP

Getting a strong recommendation from one government official can help your company build relationships with other key influencers in China. Build trust with government officials so they have no hesitation in recommending you or your company to others. (For more about building trust, see the following section.) Connecting one government official who really knows and trusts your company to a new government contact can help smooth the way with new government officials, who may have some lingering doubts about your firm or its dealings.

Getting Government Approvals

Getting business approvals in China can be quite a painful process for many companies. Approvals seem to take forever. Sometimes, you wait for long periods of time, only to hear a refusal. You can help your company get the approvals it needs by working very closely with government officials.

TIP

Forward-thinking government officials in some cities, such as Suzhou and Shunde, are making it easier for foreign investors to weave their way through the system. The concept is all about one-stop services that the local government provides to investors. The government coordinates approval, registration, permits, and more for foreign investors.

Earning your approvals

Contrary to what some people think, getting approvals in China is not about asking government officials for favors. Getting approvals in China just doesn't work that way. Your company needs to get approvals the old-fashioned way: by *earning* it from the Chinese authorities.

Some officials may expect compensation for helping your company in China. This compensation can take many forms, from outright bribes to paying for foreign travel to finding a family member a job. Unfortunately, some officials may ask for these incentives in exchange for a favor. Stay clear of any shady business dealings. If you engage in corrupt activities in China, not only are you violating Chinese law, but you may be violating your home country laws, too. For more information on how your country's laws may prohibit corrupt behavior in China, see Chapter 17.

Making your case

Create an opportunity for the government authorities to give you the approval. You have to demonstrate the economic value that the deal represents to them. Show them that by approving your deal, the government has more to gain than to lose. (Of course, they'll understand how your company benefits, too.)

Some foreign companies seem to lose sight of or don't fully understand why they're allowed to be in China in the first place. You're allowed in because your success can help China succeed. Demonstrate that you're really helping the government grow the local economy and transferring technology and good management practices. Remember the following as you make your case:

- You're reducing unemployment by creating jobs for Chinese people. Your company is probably going to help with job losses for displaced government workers.
- You're transferring management and technology know-how that helps Chinese companies grow their businesses.
- You're generating new recurring revenue for the local government through business tax, real estate tax, and value-added tax. In turn, the government can invest these monies in education, health, the environment, and more.

The tricky part is convincing officials *how much* is in it for the city or province for which they're responsible. The key is getting the message right so the officials clearly understand the value your proposal delivers. Spell out the benefits, whether it's increasing the number of jobs, guaranteeing pension benefits, keeping a factory up and running, or building a new factory. Offering the government the right mix of economic benefits is one of the best ways to get the approvals your business needs.

When dealing with the Chinese government officials, keep them informed about what your company brings to China. A friendly mention to government officials from time to time is appropriate. Tell them about the number of jobs your company has created for the local community or the total investment dollars you've committed to the area. Or mention the number of suppliers your company is supporting locally.

More than just money is involved here. The Chinese officials have seen with their own eyes what modern management practices can do to drive economic development. They only need to visit the former fishing village of Shenzhen to witness the dramatic improvement in the quality of life. Local government officials want the same. They want the best practice in areas such as quality control, logistics, financial controls, and so on. They want knowledge transferred to your Chinese employees so they can put it to good use in the future (in the minds of officials, hopefully with a Chinese company).

Helping the process along

Sometimes, government officials and workers are so overwhelmed that they may not know how to present support for a particular initiative that they want to endorse. As you get to know them well, don't be shy about asking them whether you can do anything to help. For example, you can offer to provide additional technical information in support of the initiative that may also lighten their workload.

Probably a gazillion proposals, approvals, and permits are in your local government officials' in-tray, so follow up on the status of your approval on a regular basis by checking in with your government contacts. If you don't play the game by staying in close contact, you'll probably wait months or more for the answer you're looking for.

Unblocking the blockers

When you're dealing with government approvals, you may find out through other channels that some government officials don't support your proposal. Perhaps other government officials have a vested interest in keeping the status quo. Maybe a Chinese company has a strong influence on a particularly strong government official. Or maybe an official is worried about losing his or her power base. Whatever the situation is, you can generally expect to have both supporters and blockers in the government.

Almost anybody in the Chinese government hierarchy can break up a business deal or an important project at any time and without any warning. Power plays between government officials, blocking and tackling by Chinese competitors, and other not-so-obvious reasons can get in the way. By engaging multiple levels of government and aligning with their interests (see

"Aligning Your Government Relationships," earlier in this chapter), you can get some assurance that a potential deal-breaker won't get in the way. Make sure you secure as many supporters as possible within your government network to promote your company's point of view. Hopefully, your supporters can counterbalance any blockers you bump into along the way.

Your unblocking strategy should focus on breaking down the objections into smaller parts to focus on key areas of concern. You'll likely find out what's worrying the Chinese the most. Sometimes, you discover that what worries the government officials doesn't worry you! For example, the government may be worried about guaranteeing pensions for workers in a takeover of a Chinese company; meanwhile, your company already has enough funds set aside. Hopefully, by breaking things down this way, you can find a way forward. At this point, unblocking is more like negotiating than anything else.

Sometimes, however, you find that for whatever reason, your unblocking activities fail to produce the desired results. Don't be surprised if you never find out the real reason for a rejection.

Gaining trust by keeping your word

Chinese officials constantly worry about the possibility of losing face if they make a misstep. (For more about face, go to Chapter 11.) They worry because they think they may have sold a state asset at a price that's too low. They fret because they don't want to be seen giving your company too much of a competitive advantage. They're concerned that your company is getting access to distribution at the expense of the Chinese companies. You need to reassure the government official that you're not going to take advantage of any dealings with him or her.

Never put a Chinese government official in an embarrassing situation. And don't even think about taking advantage of a government official, even if it may result in greater profits. Your relationship and the support of government officials are worth more than any short-term gains.

Educating officials (without telling them)

Clever foreign businesspeople make government officials look smart. One way to do so is to informally educate Chinese officials by providing them with valuable new insights about your industry. This technique gives you an opportunity to sell your ideas. It may expose officials to new ideas and cause officials to call those ideas their own. This method can be especially useful for medium to large foreign companies that are in highly regulated industries or restricted businesses.

Many approvals that were previously done at higher levels in the Chinese government have now been delegated to local officials in many cities or even towns. Many more local officials are now responsible for making decisions on foreign investment. Some officials aren't well equipped to handle their new assignment. They can actually go silent on you when asked to approve a legitimate proposal. Consider this an opportunity to be proactive by educating them in a professional way. You can give them confidence by guiding them with your knowledge. This technique is great for making friends with and positively influencing Chinese officials.

If you want your Chinese regulatory contacts to find out how other countries go about regulatory matters in your industry, your company can introduce a subject-matter expert. Such an introduction can give the Chinese a different frame of reference on a particular topic of interest. By providing assistance to Chinese officials on matters of concern, you can get some credit for helping them out.

Be mindful in the way you educate Chinese officials — especially in regulatory matters. You don't want to be seen as influencing government officials in the wrong way. Use careful judgment before going down this path.

Also, share your company's mission statement with Chinese government officials, especially when dealing with regulators. It helps them better understand your company and its plans for China, and it gives them a consistent message about your company's goals in China.

Be careful not to overstate your future China plans in front of government officials. For example, don't make any broad statements about plans to build a factory unless you're 100 percent sure it'll happen. You don't want the government officials to misunderstand your intentions. They'll likely hold your feet to the fire later on for not doing what you said you were going to do. (For more about sending a consistent message to the Chinese, go to Chapter 11).

Post-approval: Practicing public relations in China

When it comes to getting attention in the media, the Chinese —especially Chinese officials — usually run for cover. So check in with your government contacts on how they'd like to make a public announcement. Usually, if your company's to release any written announcement, the protocol is that the Chinese will develop an appropriate statement.

Paying it forward: Helping the government get new investors

Not only is making government officials look good a smart way to build relationships, but it's also a great way of paying back the government for their continued support. Show your appreciation by becoming a reference for the local Chinese government officials. You can offer to speak to potential foreign investors visiting China (or in your home country) to inform them of your positive dealings with the local government officials.

Another way to show appreciation for their support is to invite them to visit your country and create an opportunity for the government officials to pitch for new investment. For instance, your company can arrange an investment seminar for local companies that are interested in doing business in China. The Chinese pay for their airfare and accommodations; you arrange the venue and guests for the seminar.

You can hold a reception for the visiting officials as well and introduce them to your local business and government contacts. And you can show them around town for a little sightseeing and entertain them along the way.

TIP

Avoid any publicity for your business that involves the government — unless the idea comes from their side. Generally, shy away from any publicity that may involve government officials, especially with new ventures. Chinese officials are generally unsure how a new deal will eventually work out. As a result, they don't want to make any mention of it. In their minds, there's more to be lost than gained.

You can give officials some credit for their support without using any publicity. Consider giving government officials small symbols of recognition for their contribution, such as acrylic award plaques.

Chapter 9

Building a Local Team in China

In This Chapter

- ▶ Understanding employers' and employees' legal rights and obligations
- ▶ Preventing and fixing dysfunctional culture
- ▶ Recruiting office workers
- ▶ Retaining employees in a hot market
- ▶ Practicing hands-on management

You have to walk a lot of tightropes with personnel matters in China. Because of the small number of qualified candidates, you need to screen potential hires hard but do a great job selling them on your company at the same time. Because of cultural issues, you have to make sure employees respect you as the boss without squelching free thinking. You ultimately have to develop your own sense of how to balance, but this chapter can help you get there a lot sooner.

Looking at Employees and the Law

Because China is still a communist country, it doesn't offer employers the most flexible legal system for dealing with employees.

Under the current legal framework, local labor bureaus have a lot of power to enact and interpret employment laws and regulations. The government did enact a national labor law in 1994, but it leaves a lot of blanks for local governments to fill in. However, at the time of publication of this book, the Chinese government was circulating portions of various draft versions of a new national labor law. As the government received comments from businesses and employee groups, it did a good deal of redrafting. In general, although the new law should standardize some practices, many labor issues and interpretation of parts of the law will likely remain local.

This section discusses the current state of the law. We also mention some changes to the existing law that have been part of recent drafts. Keep in mind that these changes may be different when the law is finalized, so use the discussions on the draft law just to get a sense of the legal trends.

Employment law is changing rapidly and is oriented very locally, so don't hire employees without first seeking legal advice.

Employment contracts

Expatriates may sign employment contracts with the FIE's parent and then be seconded to the FIE, or they may contract directly with the FIE.

People's Republic of China (PRC) employees are Chinese nationals who are hired locally. For them, the current national labor law requires that seven items be specified in employment contracts:

- Term
- Job requirements and duties
- Salary and benefits
- Termination provisions
- Consequences of a breach of contract
- Behavior and discipline standards
- Working conditions

You can add other provisions, such as a probation period, to employment contracts, too. We discuss each of these components in the following sections.

A contract must be written in Chinese in order to be valid and binding. An employment contract can have multiple language versions, but only the Chinese version is official.

Term

You can create two basic types of employment contracts in China — open-term and fixed-term:

- An *open-term contract* doesn't have an ending date — it's for an indefinite period.
- A *fixed-term contract* can be for a certain amount of time (for example, one year) or for a particular assignment or project (for example, upgrading the computer network).

As we discuss shortly, getting rid of employees after their probationary periods can be difficult. One advantage of a fixed-term contract is that when it expires, the employer can let go of the employee without a problem. On the other hand, as long as the economy continues to boom, keeping good workers is going to be hard. A fixed-term contract obligates good employees to stay for a certain period of time. Most commonly, employers use one-year fixed-term contracts with their PRC employees.

In one version of the proposed draft law, if you continue to employ somebody after his or her fixed-term contract expires — even without signing a new contract — the employee will be considered to have an open-term contract. Another proposed change in the draft law says that employees without written contracts will be considered to have open-term agreements.

Job requirements

Be careful when describing the job requirements and the employee's duties in the contract. If your description is too broad, then arguing that an employee wasn't doing his or her job properly may be difficult (see "Legal disputes," later in this chapter). If you go too narrow and later try to change the employee's duties, you'll have to get him or her to sign a new or amended contract. The job description has no magic formula — you have to decide which side you'd rather risk erring on.

Depending on locale, you may be able to give yourself flexibility with a clause that specifically allows you to change the duties and requirements as necessary.

Salary and benefits

China currently has no national minimum wage (although that may change under the new labor law). However, most local governments have put minimum wages in place. Table 9-1 shows minimum monthly wages for full-time workers in some major cities (to convert to your home currency, visit `finance.yahoo.com/currency`).

Table 9-1 Minimum Monthly Wages in Four Cities

City	*Minimum Wage (RMB)*
Beijing	640 RMB
Shanghai	750 RMB
Guangzhou	780 RMB
Shenzhen	810 RMB

In addition to wages, you have to pay into at least some social welfare funds for all PRC employees. Social welfare funds usually cover

- Basic health insurance
- Unemployment insurance
- A housing savings plan
- Pension

The amounts you need to pay into the funds vary by the domicile of your employees. *Domicile,* or *hukou* (pronounced who-koh), is where a person is officially registered. It determines eligibility for social services and other benefits. It isn't the same thing as residency — a person can live in Beijing but have hukou in Xi'an because he or she was born there. Switching hukou is difficult.

For employees who have hukou in the city where your company is located, the required contributions to their funds are higher than for employees whose hukou is elsewhere. A number of factors determine the difference in required hukou contributions, but outside hukou contributions may be about half of what local hukou requirements are. There's a somewhat complicated formula for determining the social welfare fund contribution amounts, but in first-tier cities such as Beijing, it may be approximately 45 percent for employees with local hukou.

Termination provisions

The termination provisions you should list in the contract are

- How many days' notice each side must give of termination
- The allowable grounds for termination

This area is usually governed more by local law than national. Regardless of what the contract says, after the worker has finished the probationary period, terminating an employee without paying compensation is usually difficult (see "Legal disputes," later in this chapter).

Consequences of breach of contract

You can specify consequences for breaching the contract — for example, failing to give sufficient notice of leaving, terminating the contract early, or breaching a non-compete or non-solicitation clause (which we discuss later). Some companies that invest significant money in training employees insert provisions that require an employee who terminates a contract early to reimburse the company for some or all the expenses.

Local law may limit how much you can actually get from an employee for breach, and some draft versions of the proposed national labor law also contain limits on employer compensation. Regardless of whether the law limits the amount you can get, as a practical matter, your compensation is likely to be limited. Arbitration panels and courts often look at the employee's ability to pay, not damage to the employer.

Many companies don't include requirements that breaching employees pay compensation (aside from when breaching non-compete or non-solicitation clauses). The labor market's tight, and this type of provision can scare off potential employees.

Behavior and discipline standards

Usually, the behavior and discipline section is just boilerplate language reading that employees will comply with all lawful company rules and policies and that those who violate the rules and policies will be disciplined according to company procedures.

Working conditions

The working conditions clause is usually just boilerplate language reading that the employer will provide a working environment that complies with applicable laws.

Non-compete and non-solicitation clauses

For employees who deal with sensitive information and valuable clients, include a *non-competition* or *non-compete* clause in your contracts; such a clause limits their ability to use that information or those relationships to benefit a competitor. This clause works by requiring that an employee not join or start a business in the same field within a defined geographic area (such as Beijing) for a set period of time (for example, two years) after he or she leaves your company. Non-competition clauses usually also include *non-solicitation* clauses, which prohibit former employees from actively seeking out your customers and employees (whether for a competing or non-competing business).

In China, an employer must pay separate consideration (aside from the salary) to have an effective non-compete clause. This consideration varies by locale where the contract was signed, but it's usually fairly high. Generally, the law does not restrict how broad a geographic area the non-compete can cover. In other words, whether the former employee is in a different city shouldn't matter.

The national law specifies that non-competes may be no longer than three years (one version of the draft law would shorten that to two), but some locales have laws that allow for longer non-competes. Many arbitration panels and courts will look at whether a non-compete is reasonable under the circumstances.

If you take action against a former employee for breaching a non-competition clause, you have to show that the clause was valid and reasonable. You also have to prove the breach. The amount you recover is more likely to be based on what the former employee can actually afford to pay rather than on what your losses are.

Despite the legal protections against former employees competing with you for business or employees, the best protection is to compartmentalize — don't let any single employee see too much of your business. We discuss intellectual property (IP) protection strategies in Chapter 17.

Putting employees on probation

Your employment contracts should all impose a probationary period on new employees. After an employee is through the probationary period, terminating him or her — even for poor performance — without ultimately paying compensation is hard. Later in this chapter, we discuss the best ways to screen for talent (see "Finding [and Keeping] Good People"). Nevertheless, you'll still likely find that you've hired people who aren't up to their jobs. The probationary period is crucial for trying to ferret out your hiring mistakes.

During the probationary period, you can terminate employees if you discover that they misrepresented themselves during the hiring process. You can also let go of employees during this time if you decide that they aren't suitable for the position. Basically, you get a good deal of subjective leeway during the probationary period.

Currently, local laws govern the maximum length of probationary periods. How long you can keep an employee on probation usually depends on the term of the contract. The shorter the contract, the shorter the maximum probation period is. In general, you're able to have at least one month for a probationary period. Under the current national labor law, the probationary period can't be more than six months.

Terminating employees

After the probationary period (see the preceding section), an employer can terminate an employee for a "serious" conduct violation, gross negligence, or causing the employer to suffer severe losses. Also, if the employer gives at least 30 days notice, it can terminate an employee who's unable to do his or her job due to non-job-related sickness or injury or where the employee falls short of job standards despite receiving training or having other jobs.

Even though the employer appears to have leeway to terminate an employee who doesn't do a good job, as a practical matter, it's hard to do so without paying compensation. Most labor disputes must go to mediation and arbitration, and employees do pretty well in arbitration; therefore, expect that if you terminate an employee without reaching a settlement first, you may end up owing in arbitration.

REMEMBER

You're not allowed to terminate employees without paying compensation merely because you want to reduce headcount. If you want to get rid of a few employees who still have time left on their contracts, you have to work it out with them. If you own a factory or other business and want to reduce headcount by a large number, consult with the local labor bureau. The bureau will usually negotiate with you on behalf of the workers.

Legal disputes

By law, a labor dispute must almost always be heard by an arbitration panel before a court can hear it. The parties can choose to mediate the dispute before going to arbitration. If mediation isn't successful or the parties don't opt for it, the complaining party has to apply to the local Labor Dispute Arbitration Committee for arbitration. This committee is made up of the following:

- Representatives from the local labor bureau
- The local Commission of Foreign Trade and Economic Cooperation (COFTEC) or Ministry of Commerce (MOFCOM) (see Chapter 7)
- A trade union

Employees win their arbitration cases outright 47.5 percent of the time; employers win outright only 12.9 percent of the time. The balance is mixed judgments. If a party doesn't agree with an arbitration award, it can appeal it to the local People's Court. The court doesn't have to hear the dispute, though.

Unions

The Chinese Communist Party controls trade unions that are organized along industrial and geographic lines. Chinese law requires that employers allow their employees to join a trade union. Historically, trade unions haven't had much power and haven't often engaged in collective bargaining; they served social and political functions. Currently, some employers and trade unions execute collective contracts, but they're not very detailed. Instead, these contracts are framework agreements that guide employees' individual contracts. In actuality, people often see Chinese trade unions as quite pro-employer.

The trend is changing, though. Trade unions are becoming stronger and more pro-employee. In 2006, Wal-Mart had a front-page spat with a major trade union and the government over whether its employees could join a union. Wal-Mart has a firm no-union policy, but the public and government pressure on Wal-Mart in China was eventually successful. Wal-Mart allowed its Chinese employees to join a trade union. This news is likely a sign that trade unions are going to be a bigger force in employer-employee relations in the future.

The new labor law will likely give trade unions more rights and power. It may also encourage collective bargaining.

Avoiding a Shocking Corporate Culture

Controlling the workplace culture should be a top priority throughout the entire planning and hiring process. Regardless of how you run your company back home, we guarantee it has a much more developed culture of accountability and controls than what most Chinese employees are used to. Your Chinese employees need to both understand the controls and subscribe to the idea of having them. You need to get people to understand that when the system works well, the company does well and the employees also benefit.

Also, your China operation is going to need a lot of support from home (see Chapter 4), and having a common corporate culture helps a lot with that. Finally, Chinese people who want to work in FIEs are looking for something different from traditional Chinese company culture. They'll appreciate your efforts to indoctrinate them into how you operate back home. The following sections explain how to export your culture and why it's so important.

Passing up the Chinese imperial palace

Chinese imperial palaces were infamous for their over-the-top intrigue and politics. A very real risk of not implementing your company culture in China is having the FIE go the complete opposite way and become an imperial palace. Before you laugh, you'd be surprised at how many Western companies' China operations have gone that route!

Imperial palace culture in a Western company can work something like this: You have a top manager who's more concerned with enjoying the perks of his position than with running the business effectively. The most common perk he wants to enjoy is employees who are sycophants — praising everything the manager says or does and speaking extremely deferentially (or in Western parlance, "kissing butt"). These managers see themselves as the emperors of their fiefdoms.

Many Chinese employees, who've been exposed their whole lives to the rigid hierarchies that result from China's imperial tradition and government bureaucracy, immediately know how to act when an emperor is managing the office. In addition to becoming sycophantic, they rarely offer their opinions on how to improve the business. And they very rarely offer any opinion that may run contrary to the emperor's view.

The organization develops a rigid hierarchy, with each employee sizing up his or her rank relative to other employees'. Employees focus on secretly undermining employees above them. Meanwhile, they also seek to enjoy the perks of their positions by being overly harsh to their subordinates. Employees in this environment become especially afraid of being recognized as having made a mistake. As a result, they often refuse to share information or collaborate with their coworkers. They may even attempt to sabotage each other's work. The result is a dysfunctional organization dominated by fear of making mistakes and distrust of coworkers. This culture will affect your bottom line — quickly!

Guarding against imperial palace syndrome

To an extent, many Chinese employees feel somewhat comfortable in an imperial palace type of environment. They don't usually like working in it, but it's familiar to them in many ways. It reflects a lot of traditions, the educational system, and the types of jobs their parents and grandparents had. If given enough leeway, some Chinese employees will revert to this kind of system. However, by training managers and employees, you can encourage a Western-style work culture.

One of the keys to guarding against imperial palace culture is watchfulness and control. Observe your employees closely. Do they seem overly deferential to you or other managers? Do they hesitate to offer opinions? Do you sense that they're trying hard to look busy even when they aren't? Are employees making subtly derogatory statements to you about their coworkers? The following sections explain what you can do to prevent an imperial palace — or turn around the one you have.

Using home connections to export your culture

The best way to export your culture to China is through your top managers. Ideally, from your home operation, you can send over a general manager (GM) and a financial controller who understand your company and culture well. Be clear to both of them that one of their priorities is ensuring that your culture takes hold in China.

If you can't find suitable people in your operations, require that anybody you hire from outside for a senior management position work for at least six months (the longer the better) in your home operation to get an understanding of how it works. If your top one or two managers aren't long-time company employees, you may want to send HR personnel over to China during the initial period (at least several months) to help train the employees.

Hiring managers who aren't would-be emperors

If you're going to hire an outside manager (or management team) to run your operations, then you have to be especially careful. Some companies assume that they can guard against imperial palace syndrome just by hiring a Chinese manager with some Western education and experience. That's not necessarily the case. Some returnees (but certainly not all) can become emperor-managers pretty easily. Sizing up their potential to become emperors is pretty much impossible because they'll know how to act very Western when they're around their Western bosses.

The other issue with returnees is that they often can't admit to making a mistake or being wrong for face reasons. Ordinary Chinese heap many expectations on returnees, creating tremendous pressure for them to be almost perfect in their management. This situation doesn't mean that you shouldn't go the returnee route. But if you do, have a senior person on the ground in China who has the clear authority to make sure that your corporate culture is instilled.

Western expatriates who've been in Asia for a while can pose the same potential danger. They may have become so used to this culture (which is also in other parts of Asia) that they turn your company into an imperial palace. On the other hand, Chinese who don't have overseas experience can make excellent foreign-invested enterprise (FIE) managers — and for much less money! It all depends on the individual. Note that a Chinese manager who doesn't already have significant experience working in FIEs is unlikely to work well as your manager.

Beware any manager who resists your control of the culture by telling you that things are "done differently in China." You have to respect cultural differences, but there's no reason why the big picture can't resemble a Western company. Don't ever fall for the you-don't-understand-China rationale from such a manager, either. You don't understand everything, but good business practices are good business practices.

When you see this kind of imperial environment in an FIE, it usually comes from the people in charge. Usually, your top management negotiates greater job protections in their contracts than the law requires. You have two main choices when making a change:

- Take the manager completely by surprise, kick him or her out of the office one day, and more or less offer compensation per the contract.
- Work with the manager to get him or her to exit gracefully, often giving more than what the contract requires.

You don't want to decide to fire the manager but then inadvertently tip him or her off before you take action. If the manager sees the termination coming, he or she can do a lot of damage before removal. For that reason, the second approach is usually better.

Cultivating an ideal culture

Although all workers contribute to corporate culture, managers especially can help set the stage for the values and norms of your company. First, clearly tell managers that you expect them to instill a Western company culture. Provide managers with detailed *dos* and *don'ts*. For example, managers should

- Enthusiastically maintain various controls (good controls are vital in China — we discuss them in Chapter 17)
- Make extra efforts to recognize lower-level employees, such as secretarial staff
- Neither discuss employees with one another nor convey messages to employees through other employees

For information on maintaining an appropriate employee-management relationship, see "Earning respect," later in this chapter.

Frequently train your employees how to behave in an open, Western-style culture. Here's how:

- Offer employees who display great teamwork small prizes or bonuses, which should mitigate Chinese employees' tendency to view coworkers as competitors.
- Ensure that employees speak their heartfelt opinions in meetings by making each one speak out in turn and asking numerous follow-up questions until you feel that they've said their piece. Hopefully, they'll realize that they should express their opinions freely.
- Publicly praise employees for saying things that are out of consensus or contrary to your views. This move reinforces that your FIE is not a traditional Confucian enterprise.

- Assign people to work in teams, and be clear that they're collectively responsible for the success and failure of their tasks.
- Accept no finger-pointing when you have problems within the teams.
- Minimize the formal titles you give to employees. That way, they'll spend less time obsessing over their relative ranks.
- Give each person a turn to lead a team: If you form a team of four employees, let employee A lead one task. Then employee B takes a turn, and so on. After the completion of each leadership turn, the leaders fill out formal evaluations on the other team members; the other team members also each formally evaluate the leader. Such a system that minimizes rank and causes abusive team leaders to reap what they sow can reduce the hierarchy of your office.

Keeping an eye on managers and employees

The only way to prevent your company from becoming an imperial palace is to constantly and closely watch your managers and the company. Keep an eye on your employees through a combination of obvious and not-so-obvious monitoring. By obvious monitoring, we mean spending some time in the office observing. Sit in on meetings to see whether employees seem to be offering their opinions. Figure out whether they're behaving in a strict hierarchical way toward one another. Try to cultivate relationships with many of them. To conduct your not-so-obvious monitoring, speak with many of these same employees from time to time. Be careful when you do check in with them, though — if you want them to speak frankly, keep the fact of your meeting confidential and secret.

WARNING!

If your China people seem to be scheduling a lot of out-of-the-office time for your observers, you may want to ask some questions.

Finding (and Keeping) Good People

China has far more workers than jobs. However, in the segment of office workers qualified to work in foreign-invested enterprises, the market is extremely tight. You'll have a much easier time hiring factory workers, which we discuss in Chapter 13.

In this section, we alert you to common problems you encounter among Chinese job seekers, show you how to find and screen applicants, provide strategies for making an offer, and finally give you some tips for keeping as many good people as you can in China's competitive job market.

Employer beware: Avoiding common problems among job seekers

China is still in the middle of a tremendous transition from a centrally-planned, SOE-based communist economy to a more market-based one. Not everybody has adjusted to this change yet. That said, fantastic people are in the market in China — finding them may just take some perseverance and strategy.

Here are the three most common problems among job seekers in China:

- **Lack of motivation:** Some candidates aren't very motivated. Because of the one-child policy, many only children have been doted on by their families since birth, and most qualified job seekers have known only a booming economy. The fact that a lot of young people still live with their parents makes the problem worse. Because their basic living expenses are covered, they don't really need the job.
- **Serial job hopping:** Because China's job markets have been white hot for people with bankable skills, you see that people change jobs more frequently than in the West. Some people may change often because they're looking for more professional development. That's a fair reason, and that's something you have to address if you want to retain employees (we discuss how later in "Retaining talent"). However, some employees are pure mercenaries, taking advantage of the hot market conditions to up their salary numerous times per year. From some perspectives, that's also a fair reason. However, retaining these people can be harder because someone's always willing to outspend you for a qualified employee.
- **Lack of skills:** Employees whose backgrounds suggest they have certain skills (in terms of education or experience) may not have them in reality. We soon discuss the issues with some degrees and certificates you may come across.

We address ways to screen for these problems in the following sections. Although recruiting employees in China is more challenging than in the West, you may find that your best Chinese employees are more loyal, dedicated, and capable than anybody you've hired elsewhere.

Finding applicants

If you're looking to fill a higher-end position, you can always use a recruiting firm. China's major cities have a great deal of recruiters, whom you can find on the Internet and at networking events (see in Chapter 15). Another option is searching and posting on the big job Web sites in China. The most popular ones are 51job (`www.51job.com`) and Zhaopin (`www.zhaopin.com`). Also, some foreign chambers of commerce have Web sites that allow member employers to post openings.

If you're in a city with a large expatriate population, you can advertise in the magazines that cater to expatriates. Many Chinese who are interested in working in foreign-invested enterprises read these magazines out of interest and to improve their English.

TIP

When you have some good employees, the best way to find potential hires may be to ask them to recommend friends. Otherwise, use whatever network you have in China to see whether you can track down some good employees.

If your company is set up as a representative office (see Chapter 7), you have to officially hire PRC employees through a labor dispatch agency, such as Foreign Enterprise Human Resources Service Company (FESCO) or China International Intellectech Corporation (CIIC). In most cases, representative office employers find and screen their own candidates through the methods we discuss. But instead of signing contracts with the employees, representative offices sign labor service agreements with the dispatch agencies. The employees likewise sign their actual contracts with the dispatch agency, but the representative offices decide on the terms of those contracts. Probation and termination issues are the same for employees hired through dispatch agencies. The dispatch agencies collect a monthly service fee for each employee they hire.

Screening applicants

You can minimize the odds that you'll hire a problematic employee. The following sections provide some interviewing tips to follow as you screen your applicants.

TIP

Many of the people you interview aren't as polished as what you'd see in the United States, but don't necessarily count that against them. Remember that many candidates haven't been taught how to properly interview — or even how to dress for interviews. Also, if you're interviewing candidates in English, many may be nervous about the added pressure of speaking a foreign language.

REMEMBER

While you're screening employees, don't forget that they should be screening you, too. Sell good candidates on your company throughout the interview and hiring process.

And so we meet again: Holding multiple interviews

Repeatedly interviewing an interesting candidate is a good idea. A number of job seekers have memorized textbook answers to common interview questions (such as questions about their backgrounds). Asking the same questions a second and third time on different occasions can be useful because inconsistencies can signal that an answer is manufactured. Multiple

So, where are you from? Considering hukou

Some employers consider hukou (domicile — see "Employment contracts," earlier in this chapter) as a factor when evaluating candidates. Some employers believe that people with hukou from other parts of China are more likely to be motivated because they're usually not living with their parents; also, their quasi-immigrant status may mean that they're more determined because they were bold enough to uproot themselves and pursue a better life. On the other hand, some employers think local hukou is an advantage because outside hukou employees may eventually want to be sponsored for local hukou, which costs time and money. Many employers don't consider hukou at all in hiring decisions.

interviews can also help you figure out where a candidate's nervousness ends and language skills begin.

Asking questions

In general, you should ask candidates a lot of *why* questions. Focus on why they studied what they did and why they joined and left previous jobs. Also ask them a lot of questions about what they liked and didn't like about school, previous jobs, and other activities you see on their resumes. You want to hear answers that indicate the candidates have career plans. When you hear answers that sound like a candidate just views a job as a paycheck and/or was never really interested in the field, you probably want to avoid that candidate. Many employers in the West commonly ask *why* questions, but your China interviewing should emphasize it.

After you get a sense of a candidate's career plan, ask how he or she thinks working for your company fits with the plan. By looking for thoughtful candidates, you should be able to reduce the number of unmotivated or serial-job-switcher hires.

To get a sense of how a candidate may work in a team environment, ask about a group project he or she was involved with that didn't go well. Ask why it didn't go well, with a good deal of follow-up questions. A candidate who blames coworkers a lot instead of accepting individual responsibility may be a bad team member.

For employees who are going to be performing more-advanced functions, you may want to test critical thinking skills. One way is to present your candidates with case studies. Keep language barriers in mind and make sure the case-study facts are simple.

Determining the applicant's skills

You can determine whether a candidate has the necessary skills in a couple of ways. First, he or she should definitely know terminology. Ask a number of questions that use common terminology related to the skill set you're looking for. (If you don't know any of the applicable terminology yourself, hunt around online before the interview to find it.)

Also, you should rigorously test skills, especially technical skills, before you hire a candidate. The method obviously depends on the skills you're looking for. Don't shy away from written tests, either.

Weighing degrees and education

WARNING!

Degrees and certificates aren't always what they seem. Many universities, certification programs, and graduate schools in China are very profit-oriented. As a result, some of them give degrees to anybody who can breathe (and pay tuition). Also, some foreign degrees are similarly meaningless. The United Kingdom in particular has a number of diploma mills that give degrees (especially graduate) to anybody who has the money to pay. The United States and other countries have such disreputable institutions as well. If you do some homework on a Western school and find out that an extremely large portion of its student body is from China or Asia, that's a bad sign.

Before you decide that you want to hire only from China's top universities, though, remember that university admission is primarily based on just one examination. You can find plenty of extremely bright people who, for one reason or another, tested poorly on that day. As a result, they had to attend less prestigious schools. In China, you may come across such diamonds in the rough. Be open to candidates who aren't from top schools — particularly if they submit a well-written cover letter or resume. Such a diamond in the rough is also unlikely to have switched jobs a lot.

TIP

You can find good candidates among retired (55+) workers. Many of them, particularly engineers, have great skills.

Figuring out the applicant's level of initiative

The difference between a good employee and a great employee in China is often initiative. For a number of cultural and education reasons, initiative is in somewhat short supply in the workforce. You can try to figure out whether a candidate has some initiative by asking questions about a workplace problem he or she faced and how the candidate tackled it. You should also find out why the candidate chose that solution — the information doesn't help much if it was somebody else's idea. However, don't be surprised if you don't get many good answers to this line of questioning.

Another indicator of whether you have a great candidate on your hands is the quality of the questions he or she asks you during the interview. You'll probably have to work hard to make candidates feel like they can ask you questions, though. Make sure that the tone of the interview is conversational and repeatedly encourage candidates to ask questions. Getting them to query you can be like pulling teeth, but if a candidate asks some good questions, that's a great sign.

Making an offer

There's unfortunately no great way to know how much to offer somebody. China's labor market lacks good data, and salaries are inflating rapidly among FIE workers. As a result, many positions involve a big salary range.

The conventional way of finding out what you should pay is to buy data or studies from a consulting firm. Of course, this method's expensive. A more practical approach is to develop a network of people who hire similar employees. Hopefully, your network can give you a decent idea of what a certain position should earn.

The convention in China is to pay a guaranteed bonus of at least one month's salary right around the Chinese New Year (which is usually in January or February). Keep this bonus in mind when deciding on salaries. Some companies use bonuses as a retention strategy — they pay lower monthly salaries, with higher guaranteed annual bonuses.

A candidate you like is probably interested in more than money, so if you haven't done so already, explain how you're going to help the candidate develop professionally when you make the job offer. Explain the training the candidate will receive, skills he or she will develop, responsibilities you'll assign, and the path ahead. Worthy candidates need to know these things before deciding to join your company.

Retaining talent

Right now, retaining good employees in China is very hard. For job seekers with in-demand skills, most cities offer an unbelievable job market.

Employees usually decide within the first six months of starting a new job whether they're in it for the long term, so make sure employees integrate easily into their new jobs. Get small items correct right off the bat. For example, have new employees' workspaces properly prepared, and ensure that they're meeting their coworkers and are made to feel welcome.

Decent Chinese employees are often amazingly motivated to learn from you and your company; after all, the opportunity to pick up new skills and perspectives is one of the main reasons the Chinese join foreign-invested enterprises. If you want to keep your talent, you need to fulfill your end of the bargain by providing them with opportunities to grow.

The other trick to retaining your talent is to nurture them. There's a difference between coddling employees (which won't help you retain them) and providing a supportive environment. Stay attuned to any issues that develop. Staying aware is a little harder because of the language and cultural barriers but isn't impossible. In fact, you can task some of your Chinese employees with helping you out on this front.

At the first sign of a possible problem, sit down with the employee to figure out what's bothering him or her. This preventive maintenance can hopefully save your company from costly turnover. The real challenge is figuring out which squeaks are important and which you can ignore.

Managing Your Employees

Managing employees anywhere is challenging. In China, it's even more so because the Chinese workforce is experiencing growing pains as it adjusts to a more market-based economy. To properly manage employees in China, you generally have to be more hands-on than in the West. For this reason, telecommuting isn't usually an option in China for employees (nor for their bosses, unfortunately).

Setting your expectations for basic training

The first challenge with managing employees in China has more to do with yourself: You need to have reasonable expectations. In many cases, comparing Chinese workers to U.S. or European ones is unfair because of the differences in background and education. On the other hand, managers who've worked throughout Asia say that Chinese employees often compare quite favorably to those in some parts of Asia.

Don't expect your employees to know all the basics that Westerners take for granted, such as proper phone etiquette, how to behave in front of customers, and appropriate workplace attire. Most of them are able to pick up the basics easily if you train them. Think about all the functions a new hire will perform — large and small — and be ready to instruct. You may have to offer training for even the most mundane tasks, such as taking phone messages.

Helping employees manage their work

One of the areas Chinese employees commonly need help in is organizational skills. If you're assigning multiple tasks to your employees, you need to stay on top of them to make sure they're handling their tasks. Don't expect them to come to you for help if they're feeling overwhelmed — they may be afraid of losing face.

General questions such as "Is everything under control?" may not get you good answers. You probably need to ask about the status of each task the employee is supposed to handle. Ask each employee for such updates until he or she shows the ability to multitask effectively.

Earning respect

Although you don't want to be an emperor (see the earlier section "Passing up the Chinese imperial palace"), you do have to be more autocratic in many ways than you'd be in the West.

When employees lose respect for the boss, they lose their motivation to perform assigned tasks. They don't want to do this, and you don't want them to, either. Regaining lost respect is difficult — in the end, you may have to get rid of the employee! Ignore this section at your own risk.

Many (but not all) of your Chinese employees need you to be a strong leader in order to earn their respect. Put another way, you should be clear that there's a separation between you as the boss and them as the employees. You should of course be friend*ly* with your employees and treat them well; however, you shouldn't cross the boundary into being *friends* with most of them.

Creating a clear separation between you and your employees would chafe on many Western management experts. However, China is a very Confucian society. Confucian values stress subservience and respect to leaders and elders. In the minds of some employees, if you don't act like you're the boss, then you're an employee just like they are.

Creating that separation without going crazy and becoming an emperor is fairly easy:

- Always be conscious of maintaining your face in front of your employees (see Chapter 11 for details on face).
- Take a personal interest where appropriate in their lives, but don't share too much of your personal self with them.
- Don't ever reveal too much of what you're thinking.
- Don't be overly apologetic (or apologetic at all) for giving them an assignment that's unpleasant.
- Speak sternly when the need arises (do so privately in most cases).
- Have employees come to your office most of the time instead of going to their desks or offices to speak.

REMEMBER

Creating the boss aura doesn't mean discouraging employees from publicly stating opinions that differ from yours. *Always* encourage them to speak out, even if they disagree with you. Insist that they do so respectfully, though. And when you've ended a debate, make sure it's over.

Maintain your aura around all new employees until you feel that a particular employee doesn't need it. The employees who don't need that aura may come to resent some of what you do to create the aura, just as a Western employee would. In general, more educated and experienced employees are the ones who fit into this category.

WARNING!

Using the boss aura on your expatriate employees isn't a good idea. They'll definitely resent it. If that means that you openly treat your expatriate and Chinese employees differently, Chinese employees will usually accept that (unless the difference is enormous).

Managing office politics

Your company can become pretty political when you have Chinese employees. Watch out for employees who are looking to unnecessarily involve themselves in coworkers' assignments or trying to assert authority over each other. For example, your office administrator may start insisting to other employees that they get his or her approval before doing something. Don't be surprised to see this happen even though you never spoke about the idea with a single employee! This maneuvering is part of the great bureaucratic tradition of China — people and organizations constantly jostle each other to increase their areas of responsibility and thus their power. Again, you have to be very hands-on and vigilant as a manager.

To preempt political behavior, provide training that stresses teamwork and cooperation. The training should stress Western management models and methods. See "Cultivating an ideal culture" for details.

Chapter 10

Getting Your Mind on Money

In This Chapter

- Knowing how China tightly controls its currency
- Choosing banks and opening accounts
- Maximizing how much money you can take out of China
- Finding funding
- Understanding company and individual taxes

This chapter is complicated, but it's essential reading for doing business in China. We start with basics about China's currency, the renminbi (RMB). Then we quickly get into how the RMB affects your day-to-day business. This chapter also covers how to get financing for your business. Finally, we discuss China's corporate and individual tax systems and how to get your money out of China.

Introducing China's Currency: The Tricky RMB

China's currency has two names: the renminbi (RMB) (run-mean-bee) and the yuan (yu-en). *Renminbi* literally means *the people's currency.* As this section explains, the RMB is quite unlike most other currencies you're familiar with. It's considered a *soft currency,* which means that it isn't traded on world exchanges. China places a lot of controls on trading the RMB, and they affect almost every aspect of your business. (For information on cash, including its denominations and appearance, see Chapter 5.)

The Hong Kong dollar

Hong Kong's currency is the Hong Kong dollar (HKD). Even though China has assumed sovereignty over Hong Kong, Hong Kong maintains separate control over its currency. In contrast to the RMB, the HKD is a *hard currency,* which means that it can be exchanged anywhere in the world. The Hong Kong Monetary Authority (HKMA) manages the currency. For many years, the HKMA has kept the HKD pegged to the U.S. dollar. In other words, the HKMA ensures that the HKD maintains a steady value against the USD, which is about 7.7 to 7.8 HKD to 1 USD.

What you need to know about the RMB

One of the crucial aspects to doing business in China is understanding China's system for converting money. The RMB is only a *semi-convertible* currency — that is, you can convert the RMB to U.S. dollars, euros, or other foreign currencies only under certain circumstances.

In the system you're probably used to, a person in the U.S. who wants to get euros goes to the bank, which then takes the customer's dollars and gives him or her euros. The next step is the key: The bank sends the dollars to Europe, where it can exchange them to replace the euros it gave the customer. If the bank couldn't send out the dollars, it wouldn't be able to exchange the money for the customer. The customer has money, the bank has money, everything's done. These days, bank exchanges are electronic, but the principle is the same.

In China, you find a number of restrictions on sending RMB out of the country. Under these restrictions, banks (as well as other businesses and individuals) can't send RMB overseas for many types of transactions. You even see some limitations on receiving foreign currency from overseas in China. All these restrictions make having a worldwide market for RMB impossible. Therefore, the world market doesn't set the RMB exchange rates. The People's Bank of China (PBOC), which is China's government-run central bank, is in charge of managing the RMB. The PBOC sets the RMB's exchange rates, or *peg.* (You can find the current exchange rates into RMB [Chinese yuan] at `finance.yahoo.com/currency`.) Because the RMB isn't traded in world markets, exchanging RMB outside of China, except in Hong Kong, is hard.

China limits the flow of the RMB because it wants money flowing into the country to fund investments. Allowing money to freely flow out may reduce the amount of money available to fund investment in China. Also, the government still likes to maintain some control over the economy, and setting the exchange rate is a powerful way to do so. If China increases (appreciates) the value of the RMB against other currencies, then its exports become more

Getting a fix on the politics of exchange rates

China's currency is a hot-button issue in international politics. The U.S. and some other governments accuse the Chinese of keeping the RMB value too low. According to these critics, China makes its exports cheaper than they should be, which costs manufacturing jobs elsewhere. In 2005, China moved the peg for the first time in years, appreciating the RMB slightly. Since then, it has gradually moved the peg more.

Adding to the political pressure on China's RMB policies, many mainstream economists argue that China should let the market set the exchange rate. According to this view, markets are always better at coming up with exchange rates than governments are. On the other hand, markets can sometimes mean drastic and destructive currency fluctuations. The 1997 East Asian financial crisis is an example. During the crisis, the economies of many Asian countries that had freely convertible currencies ground to a halt overnight when their currencies dropped suddenly and sharply. China, with its currency restrictions, was relatively unscathed.

expensive to foreign buyers but imports become cheaper in China. If China decreases (depreciates) the value of the RMB, then its exports become cheaper overseas but imports to China become more expensive.

What RMB exchange controls mean for your business

In a nutshell, the exchange controls relating to RMB mean more red tape for you. Your company is going to have to open multiple bank accounts to deal with different types of foreign currency transactions (which we talk about in "Opening All the Necessary Accounts"). The controls may affect how you finance your company (see "Financing Your Business"). And the exchange controls also make getting money out of China more complicated for foreign shareholders and lenders (see the later section "Getting Your Money Out of China). But as we discuss, you do have ways to structure your company to make these tasks easier.

Choosing a Bank for Your Business

When choosing a bank for your business (and possibly personal) accounts, you can choose between a foreign bank and a Chinese bank. In a major city, you can usually find branches of foreign banks. Forgetting any other factors, such as financing, foreign banks are generally considered to offer better service than Chinese banks do, though the costs are higher. Foreign banks also have fewer branches, so they may not be very convenient. And there are limitations (that vary by bank) on how much RMB business they can do. Depending on your needs and preferences, you may end up banking with both a foreign bank and a Chinese bank.

A number of Chinese banks offer good service — some say even better than the service at foreign banks. They're usually the small- to medium-size Chinese banks, such as China Merchants Bank (CMB). Major Chinese banks, such as the Bank of China (BOC) and Industrial and Commercial Bank (ICBC), are rapidly improving their service, and they have the best branch networks.

TIP

One test of your bank's service is whether it'll take care of all verification and processing related to the State Administration of Foreign Exchange (SAFE) without charging you fees. (See the upcoming section titled "Switching things up: Accounts for foreign exchange" for info on SAFE.)

REMEMBER

If you're going to borrow money for your business from onshore sources (see the upcoming section titled "Borrowing from onshore"), you'll probably end up borrowing from the bank where your business accounts are. Therefore, if you think you'll apply for loans, focus on banks' lending departments when figuring out where to open your accounts.

Opening All the Necessary Accounts

After choosing a bank, you're ready to set up your accounts. Most foreign-invested enterprises (FIEs) open from three to five accounts — one RMB account and two to four for dealing with transactions that involve exchanging foreign currency. Read on.

Working with the people's currency: Your RMB account

The RMB account is for paying RMB-denominated expenses. These expenses usually include your PRC employees' salaries, overhead, and payments to domestic suppliers. You also deposit your RMB revenue into this account. Most smaller businesses don't need more than one RMB account.

Switching things up: Accounts for foreign exchange

In addition to an RMB account for RMB transactions, you need to open several accounts in order to navigate the RMB exchange controls (which we discuss in the earlier section "Introducing China's Currency: The Tricky RMB"). You need separate foreign exchange (forex) accounts for all *remittances,* or foreign currency payments sending money into or out of China.

The body that enforces China's forex laws and regulations is the *State Administration of Foreign Exchange* (SAFE). Regulating these types of forex accounts and remittances is one of its primary jobs. You first need SAFE approval to open each forex account — your bank should be able to walk you through the SAFE approval process.

When SAFE approves opening a forex account, it specifies the scope of the account (the types of transactions that the account may be used for). SAFE also specifies the maximum amount of foreign currency allowed to be held in the account, based on the company's registered capital (see Chapter 7) and foreign currency needs. Any amount of foreign currency in the account above the maximum needs to be exchanged for RMB and moved to the RMB account.

China divides forex transactions into two general types: current account and capital account. You almost certainly need at least one account for each type of transaction, although some companies open additional capital-item bank accounts to deal with loans. We discuss current and capital accounts in the following sections.

Current-item bank accounts

Current account items involve the day-to-day forex transactions that a company may undertake. Examples of typical current items include trade payments for imported goods and services, intellectual property (such as trademarks and patents), licensing fees, expatriate salaries, payments of dividends and after-tax profits, and foreign travel expenses.

As the name implies, your company may use its current-item bank account only for current account items. This is the account from which you pay your current account expenditures, and it's also the account into which you receive foreign currency payments for your overseas sales.

SAFE has been giving banks more authority to supervise forex transactions on their own. In almost all cases, you don't need SAFE approval for current account transactions. In order to pay a current account item (either with foreign currency already in your account or by converting RMB into foreign currency), you need to show the bank some basic documentation about what you're paying for.

For example, to pay for imported goods, your company may have to present the import contract, invoice, and some other documents. Submitting these documents isn't part of an approval process — it's usually just a formality.

Capital-item bank accounts

Capital account items are less frequent than current account items and are usually investment-related. They include registered capital contributions (see Chapter 7), loan repayments, asset sale proceeds, and funds for overseas investments.

You need at least a general capital item account; however, many businesses set up three types of these accounts:

- **General capital:** The general capital account is the account you deposit your foreign currency capital contributions into. Note that if your current account has no foreign currency but your capital account does, you can often use the money in your capital account to pay current items.
- **Loan proceeds:** If you're going to borrow money from overseas (which we discuss later in this chapter in "Borrowing from offshore"), you must set up another special capital item bank account just to receive and hold the loan proceeds.
- **Loan repayment:** In order to repay an overseas loan, you have to open yet another special capital item bank account specifically for your loan repayments!

We include this info on the Cheat Sheet as well. Keep it handy when you do your banking to make sure you put funds in the right accounts.

You must pay all registered capital contributions into the proper capital account at the bank. Any money otherwise sent into China doesn't count as contributed capital. Moreover, if you or the parent company is going to pay any expenses for the FIE, make sure you pay them through the FIE's capital account — otherwise, these expenses also won't count toward the capital contribution.

To exchange RMB to pay for capital account items, you need approval from SAFE. Your bank should be able to tell you what documents you need to provide in order to get approval.

Getting Your Money Out of China

In this section, we tell you how to get your profits out of China, as well as how to recoup portions of your investment — short of liquidation, of course. (For information on whether you need approval to convert your RMB, see the earlier section called "Switching things up: Accounts for foreign exchange.")

Sending profits back home

Don't worry — you can get your profits out of China! Your company is allowed to send *dividends* (profits) to all foreign shareholders on the current account (see the earlier "Current-item bank accounts" section). First, though, your company's registered capital (see Chapter 7) must be completely paid in; second, you can remit dividends only after the company has paid all applicable taxes on the profits.

To send out the dividends, you have to give the following documents to the bank:

- Your company's tax payment certificate and tax return; if your company receives any preferential tax treatment (which we discuss later in "Corporate taxes"), you have to also provide supporting documents from your local tax bureau
- An auditor's report for the current year
- A resolution from the company's board of directors authorizing the dividends
- The Foreign Exchange Registration Certificate (FERC), which your company receives from the State Administration of Foreign Exchange (SAFE) when you get approval for your general capital account
- The capital verification report (see Chapter 7)

SAFE may also require other documents on a case-by-case basis. In most instances, the process for remitting dividends is a formality rather than an actual review and approval. However, particularly large remittances (over US$100,000) and other questionable transactions may receive SAFE scrutiny even after the bank approves them.

REMEMBER

When your FIE expires or is terminated early, you may remit all money remaining in the company overseas as well.

Unfortunately, you do encounter some limitations in paying dividends:

- Your registered capital must be paid in full.
- You can pay dividends only after the business has been audited for the year and paid all its taxes (see "Paying the Government without Taxing Your Patience," later on). In other words, even if you've contributed all the registered capital, you have to wait about a year in between dividends. Your dividends won't be tax-deductible business expenses.
- You're not allowed to dividend out more than the company's net income in any given year.

Repaying foreign debt

Foreign debt is any debt that a company registered in China is required to repay in foreign currency. Among other items, foreign debt includes loans from a company's own shareholders (if they must be repaid in foreign currency) and trade credit.

Being able to repay foreign debt is a two-step process:

1. **Register the foreign debt with the State Administration of Foreign Exchange (SAFE).**

   If you don't register the debt with SAFE, your company may not be able to get approval to exchange RMB to pay it. After you register your company's foreign debt, you receive a Foreign Debt Registration Certificate (FDRC).

2. **Apply to SAFE for verification when you want to make a foreign debt payment.**

   To apply for verification, your company submits the FDRC, the loan agreement, and a notice for payment from the creditor. Provided that you've registered the debt, SAFE verification is usually routine.

   In repaying a foreign debt, your company first has to use its existing foreign currency; then it has to get SAFE approval to exchange RMB for any remaining debt amount.

TIP

Some banks handle the SAFE payment verification procedures free of charge. When shopping for banks, discuss whether they'll handle this process without charging fees.

Prepaying foreign debt (that is, paying before the loan is actually due), presents some special issues. SAFE will likely allow you to prepay only if the loan contract specifically states that you can prepay the debt. You need to make any prepayments using foreign currency you currently hold — SAFE won't approve conversion of RMB for prepaying a loan. In other words, if you don't have spare foreign currency, you can't prepay the loan.

Using other money exit strategies

Fortunately, you have additional ways of getting money out of China. The following sections name some options.

Intellectual property agreements with offshore companies

One common way to get money out of China is for the foreign-invested enterprise (FIE) to sign intellectual property (IP) licensing agreements with offshore companies that are owned by the same shareholders as the FIE.

Trademarks and technology (either patents or know-how) are the types of IP that are commonly licensed.

For example, say you set up an FIE in China and you also set up a company offshore in a nation that has a fully convertible currency. Setting up a trademark license is relatively easy — after your trademark is registered offshore, you register it in China. Your offshore company then licenses IP to the FIE. The FIE can then make regular licensing or royalty payments from its current item account.

Of course, these licensing agreements do have limitations. For one, there must actually be IP. And you need to make sure that no one in China has already registered your trademark. Also, note that some types of IP license agreements — such as technology license agreements — must be registered with governmental authorities so you can remit licensing fees and royalties. Also, the amounts the FIE remits as fees and royalties must make sense to the tax authorities and SAFE. See Chapter 17 for more info on trademarks.

Consulting agreements

Another option for getting money out of China is to sign consulting agreements between the FIE and an offshore company (or yourself). The idea is that your offshore company (or you) is providing valuable consulting and management services to the FIE, even if those services involve only your time.

Shareholder loans to FIE

A common technique for getting money out of China is having a parent company provide a shareholder loan to the FIE, which we discuss later in "Borrowing from offshore." That way, the FIE must make regular foreign currency loan payments to the lender — its shareholder!

Financing Your Business

This section mostly discusses debt financing. We begin by talking about general commercial loans, both from offshore and onshore sources. We then discuss specialized types of financing, which include two non-debt types: venture capital and private equity.

REMEMBER

Keep in mind when seeking loans that China sets upper limits on the amount of debt a business can have relative to its registered capital. The maximum ratio varies by investment size, and it gets higher as the investment gets larger.

Before reading further, you should know some terminology. Collateral for loans is often called *security.* When a borrower provides security, it's called *pledging* — for example, a borrower can pledge its production equipment as security for a loan.

Borrowing from offshore

In theory, your company can borrow either from banks offshore or within China. Consider a number of factors when deciding where to borrow from. Here are the advantages of borrowing from offshore banks:

- If your offshore parent has good credit and this is its first time investing in China, getting financing from offshore will probably be easier. Banks in China are interested in your asset base (which won't be big if you're just established) and your track record in China.
- Sometimes the interest rates are lower offshore.
- If you expect the RMB to appreciate against your loan currency, and your foreign-invested enterprise's (FIE's) revenue is in RMB, your loan will become cheaper to repay as the RMB goes up.

The main disadvantage of borrowing from offshore is that all foreign debt must be registered. China has no similar regulation for domestic debt; therefore, if you have foreign debt, where your company stands in relation to its maximum permitted debt-to-capital ratio will be more obvious to the authorities.

TIP

The minimum loan size from an offshore bank to an FIE is usually around US$10 million. However, if your parent company has an existing relationship with an offshore bank, the parent may borrow the money and then lend it to your FIE in the form of a *shareholder loan.* Shareholder loans are an easy way to get some of your investment back because FIEs repay them in foreign currency, not RMB. The parent may also contribute any money it borrows in its own name as registered capital.

Shareholder loans must comply with most lending laws and regulations. Whenever an FIE submits a loan contract (whether shareholder or third party) to the State Administration of Foreign Exchange (SAFE) for verification of a loan payment, SAFE reviews the interest rate to ensure that it's in line with market interest rates. That means that you can't get extra cash out of your FIE by charging an excessive interest rate!

REMEMBER

If you borrow from offshore, you may have to pledge your shares in the FIE as security. If you pledge your shares, you have to get approval from the original approval authority for your FIE. After you receive approval, the pledge must be registered with the local Administration of Industry and Commerce (AIC), one of the key approval authorities that companies deal with. See Chapter 7 for more info on approvals.

Borrowing from onshore

When looking to borrow onshore, you can borrow from foreign banks as well as domestic ones. In many cases, you borrow from the bank where the business accounts are — especially for small loans — but you do have other options. (You may want to consider your borrowing options when selecting your bank — see the earlier section called "Choosing a Bank for Your Business.")

Your company can borrow from onshore banks in foreign currencies, regardless of whether the banks are foreign or Chinese. However, borrowing foreign currencies from onshore banks is rare because your proceeds are almost always used to pay for expenses within China.

Considering loans from onshore foreign banks

Although most onshore loans come from Chinese banks, the government is opening the banking industry to foreign banks. As a result, foreign banks are becoming bigger players in onshore deposits and lending. If your parent company has an offshore relationship with a foreign bank, you may get the best loan terms at one of the foreign bank's China branches. Citibank is becoming particularly aggressive among foreign banks in lending to small and medium FIEs.

Foreign banks in China tend to be more interested in cash flow than assets.

Getting loans from Chinese banks

Traditionally, when most FIEs have borrowed from onshore, they've borrowed from Chinese banks. Chinese banks usually offer better borrowing terms on RMB loans because they have a lot more RMB to lend than foreign banks do. Also, if you borrow from a Chinese bank, the loan agreements when you borrow from onshore are simpler than what you'd get in most Western countries. Often, they're only seven to ten pages long and are missing many of the financial restrictions that Western loan agreements have (for example, many Western loan agreements place a limit on how much overall debt a company may have).

Chinese banks have historically made asset-based loans, and the banks are still leaning quite heavily toward asset-based lending. *Asset-based* lenders determine borrowers' creditworthiness and maximum loan amounts by the values of physical assets on the balance sheet. That way, if a borrower defaults, the bank can foreclose on the assets, sell them, and receive the proceeds.

However, Chinese banks are now beginning to take a more cash flow–based approach. *Cash flow* lenders make loan decisions according to financial projections of how much money will be available to make the payments. Making cash flow–based loans takes more sophistication because it involves analyzing business prospects. Therefore, when you apply for a loan in China, your company ideally has a good balance sheet and realistic prospects for strong cash flow.

Looking at special considerations for new businesses

If you're just starting your business in China and want to borrow from onshore banks, all is not lost — you just have to work a little harder to get the loan. Because many newly-established FIEs don't yet have significant assets, you have to make a pitch to the bank based on your business's projected cash flows. The feasibility study you include in your FIE application packet (see Chapter 7) shows the bank that your company will be able to repay the loan.

If your offshore parent company is financially strong, it can help the FIE get a loan by providing a *parent guarantee* — that is, the parent agrees to be responsible for the debt in case the FIE defaults.

If your company is just starting up and you plan on purchasing fixed assets (land, buildings, or machinery), getting mortgages for those assets is probably easier than getting a general business loan. We discuss mortgages and other special types of financing in the next section.

If your FIE is a joint venture (JV — see Chapter 7) and it wants to borrow money, onshore banks often want the shareholders to the JV to each guarantee loans in full. For example, if the JV borrows 10 million RMB, the bank may want each parent company to guarantee the 10 million RMB. The problem is that the law limits how much Chinese JV partners can guarantee to the amount of registered capital that they own. In this example, if the Chinese side owns 5 million RMB of registered capital, by law it can guarantee only 5 million RMB of JV debt.

Checking out special types of debt financing

Even if your company is able to get enough funding internally or from general business loans, you may want to consider the following types of specialized financing. The financing costs or other terms of these alternatives may be more attractive.

Mortgages

A *mortgage* is a loan specifically to purchase a fixed asset, and it's also secured by that asset. In other words, if a borrower defaults on the loan, the bank can seize that particular asset in order to recover the loan. Usually, banks lend only up to a certain percentage of the purchase price because they want to make sure they have enough of a financial cushion if they have to foreclose. Therefore, you have to put up at least some of the money yourself. How much the bank lends as a percentage of the asset's value (called *loan to value,* or LTV) mostly depends on the type of asset, the bank, and your company's strength.

In general, you can get two types of mortgages: mortgages for land or buildings and equipment mortgages. You usually get a larger LTV for land-building mortgages. Again, the LTV depends on several factors, but 70 percent is usually a reasonable expectation for land-building mortgages. Equipment mortgages usually have lower LTVs.

Letters of credit

Two main types of letters of credit (LCs) are available. One is called a *standby letter of credit,* and it's usually connected with a general bank loan. Standby LCs are issued based on the same lending criteria as general business loans.

The other type of LC is a commercial LC, which is vital to the import/export business. A *commercial LC* is a guarantee from a bank for payment of a trade-related expense. For example, say your company wants to import some raw materials from a supplier that you haven't dealt with before. Because the seller doesn't know you, it wants payment before it ships the goods; however, you don't want to make payment until you know the goods are on the way.

Commercial LCs are easy to come by because they're usually not very risky for the bank. Depending on your company's credit standing with the bank, it may have to put aside the money for the LC in a separate bank account.

As we discuss in Chapter 12, inspecting a product before you pay for it is a good idea. When a bank issues an LC, you're on the hook for the money. Therefore, you do run the risk of not getting what you bargained for.

Working capital loans

Working capital loans are small loans used for day-to-day expenses, such as purchasing inventory, paying rent, and paying salaries. Because working capital loans are small, getting them from your bank usually isn't hard. Sometimes you don't even have to provide security. If your company does have to provide security, it's usually the business's inventory.

To get a working capital loan, you have to show the bank that the amount is a reasonable size for your business and that your cash flow can support the loan.

One caveat with working capital loans is that they're often *uncommitted.* In other words, the bank can demand repayment at any time.

Getting private equity financing

You may be able to get *equity financing,* in which your company sells partial ownership to an investor. Instead of agreeing to receive a fixed amount of money in return (as with a loan), the investor shares the upside (or downside) of the business as a shareholder.

Public equity is raising money by selling stock to the general public, with the equity sold (stock) able to trade on a stock exchange. However, public equity isn't an option for startup companies. This section discusses *private equity* (PE), an invitation-only type of financing — in other words, the general public can't participate in the financing. In addition, the equity the investors purchase can't be traded (at least initially) on a stock exchange.

Venture capital

Venture capital (VC) is a type of private equity financing. Companies raising venture capital are in their very early stages. In many cases, VC investors invest in a business that's little more than a business plan. Venture capital is sometimes called "vulture capital" because VC investors usually require entrepreneurs to give up large amounts of equity (and sometimes control).

REMEMBER

VC investors take a lot of risk by investing in young companies; therefore, they want a lot of reward if things work out (hence their vulture nickname). If you're looking for VC money, you mainly need to be able to show VC investors two things:

- That your company will be successful (so present a solid business plan)
- How and when they can exit the investment — in other words, how and when they can make their money

Far and away, VC investors like to plan to exit by having the company *go public* — that is, to have its stock listed on a stock exchange. After the company's stock is listed, finding buyers for the stock is easy for investors.

On rare occasions, some VC investors invest with the hope of receiving large annual cash flows. However, pitching this type of strategy to VC investors is difficult because they usually don't want to hold onto an investment for more than a few years. Even if they're getting cash yields of 20 percent on their investment starting immediately (which would be an incredible feat for your company), investors would still need five years just to break even. For most VCs, that's an unacceptably long time.

China's special VC features

China venture capital (VC) investing has a number of special characteristics not found in most countries. The main source of these differences is the currency controls (see "Introducing China's Currency: The Tricky RMB" at the beginning of this chapter).

You can't directly take an FIE public in another country for a number of reasons. For one, because a limited liability corporation (LLC) — the standard form of Chinese corporation — doesn't have shares, it can't sell shares of stock to be traded on an exchange. And listing on China's domestic stock exchanges (in Shanghai and Shenzhen) is currently not a workable option for FIEs for a host of legal and practical reasons.

If you want your FIE to go public, first set up a special offshore company to hold your investment in the FIE. Setting up your offshore holding company first, rather than setting up your FIE and then transferring ownership to the holding company, is by far the better option. If you instead set up the FIE first, you need to go through the lengthy application process to set it up. You then need to go through another lengthy approval process to transfer the ownership to the holding company.

The government doesn't usually want People's Republic of China (PRC) investors to invest at the offshore level for onshore ventures (an act called *round-tripping*) because round-tripping defeats currency controls and can be a way to evade paying tax; therefore, PRC investors — either PRC citizens or PRC registered companies — need SAFE approval to join you at the offshore level for an investment in China. If you don't heed this warning, SAFE may revoke your company's foreign exchange privileges. For more, see Chapter 7.

If your Chinese partner brings up the idea of joining you offshore, you may want to kill the idea then and there. Some Chinese are used to ignoring these laws, and by the time they find out that they can't get the approvals (likely to be the case), you'll have wasted a lot of time. Also, a company that's directly or indirectly (through other companies) controlled by a PRC investor needs the same approvals.

Because of the numerous China-specific issues with VC — including getting cash offshore (see the earlier "Getting Your Money Out of China" section) and issuing stock options to your employees — make sure you work with a law firm experienced in VC. Most VC work is currently done at foreign law firms, but some Chinese law firms (especially those with U.S.-trained partners) are now doing a lot of VC work as well. Your VC investor usually chooses the law firm. Before pitching to a potential investor, though, try to bone up more on legal issues with China VC. Large foreign law firms that do a lot of VC work in China often have useful articles on the topic on their Web sites.

VC is common in China, but you have an uphill battle if you're going to pitch to VC investors who aren't yet familiar with China's markets — they may be scared off when they first hear about the numerous complexities. Decide whether you're willing to take the risk.

TIP

Evaluate your VC investors carefully — and not just in terms of how much money they're willing to invest. Look at how much control they want, whether they can provide useful advice, and whether they have a track record of bringing China businesses public. The *Asian Venture Capital Journal* (`www.avcj.com`) is a good source of information on China's VC players, market, and challenges.

Non-VC private equity

Non-VC private equity (PE) investors invest in more mature companies. Here are the two types of PE investors:

- **Strategic:** Strategic investors invest because of some relationship with their existing business. For example, a European car company may buy part of a Chinese car manufacturer because the two companies want to produce cars in China together.
- **Financial:** Financial buyers buy businesses purely for profit reasons. Unlike most VC investors, these buyers may be interested in making their money back through cash flows. Their motivation may also be to bring the company public: Sometimes financial PE buyers buy public companies, make them more efficient, and then bring them public again a few years later.

If you're thinking of eventually looking for PE investment, the offshore holding company structure is a good idea as well. You'll save a PE investor a lot of headache that way.

Paying the Government without Taxing Your Patience

In dealing with China, you have to deal with both corporate and individual taxes. As we discuss in the upcoming sections, individual taxes for foreigners and Chinese nationals vary.

Corporate taxes

In March 2007, the government enacted a new corporate income tax (CIT) law, which takes effect January 1, 2008. Unfortunately, because the implementing regulations haven't yet come out, the new tax regime isn't entirely clear.

Here are some of the changes:

- The main thrust of the new law is equalizing income tax treatment of Chinese companies and FIEs at a national tax rate of 25 percent (the current framework often favors FIEs over Chinese companies). Some companies may qualify for lower rates of 20 percent (for certain small companies) or 15 percent (for certain technology companies).
- The law also alters the tax-incentive structure. Most likely, incentives will be more narrowly tailored to encourage investment in certain industries, such as environmental protection, production safety, and clean energy.
- The new law provides for more stringent enforcement of the CIT, particularly focusing on *transfer pricing* — the prices for various goods and services that affiliated companies pay one another. (For info on representative office taxation, see Chapter 7.)

The rest of this section explains China's *currently effective* (as of writing) business tax framework, which the new CIT tax law alters. Despite the changes, reading this section is still useful because it can give you the lay of the tax land — particularly in regard to non-income related taxes. Also, portions of the current tax regime will remain in effect.

Speak with a tax professionals as soon as possible if you're seriously considering starting a business (or opening a representative office) in the People's Republic of China.

FIE income taxes and incentives

The biggest corporate tax in China is the income tax. All companies legally established in China are subject to a base income tax rate of 33 percent of pretax income (30 percent to the central government and 3 percent to the local government). FIE income tax must be paid within 15 days after the end of each calendar quarter based on estimated annual taxes, and FIEs must finally settle their taxes for a given year within five months of the end of the calendar year. We discuss representative office taxation in Chapter 7.

Even if you don't set up an FIE in China, your company may still be subject to China tax if you're doing business there. Depending on the type of business you're doing, your China-based customers may be required to withhold your taxes for you.

Under the current framework, FIEs are able to take advantage of a number of tax preferences that greatly reduce these rates. As a result, the average FIE actually pays taxes of only around 10 percent! Income tax incentives are usually available to an FIE based on several factors, including the following:

- How large the investment in the FIE is
- How much the FIE will export
- How advanced the FIE's technology is
- How closely the FIE's business matches China's economic goals

Take a look at the most common legally authorized tax subsidies:

- Manufacturing FIEs that the Ministry of Commerce (MOFCOM) or the Commission of Foreign Trade and Economic Cooperation (COFTEC) certify as "technologically advanced" can have their 50 percent rate reduction extended another three years, provided that their tax rate is at least 10 percent during this period.
- FIEs located in the Special Economic Zones (SEZs) — Shenzhen, Xiamen, Zhuhai, Hainan, and Shantou — pay maximum income tax of only 15 percent (after expiration of any tax holidays or reductions).
- Qualifying service FIEs in SEZs may have a tax holiday during their first profitable year and pay only 50 percent of the tax rate (in other words, 7.5 percent) the following two years.
- Qualifying manufacturing and high technology FIEs in various economic development zones may have reduced income tax rates of 15 percent or 24 percent, and they may be eligible for full tax holidays of one to two years and 50 percent holidays for additional two- to three-year periods.
- Local governments can approve complete exemptions from local taxes for encouraged foreign investments (see Chapter 7 for info on *encouraged* status).
- A foreign investor in an FIE who directly reinvests his or her share of the FIE's profit in that or another FIE with a term of at least five years can get a refund of 40 percent of the taxes paid on the amount reinvested. If the reinvestment goes into starting or expanding an "export-oriented" or "technologically advanced" company, the tax refund is 100 percent.

Note: It's technically illegal for local governments to offer tax subsidies beyond those specifically authorized by law. However, local governments receive a substantial portion of the central government's 30 percent tax on corporate income. They also receive a lot of money from the other corporate taxes. Therefore, the local government may have the means to offer your company large financial incentives (although as we mention in Chapter 7, stay away from land subsidies!).

The following incentives are currently common, but they'll be narrowed or will disappear under the implementing regulations of the new law:

- Manufacturing FIEs with terms of at least 10 years have a complete tax holiday for their profitable year and a 50 percent rate reduction for the next three years. This incentive is the minimum incentive available to manufacturing FIEs. Manufacturing FIEs can still qualify for other applicable incentives.
- FIEs that export at least 70 percent of their output in any year can have a 50 percent reduction in their tax rate for that year, provided that their tax rate is at least 10 percent.

Value-added tax for manufacturers

Manufacturing companies pay a *value-added tax* (VAT) on items they use as inputs for their production (that is, raw materials or parts). The VAT on most items is 17 percent. However, companies that export their production receive refunds of most or all VAT paid on the exported products.

Small businesses (defined as having sales of less than 1.0 million RMB or 1.8 million RMB, depending on the type of business) pay a VAT of 4 percent. These small businesses are not eligible for VAT refunds on exports, though.

Encouraged FIEs (FIEs that invest in sectors in which the government offers incentives for foreign investment — see Chapter 7) can import machinery and equipment free of VAT and customs duties, provided that they don't sell these items for at least five years.

Business tax on services

Service businesses pay business tax on their sales related to most services. The business tax varies between 3 and 20 percent of sales, but most services are taxed at 5 percent.

Individual taxes

China's individual income tax (IIT) system is progressive (see Table 10-1 for IIT rates). IIT must be paid each month. Employers located in China are responsible for withholding IIT payments from employees' salaries. As a foreigner, how much (if any) of your income is subject to China tax depends on whether it's China source income (see the upcoming section called "China source income for foreigners). As a foreigner, you're entitled to deduct a decent amount of your income for various living expenses. Your Chinese employees' income earned in China is all taxed at the standard rates, subject to only some small deductions.

Table 10-1 Individual Income Tax Rates

Monthly Taxable Income (RMB)	*Tier Tax Rate*	*Cumulative Tax Owed*
0 to 500	5 percent	0
500 to 2,000	10 percent	25
2,000 to 5,000	15 percent	175
5,000 to 20,000	20 percent	625
20,000 to 40,000	25 percent	3,625
40,000 to 60,000	30 percent	8,625
60,000 to 80,000	35 percent	14,625
80,000 to 100,000	40 percent	21,625
100,000+	45 percent	29,625

Here's how to use Table 10-1 to calculate the amount of tax owed each month:

1. **Calculate your China-source monthly gross income (see the following section for details).**
2. **Subtract all allowable deductions (which we discuss later in "Allowable deductions for foreigners") from monthly gross income to get the monthly taxable income.**
3. **Find the row that applies to the monthly income and subtract the lower end of the income range from the monthly income.**

   For example, for a monthly taxable income of 30,000 (RMB), you go to the 20,000-to-40,000 row and subtract 20,000 from 30,000, which gives you 10,000 RMB.
4. **Multiply the number you just got by the tier tax rate.**

   Multiply 10,000 RMB by 25 percent (the tax rate for that row), which equals 2,500 RMB.
5. **Add that number to the cumulative tax owed amount in your row.**

   Add 2,500 RMB to 3,625 (the cumulative tax owed for that row), which gives you a total of 6,125 RMB. The monthly tax payment is 6,125 RMB.

China source income for foreigners

In some cases, which income is China source income is clear. If you're being paid a salary by a company established in China, it's almost always China source income. However, if you're being paid by a foreign company (such as the parent), your income may not be entirely (if at all) considered China source:

- For people in most countries, if you're in China less than 183 days in a year while being paid by a foreign company, then none of your income is China source. If China doesn't have a tax treaty with your country, the cutoff is 90 days.
- If you're in China more than 183 (or 90) days, your income may not be entirely China source if your job involves non-China duties (such as Director of Asia). In this case, you need to determine what portion of your income is from your duties in China. However, the entire amount of salaries paid to senior managers in China (that is, China CEOs, CFOs, and so on) is usually considered to be China source.

As a related matter, China launched a compulsory individual tax filing system in January 2007. Under it, taxpayers must report their income with the local tax authorities if they meet one of the following criteria:

- Their annual income exceeds 120,000 RMB.
- They receive income from more than two sources located in China.
- They receive income from abroad.

After you figure out how much your China source income is, you can take your allowable deductions and then apply Table 10-1 to figure out about how much you owe in taxes.

WARNING!

If you live in China for five consecutive years without having been absent from China for an extended period in any one calendar year, then your global income will be subject to China tax. That means *all* your income from anywhere in the world will be taxed in China. If you're in China for the long haul, you may want to plan on taking a long holiday outside of the country sometime before you begin your sixth year in China. You need to leave for at least 30 consecutive days or a total of 90 days in any calendar year.

Allowable deductions for foreigners

Foreigners are entitled to a standard deduction of 4,000 RMB per month. Foreigners are also allowed to deduct "reasonable amounts" of the following expenses from income:

- Housing
- Laundry expenses
- Unprepared food and restaurant meals
- Transportation
- Two trips home per year with family members
- Language training and education for all accompanying family members

The key, of course, is how much is *reasonable.* It depends on the city and even on the district within a city. Your company's tax accounting firm should know what the local tax authorities' policy is. The tricky part is that at the beginning of the year, you have to estimate how much your deductions will be for the entire year. You then divide those deductions by the number of months you'll be paying taxes (12 for a full year, obviously) and subtract the monthly average deduction from your monthly gross China source income. Then you have your monthly taxable income.

WARNING!

You need to show official invoices called *fa piao* (fa pee-ow) for all expenses incurred in China. For expenses incurred outside of China, you need the receipts. If you don't have enough receipts and *fa piao* at the end of the year, you have to pay extra tax.

TIP

Always ask for *fa piao!* Many businesses, especially grocery stores and restaurants, don't give you *fa piao* unless you specifically ask for it.

Chinese employees' IIT

Chinese employees' IIT basically works the same way as foreigners'. The only real difference is that Chinese taxpayers aren't entitled to the deductions that foreigners are. Chinese employees are usually entitled to deduct only 1,600 RMB each month from their gross incomes. This is a standard deduction, so they don't need to show *fa piao.*

Part III
Conducting Daily Business

The 5th Wave   By Rich Tennant

In this part . . .

In this part, we show you how business gets done the Chinese way. We discuss how to conduct yourself in business settings, concentrating on the substantive aspects of doing business in China. We give you expert advice on finding suppliers and explain how to set up a factory the right way — and what to watch out for. Finally, we discuss selling in China from A to Z.

Chapter 11

Understanding How China Works (and Doesn't Work)

In This Chapter

- Figuring out the Chinese way to get things done
- Planning for business meetings
- Communicating with the Chinese electronically

China is known as one of the most challenging places to do business on the planet, so you have to walk before you run in the Chinese market. And you'll be doing a lot of figurative walking, because the Chinese like to do business at a different pace than what you're probably used to.

Keep an open mind when working with the Chinese. When you think things can't possibly work some way, you may be surprised to find out that they actually do! You can begin to understand better by reading this chapter. We explain a bit about Chinese business values, how to prepare for a business meeting, and ways to get your message across when you can't meet face-to-face.

Getting Things Done the Chinese Way

One thing's for sure: Things really work differently in China. To be fair, the Chinese would say the same thing about doing business in the West, so everyone has to make a few adjustments. Recognizing the differences in how things work is important to your success in China. Get it right, and you may find the key to success in the Middle Kingdom.

Honoring face

Face, or *mianzi* (pronounced mee-en-zuh), is a key cultural concept to understand when doing business in China. *Face* is very similar to pride, but how others perceive you matters more. In other words, nice compliments from your boss in a one-on-one meeting are good, but you don't get face until your boss singles you out in front of your coworkers as a model employee. Here are the three ways you deal with face in China:

- **Give face:** Giving someone face is easy: Treat him or her like a big shot, offer compliments in a group setting, or treat him or her to a big fancy meal at the trendiest new restaurant. Overall, make sure you're courteous. Giving face is really all about showing respect.
- **Save face:** Many Chinese say saving face is the most important kind of face; it has a grand tradition in ancient Chinese history through legends and stories. Saving face is avoiding a loss of prestige — most often, you save someone else's face rather than your own (hopefully somebody will do the same for you, too). For instance, perhaps you rescue a friend or contact who needs help in a business deal that's going sour. Or when disagreeing, maybe you qualify what you say as much as possible by frequently using *maybe, possibly, a little, might,* and so on to soften any possible embarrassment.
- **Lose face:** Losing face is a serious offence to the Chinese. You cause somebody to lose face by embarrassing him or her or through a private insult. The insult may not even be that damaging as far as you can tell, but a person's face is supersensitive to anything that someone maybe, possibly could perceive as an insult. You may accidentally cause someone to lose face in many ways. For example, perhaps you don't send someone of high enough rank to pick up an important visitor at the airport, get really angry at someone in front of others, or write or speak too directly to someone.

REMEMBER

The most important thing to remember about face is that losing it or causing someone else to lose it has consequences. If you cause somebody, even by accident, to lose face, you can expect never to receive his or her cooperation again. In fact, the consequences can be a lot more extreme than that: Even if doing a certain action (such as signing a settlement agreement) seems to make all the sense in the world for a Chinese person, he or she usually won't carry it out if it benefits a person who has made him or her lose face. Also, other Chinese people may think less of you or your company if you cause someone to lose face. After all, word gets around.

Note: You know you're making friends in China when your Chinese friends feel comfortable enough to joke around with you. The Chinese would never attempt to poke fun at you if they didn't consider you a true friend. This would be a grave insult and loss of face.

Focusing on consensus

Decision making in China is largely done by consensus. Thus, the Chinese work together to make decisions instead of passing along responsibility to one group or worker. Not only may the need for agreement cause delay, but you sometimes feel powerless to understand what's really going on.

Consulting Confucius for business advice

Tradition has it that Confucius, a famous Chinese philosopher and writer, lived about 2,500 years ago. This legendary scholar has influenced the Chinese system ever since. Many of Confucius's teachings can give you insight into the Chinese way of thinking and doing. Take a look at some of his most famous sayings:

- "Do not do to others what you do not want done to you."
- "Before you embark on a journey of revenge, dig two graves."
- "He who speaks without modesty will find it difficult to make his words good."
- "The cautious seldom err."

Confucianism is not a religion but rather an ethical and philosophical system. The teachings have had a particularly strong influence over China's politics and morals. You can see evidence of Confucianism in your business dealings as you witness the importance of reciprocity, patience, modesty, prudence, and hierarchy.

What foreign investors sometimes don't appreciate is what takes place behind the scenes. Because the Chinese work to gain consensus, a lot of healthy debate and internal conflicts are going on among them. Sometimes the internal debate or discussion may have nothing to do with your firm. Often, the Chinese themselves simply don't know how to proceed. This indecision can be the result of conflicts of interest, vague regulations or laws, or power struggles among certain officials.

TIP

While you're waiting for the Chinese to gain consensus, not knowing where you stand can be quite frustrating. You shouldn't expect the Chinese to voluntarily give you regular updates on the status of your project or deal. Your best approach is to stay in regular contact with them from time to time. Just check in every week or two.

Teamwork is a part of the cultural heritage that makes China what it is. It's a rich tradition and belief system, largely influenced by the scholar Confucius. His teachings are about respect and responsibilities to key relationships, including those with superiors, family members, and friends.

Working together for mutual benefit

Many Chinese want to participate fully in the opportunities that international business relationships provide, and your Chinese business partners want a win-win relationship. Therefore, making sure your working arrangement is mutually beneficial is up to you. You can find lots of profitable opportunities in China, so share the pie with your business partners.

Corporate giving in China

Corporate philanthropy has a long tradition in business, and the Chinese like to see that a company is committed to benefiting the nation. Therefore, if your company has the resources, you may want to consider giving back to China.

Whether the giving is focused on health and welfare or humanitarian efforts or education, foreign companies are helping China in many ways. Often, companies directly sponsor specific programs. For example, some companies build schools in China's rural areas. Others provide grant money or scholarships to students. Some companies even align their business activity to the effort. For instance, drug companies may provide healthcare, insurance companies may provide scholarship programs to actuaries, and wind-generating manufacturers may donate advanced products to rural farmers.

And some companies provide direct monetary support to the growing number of nonprofit organizations now operating in China. For instance, many foreign companies have supported Golden Key Research Center (`www.goldenkey.org.cn`), one of the earliest nonprofit organizations in China. Golden Key, which has been a UNESCO partner since 1998, aims to provide education for children with visual impairment or blindness.

The Chinese tend to do business with people whom they know and trust, and as your friend and business partner, they expect to be treated fairly. However, the Chinese can be somewhat suspicious of foreign businesspeople because foreigners have had a history of exploiting the Chinese (see Chapter 3). If your company doesn't have a lot of experience in cooperating with business partners, reconsider whether your company is ready to partner in China.

You may think the Chinese are too hands-on about the details of your business arrangements, but to them, they're just making sure that all your ducks are in a row. Get used to this involvement and remind yourself that working with the Chinese may benefit your business. After all, they understand the business landscape there better than you do.

Working with a Chinese company doesn't necessarily mean having a joint venture (JV). You can have contractual arrangements with the Chinese for things such as distribution, technology licensing, and so on. Of course, making a mutually beneficial deal with the Chinese can be tricky business. For details on negotiating with the Chinese, see Chapter 6.

WARNING!

As in anywhere in the world, plenty of untrustworthy businesspeople are out there. Some people may say all the right things about friendship and trust, but their intentions don't line up. Be on your guard when dealing with people you don't know. (For information on finding out more about whom you're dealing with, go to Chapter 17.)

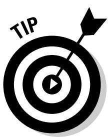
Although partnering or collaborating with the Chinese can deliver mutual benefit, many foreign companies prefer to control their own destiny. Some foreign companies go solo so they can understand how to build competitive advantage in the market. This may be a good alternative for your firm, but consider the risks and rewards before going it alone.

Developing patience

Make no mistake — the Chinese take a really, really long view. Before any business can really start, just getting to know and trust you takes time. After you're in, you have to wade through layers of government bureaucracy. Negotiations with the Chinese seem to take forever when you're dealing with the government, and getting approvals eats up even more time (for more on earning approvals, go to Chapters 7 and 8). The Chinese seem to have taken a page out of Confucius's book: "It does not matter how slowly you go so long as you do not stop."

The Chinese often discuss and consider issues internally for a while before making a decision. (However, their planning and decision-making processes are often far less sophisticated than what you're used to — for instance, they lack detailed financial models and market data collection.) Where you'd likely make a business decision, the Chinese prefer to mull it over a few days and consult a few insiders before committing. The benefit to them is that they make fewer mistakes and probably won't lose face.

Give full consideration to most propositions that the Chinese make. Because of the time involved in deliberating, failing to give full consideration to an important issue is almost an insult. (Of course, you don't have to consider outrageous demands — see Chapter 6.)



Be careful about deadlines that you may need to commit to *internally* at your company. A good guideline is to double how long you think a task may normally take. Don't necessarily look at this additional time as being all bad, though. Use the extra time to your advantage and research anything you're unsure of. Remember that being tactful wins you more points than screaming at the Chinese because of delays.

Chinese entrepreneurs on fast forward

Unlike the large and sluggish state-owned enterprises (SOEs), businesses in the private sector are used to getting things done at a breakneck pace. Chinese entrepreneurs need to get their products to market, build their company's brand, and get their business to reach economies of scale. They're trendsetters for the way business gets done today in China.

Entrepreneurs in China are on the move — especially in China's small- and medium-sized companies. Don't be surprised to hear comments such as "we need to get this done quickly" when working with Chinese entrepreneurs. Your business dealings with most private sector firms will move forward at a faster pace than with the SOEs.

Sending consistent messages

Foreign businesspeople are sometimes thought to be inconsistent in their business dealings in China. Try explaining to the Chinese why your company decides to go in a different direction — why new senior management who have never been to China are now in charge of dealings in the country or why your profit center is being combined into another business unit within the company. Don't be surprised if you get a lot of blank stares and silence from the Chinese when telling them about changes in your China plans.

The Chinese are usually consistent in their messaging with foreigners because of their consensus style of management, which requires them to work together internally to arrive at the right answer together. They all seem to be going in the same direction.

Make sure you're consistent in your dealings with the Chinese. That means that everyone in your company who deals with the Chinese needs to have the same goals and objectives for China. Everyone has to follow the same plan.

You don't want to show the Chinese that you have conflicting views within your company, which indicates disorganization. Be careful because the Chinese often try to take advantage of internal conflicting views and lack of harmony (see Chapter 6 for tips on negotiating). The Chinese will be watching every word you say that may be of advantage to them.

Being consistent means that you also need to get a good read on what the Chinese are saying to you. Take careful notes at all your meetings, and review them as a group afterward. It's a good idea to provide the Chinese side with a summary of your meeting notes for review to reduce the number of misunderstandings.

Sharing information

The senior Chinese business leader in charge manages and controls most of the information you receive. The Chinese are careful about sharing information or asking questions because they don't want to make a mistake that may cause them to lose face. The Chinese would rather hold their questions or comments for later and then sort things out internally before approaching you. They ask you to explain your view instead of asking specific questions.

Don't brainstorm or try to share ideas with the Chinese. Instead, listen carefully for clues on how the Chinese want to proceed. Don't be shy about asking the questions you need answered — just make sure you don't ask them the first time you meet the Chinese side. You may find common ground or understand how far you are apart in your thinking.

Many things may be communicated to you through other means. Sometimes, single representatives of the firm or a trusted middleman who has a good relationship with the Chinese company may give you an important piece of information at another time.

Don't give away important information about your firm's products or services. You can share appropriate information after you've struck a deal with the Chinese.

Keeping the dialogue going despite bumps in the road

Sometimes you think you're doing all the right things with the Chinese and then your discussion seems to fall apart. Perhaps internal approvals haven't yet been secured, your business partners are talking to your biggest competitor, or things are stalled with the local government politician who needs to give it his blessing.

Much of the time, the reasons remain a complete mystery. You can't expect the Chinese to tell you what you can do differently to improve your position. However, if the Chinese are committed to working with you, they'll likely keep the dialogue going with more negotiations. And if you have friendly relations with some key people, they may confide in you. Or an intermediary may be able to assist you in getting to the bottom of things. For more on unblocking strategies and negotiating with the Chinese, please see Chapter 6.

By now, if you have a contingency plan, you're likely looking at alternatives to your current plan. But if discussions look precarious, don't give up just yet. Some firms wait to see whether they have a chance for a breakthrough. If you're still waiting after a year or more to get approvals from the government, you probably want to make one last attempt at getting discussions going again before packing your bags and heading home.

Talking to the right authorities

Especially in state-owned enterprises (SOEs), the highest-ranked person you meet with may not have the decision-making power. A more junior Chinese businessperson may instead be a senior-ranking Party member, and the most senior Party official involved always trumps all other players. Be careful in your dealings with all business leaders you meet. Sometimes, you never find out which one is the senior Communist Party leader!

When dealing with privately-owned companies, the owner is often the decision maker. Although he or she may try to develop a consensus internally, the owner makes the final decision. You may be wasting your time speaking with somebody else when you're dealing with a private company.

REMEMBER

Getting to know who's in charge isn't usually too complicated. Because the Chinese are so focused on understanding the leadership structure of the delegation or group, they give you obvious clues about who's in charge on their end. The senior person and key decision maker from the Chinese side generally leads the discussion at the meeting. And if you're sitting across a meeting room table, the person opposite the leader of your delegation is the Chinese leader.

Making Face-to-Face Business Meetings Work for You

Communicating face-to-face is best because it helps build trust. By formally meeting with your new Chinese friends, you can hopefully create *guan xi* (right relations — see Chapter 15). You can later arrange one-on-one meetings with your business partners, and over time, you can bypass a lot of the formal meetings and do more business directly with your counterpart at the Chinese company.

Because formal business meetings in China can open up communication, they take on a new meaning for foreign visitors. Conducting business at formal meetings involves a lot of protocol, as the following sections explain.

Getting your basic presentation ready

Having your presentation ready before you arrive in China is the best way to get organized. Your presentation must be in English and Chinese (usually Mandarin) and be easy to understand. Make sure that the Chinese version of the presentation is correct and clearly explains your company's point of view. (See the info on translators in Chapter 2.)

The following sections explain what to cover in your first presentation and what format to use. We explain delivery in "Making a presentation," later in this chapter.

Content

Make the presentation short and sweet and you'll likely deliver the message. Within 10 to 15 pages, your first presentation should explain the following:

- The history of your firm
- The market you serve

- Your products and/or service
- Your main channels of distribution
- How many people you employ
- Other relevant details of your business

If you have experience in China or other parts of Asia, your presentation should say so. Tell your Chinese business partners if you already have experience in buying or selling products in Asia — for example, if you export products from California to Tianjin.

If your company does business with a well-known or particularly large or successful company, such as one of the Big Three automotive companies, be sure to tell the Chinese about that relationship. They'd like to know about your high-profile clients or suppliers.

TIP

If you have an impressive building as your headquarters, show it off with an appropriate picture in your presentation. You don't necessarily have to own the place — the fact that you occupy a significant business building is good enough. An impressive headquarters indicates that your company is highly successful and may be worth doing business with.

Mode of delivery

You can share information about your company by using handouts. Distribute the handouts as you start your presentation. Bringing along some company brochures or your annual report in English may help, too. The senior leadership may not be able to read English, but some of the junior people can give them the highlights of your handouts at a later time.

Consider sending your presentation to your hotel in China by express mail service before your visit. Some foreign visitors like to bring copies of the presentations with them on the flight. That way, there's no chance of losing them. Depending on where you're staying, you can get copies made at the business center at your hotel; however, you should first ask the business center whether they can print color documents. China's more developed cities have some copy centers, but they're not that widespread yet.

WARNING!

In more formal meetings, don't expect to break out a flashy PowerPoint presentation to kick things off. For less formal meetings in the private sector, making a PowerPoint presentation may be appropriate. Some of China's more sophisticated companies may make PowerPoint presentations, too. Check with your Chinese contacts before considering this option because you may have to make special arrangements well in advance.

Preparing to speak the local business language

China boasts many regional dialects, which are more like different languages than the differences you'd notice between the speech of an American and a Briton. English and Cantonese are the official languages of Hong Kong, although many people there speak some level of Mandarin these days. Cantonese is one of the most common dialects in the south.

In the mainland, apart from Hong Kong and Macao, most business meetings are conducted in Mandarin, the official language of China. In Chinese, this dialect is called *Putonghua* (pronounced poo-tong-wha; ordinary speech). For you, it's anything but ordinary! The good news is that you'll likely be doing business in English with translation into Mandarin. If you normally speak a language other than English, you generally need to find a specialized interpreter or speak in English.

Even if you have no Chinese skills at all, try to say a few words in Chinese. The Chinese will appreciate even a feeble attempt, so put aside your ego or self-consciousness. Just saying hello in Chinese (*ni hao;* pronounced nee how) is a step in the right direction. For some more Chinese phrases, see the Cheat Sheet in the front of this book. And for more information on Mandarin, check out *Chinese For Dummies,* by Wendy Abraham (Wiley).

Making an appointment

Setting up business meetings in China requires some advance planning. This section tells you a bit about scheduling the meeting and making sure your Chinese partners are prepared.

Setting a date and time

Your first step in planning a meeting is choosing the date. First of all, don't make any appointment when Chinese New Year is coming up. This holiday can fall in January or February. No business is conducted during the Chinese New Year week-long holiday (though Hong Kong and Macau celebrate the Chinese New Year over three days only). Also, business is usually very slow the week before Chinese New Year and a couple of weeks after. (For information on how you can celebrate the holiday in China, see the nearby sidebar).

Besides Chinese New Year, avoid two other major Chinese holiday periods. Labor Day starts a week-long holiday beginning May 1. The other big holiday period is the week-long National Day celebration from October 1 to 7. Business gets done right up to and just after these two holidays, unlike Chinese New Year.

Celebrating Chinese New Year

Chinese New Year is the biggest holiday in China. Often called the Spring Festival, Chinese New Year is considered the start of the spring season. The date is based on the Chinese lunar calendar, so the holiday takes place at a different time each year.

Chinese New Year is a great time for business partners, friends, and families to celebrate together. Many people share food, drink, and gifts during this special Chinese holiday. You and your business can join in the festivities of Chinese New Year in several ways:

- Treat your Chinese friends to a celebratory meal a couple of weeks before the official holiday.
- Send Chinese New Year cards to your Chinese contacts.
- Select an appropriate gift for your Chinese friends (see Chapter 16 for info on giving gifts).

But don't plan on traveling to China to do business during this time. It would be like trying to make business deals on Christmas or New Year's Day!

Business hours in China are from 8:00 a.m. to 5:00 p.m. from Monday to Friday. You may be able to arrange for a Saturday morning meeting, but you should do so only if you can't get a weekday appointment. Government offices generally have internal meetings on Friday afternoons, so don't schedule any meetings involving government officials at that time.

Meetings tend to be about as long as you'd expect elsewhere. They can be as long or short as necessary. Keep these points in mind when scheduling your meeting:

- You want to avoid canceling any appointment you make with the Chinese, so make sure you can honor the plans before you set up the meeting.
- Stagger the timing of your appointments while visiting your Chinese contacts. That way, you build in a time buffer in case an earlier meeting goes into overtime.
- As congested as most Chinese cities are, you need to build plenty of travel time into your schedule. (Please see Chapter 5 for info on traveling in China.)

Your business partners may invite you to a Chinese lunch after a morning meeting. That lunch may end up being a midday Chinese banquet (see Chapter 16). If you're not going to lunch with the Chinese, be sure to conclude your meeting before the lunch hour, around noon. Working lunches — in which everybody sits around the table and continues the meeting — don't exist in China. Also, people are often unavailable to speak by telephone during their lunch hours.

TIP

Always set up and confirm the meeting place and time by fax, e-mail, or telephone. As you get closer to the meeting date, follow up and double-check on things.

Choosing a location

Making appointments in China generally means meeting the Chinese at their offices. The Chinese pay a lot of attention to their surroundings. They believe that a location's *feng shui* (fung-shway) may have a direct bearing on the success or failure of their business. *Feng shui* translates to *wind and water;* it's a Chinese way to seek harmony, balance, and energy through the arrangements of objects, buildings, plantings and more. (For more info on *feng shui,* check out *Feng Shui For Dummies,* by David Kennedy, and *Feng Shui Your Workspace For Dummies,* by Holly Ziegler and Jennifer Lawler.)

TIP

If you have to arrange the location to meet the Chinese during your visit, keep in mind that surroundings are important. For an appropriate meeting place, you should be fine at any upscale meeting room in an upscale Western hotel. Just make the reservation for a room that meets your needs as you would at any hotel. Or if you happen to have your own office or shared business office in China, you can invite the Chinese to meet with you at your office, but do so only if your office location is highly desirable and can give your company lots of face. Don't meet in the hotel lobby, your room, or any bar.

Communicating your objectives

To prepare everyone for the business discussions, clearly communicate your objectives for the meeting to the Chinese well before you walk in. You can include your goals in a fax or do it verbally when you make the appointment. You don't, however, need to go into the specifics of the meeting. Meetings in China generally don't follow a formal agenda.

Making a respectful entrance

The Chinese place a lot of emphasis on protocol, and it extends to how your group enters a meeting. The following sections can help you communicate certain important signals to the Chinese party.

Getting there

Being late is disrespectful, so plan to arrive early. Your entire group should arrive together. If you're early, you can just wait outside if weather allows until it's time for the meeting. Being late — or even worse, not showing up for the meeting at all — can damage your relationship.

Finding the office location can be a bit of a challenge. Getting directions in advance can go a long way toward making your life easier. Allow yourself plenty of time to get there, and be sure to have a mobile phone so you can call or send text messages to your Chinese contacts if you're running late (see the upcoming section "Communicating Effectively Outside the Meeting Room" for details).

In major cities, street signs are in Chinese and English, but the English translations aren't always correct. Make sure that you have clear directions and/or an address before you get in a taxi, and don't let the taxi go until you're certain that you've arrived at the right address. (See Chapter 5 for info on getting around China.)

Asking your Chinese host for directions to your next appointment may not be a good idea. You don't want to share this type of information if you're meeting with one of their competitors! But if you're going to see your lawyer, for example, seeking some help is perfectly all right.

Entering the room and introducing yourself

The Chinese you'll be meeting with may already be waiting in the meeting room. As soon as you and your company representatives arrive, a representative of the company guides you to the meeting room. The senior person for your company should be the first to enter. The senior Chinese leader then welcomes your company leader.

Introduce yourself to as many people as possible before the meeting starts, and shake hands with both men and women. Usually, the higher ranking leaders are busy meeting each other, so not everyone meets at once. You may not meet everyone, and that's okay. The introductions can sometimes be a bit awkward because many Chinese people are shy and won't necessarily introduce themselves to you while you're milling around.

Exchanging business cards at the beginning of the first meeting is customary for the leaders and the rank and file (see the info on greeting and meeting the Chinese in Chapter 16). Often, exchanging cards with everybody in the room is impossible. Formally introducing yourself to somebody at the end of the meeting is okay, too, but do so quickly because meetings can sometimes end before you know it.

Keep the business cards you've exchanged on the table in order to keep track of who's who.

Finding your seat

In more formal business meetings, you use a large, well-appointed meeting room. The room is set up in a U-shape, with many comfortable armchairs and tables for setting down your tea. Leaders sit at the end, with Westerners on one side of the room and the Chinese on the other.

The Chinese leader guides the senior person from your company to his or her proper seat. The leaders sit across from each other, with a small table between them. Then the second-highest-ranking leader from your company sits on the other side of your senior leader. This process continues until you're all seated based on your rank in the firm. The Chinese side does the same so that equally ranked people end up across from each other on opposite sides of the room. (***Note:*** Your interpreter should sit just to the right of your leader.)

Instead of being in a reception-type meeting room, you may be in a typical meeting room where everyone lines up in rank order opposite one another (Chapter 2 can tell you more about rank). Thus, the group leader from the Chinese side sits across from your company's leader and so on down the line.

Meetings with privately owned companies put less focus on formalities of who sits where, especially when you're dealing with younger management or managers who've been educated or worked overseas. Just let the Chinese guide you to where they want you and your team to sit.

Taking time for tea

Tea is a part of doing business (and enjoying life) in China. When you arrive at a business meeting, you nearly always receive hot tea, usually green tea in a small cup with a lid. The Chinese don't add anything to their tea, so don't ask for cream or sugar.

You can certainly wait until the tea cools off before taking a sip. That way, the tea leaves sink to the bottom of the cup and don't get in your way. Of course, accidentally swallowing the tea leaves is okay. You don't need to finish the tea, but be polite and take at least a few sips during your business meeting.

If you finish your cup, someone may come by and refill it with fresh hot water. Unlike lower-quality tea bags, loose tea leaves can be used several times and still remain fresh. Be aware that the longer you let the leaves steep before you drink, the stronger the flavor will be, so if you aren't a tea fan, drink early so you don't look rude.

Making small talk

After the introductions are made and tea is served, some small talk is common. Any small talk should be between only the two leaders. Small talk can be about the weather, the wonderful hotel where you're staying, what day you arrived in China, and so on. In the meantime, the rest of the team should just wait until the leaders are ready to get the meeting going.

Takin' care of business

The first meeting with your Chinese contacts is more about getting to know each other. You probably won't get a lot of business done. Gradually, your meetings become more productive. This change happens when the Chinese side feels that they've gotten to know you better, can trust you and your company, and want to do business with you. This section explains a bit about how business meetings generally progress.

All the tea in China

Tea drinking in China goes back thousands of years. Tea was one of China's first major exports, and it remains popular in China to this day. The Chinese love sharing this part of their culture with others. Drinking tea is common in all business dealings with the Chinese.

Eight different types of tea are harvested in China: green, oolong, black, red, white, yellow, flower/scented, and compressed. Within those types are thousands of variations. Green tea, the most common tea offered to foreign visitors, is the most natural class of tea. It's dried by heat only and doesn't undergo a fermentation process. Green tea's taste tends to be light, slightly bitter, and possibly grassy. It has very little caffeine. Westerners are usually more accustomed to black tea, which is fully fermented, making it full-flavored and dark.

Tea is valued not only for its taste but also for its supposed medical benefits. Green tea is loaded with antioxidants and is said to lower total cholesterol levels, improve your ratio of HDL (good) to LDL (bad) cholesterol, and aid your body in fighting cancer, cardiovascular disease, and infection. Some have found that black tea also lowers LDL production and stroke risk in men.

REMEMBER

Because of the fear of losing face, the Chinese rarely make significant decisions during meetings. In most cases, you get the answer you're looking for at the next meeting.

Giving opening remarks

Here's how meetings usually start:

1. **The meeting formally begins when the leader of the Chinese group welcomes the foreign leader and the rest of the visitors.**

   Your company leader follows with some opening remarks, too.

2. **The senior leaders introduce their teams individually and explain each person's function within the company.**

   You don't need to get too hung up on titles for the more junior members of the team. In more casual meetings, each person may introduce him- or herself.

3. **The leaders exchange some broadly worded polite statements.**

   Open by saying how delighted you and your team are to have the opportunity to meet with the Chinese company's leadership. Give the Chinese side a turn to do the same.

4. **You make a brief introduction of your firm to the Chinese.**

   Do so verbally before launching into any presentation, and allow the Chinese side to introduce their company as well.

Relying on an interpreter provided by the Chinese side isn't a good idea. Often the interpreters are recent students or young professionals who probably don't know your business and its terminology. You want to make sure that your presentation makes the impact you planned. Therefore, having your own interpreter — someone you can work with fairly — is better for you and your company. See Chapter 2 for details on interpreters.

Making a presentation

Hand out your presentation just before you want to start so the Chinese side can read the Chinese version of your handout while they simultaneously listen to the Chinese interpretation. The ultimate goal is to improve communication with the Chinese and yourselves as much as possible. Bring plenty of extra copies with you, because sometimes more people than you expect show up.

From here, the person representing your company needs to kick off the discussion. The Chinese side expects the foreigner to lead the presentation, and they expect to follow you when you're finished. In most first meetings with the Chinese, your presentation is really about introducing your company, explaining your business and the company's history. Then you can begin to launch into the reason why you're there today to meet with the Chinese firm.

Be sure not to dominate the conversation with the Chinese when you first meet them. Give them equal time to give you their company story, too.

The Chinese place a lot of emphasis on rank, so the two leaders do most of the speaking and direct the discussion. Your company's leader needs to speak directly to the senior Chinese representative, so your leader should turn to face the senior Chinese leader, not the rest of the group or the interpreter.

Your leader sets the stage for discussion by introducing general concepts first. As he or she gets into the specifics, the leader can hand off a portion of the presentation to a technical expert. Use your team wisely to make the maximum positive impact on the Chinese — show off your company's expertise! Asking other team members to speak also allows each side to get to know who the subject matter experts are. However, remember that speaking up at a business meeting without being asked to do so by the company leader is disrespectful.

As the leaders converse, the others from your company can use the time wisely by taking notes about what the Chinese are saying and doing. Chinese businesspeople take careful notes at meetings with foreign visitors so they can recall what you've said for their benefit later.

Using interpreters wisely

A lot of business communication depends on using your interpreter well. We discuss finding interpreters in Chapter 2, but here's some advice on speaking through an interpreter during meetings:

- **Stay away from difficult words, slang, and industry jargon.** Avoiding difficult English words or phrases gives your interpreter more time to fully understand and translate what needs to be said. You're better off by speaking slowly and clearly in a Chinese meeting.
- **Say only about two sentences at a time and then pause for a short while.** Your interpreter then has a better chance of getting the words and concepts right.
- **Make eye contact with your Chinese counterparts rather than with your interpreter.** Some people say that the Chinese can be distrustful of people who don't make eye contact.
- **Don't rush the Chinese response.** Don't be surprised if the Chinese side chooses to pause and reflect on what's been said during the meeting. The Chinese often collect their thoughts before giving a reply to make sure they're giving an appropriate response.
- **When in social situations or during meeting breaks, make sure your interpreter doesn't upstage you with the Chinese party.** Your translator should translate even idle chit-chat between you and the Chinese. The translators should not be trying to impress themselves upon your Chinese contacts. Keep them in line!

Never assume that the Chinese don't understand English. Whether during the meeting or a bathroom break, be very careful about what you say.

Wrapping up the meeting

When the meeting is over, say *thank you* to your Chinese contacts. (You know when the meeting's over because one of the leaders says so.) You can thank the Chinese for their hospitality, the opportunity to get together, and the positive business discussions. Shake hands with all the Chinese on your way out, and send a final message about working together to the senior Chinese who's in charge.

You and your company representatives leave the room first. You don't leave the meeting room with the Chinese. They often send one representative to make sure you find your way out of the building or to the elevator.

Communicating Effectively Outside the Meeting Room

Because the Chinese value personal relationships, people prefer to do most business in person. However, with mobile phone use in China growing by leaps and bounds, getting in touch with the Chinese by phone is becoming an option. And other forms of electronic media, such as the Internet and text-messaging, are creating more opportunities to communicate with the Chinese, which is good for your business.

Using the telephone

People are doing more and more business on the telephone in China. Mobile phone use in China is skyrocketing. (In China, they prefer the term *mobile phone* to *cellphone*.) Mobile phone users in China now number close to 500 million, and around 50 million new mobile phone users are added each year in China.

WARNING!

Don't work by phone on important business matters unless it's absolutely necessary.

Reaching people in their offices

Reaching someone by the office telephone is difficult in China. Executives often aren't around because they're too busy in face-to-face meetings all day. Don't be surprised if you don't get through at all and the phone just continues to ring and ring.

Most senior Chinese businesspeople still rely on assistants to answer their telephones at the office. However, trying to reach your contact's assistant isn't easy, either. Get to know the office assistant — perhaps the assistant can give you a direct line to contact him or her if you have a problem.

Calling and using mobile phones

Calling mobile phones is the best way to get in touch with your business partners in China. Rarely do Chinese businesspeople turn off their mobile phones — even during business meetings! (You can set a good example by turning off your own phone.) If you know your contacts well, you can call them after business hours. Getting the mobile phone number of your Chinese business contacts, though, can be tricky. They usually have to know you pretty well.

Using your mobile phone in China may require you to make some changes to your phone if you don't have international roaming services before you go to China. Call your mobile phone provider at least a month before you leave to find out whether you can unlock your phone for use in China. If you can unlock your phone, you can use the services of a Chinese telecom carrier at a very reasonable cost. You buy a set number of minutes and can buy both international and China roaming services.

Get the message: No voicemail

Believe it or not, Chinese businesspeople don't use voicemail. They don't use it in the office. They don't use it on their mobile phones. They don't use it, period.

When Chinese people call you, they want to talk to you. They don't want to talk to your voicemail. So in China, you either get through to the person by phone or you don't — but you can't leave a recorded message. Most Chinese people don't have voicemail systems at work or on their mobile phone. If you can't reach your contact by phone, send a text message (SMS) instead of continuing to call.

When you're in China, you can easily purchase a pre-paid SIM (Subscriber Identity Module) card (called a *SIM Ka*) with cash in any major city to make international and local calls through a Chinese telecom company. This way is cheaper and easier than roaming. You can purchase a SIM card at convenience stores, newspaper stands, and many other places. Be sure that you have text messaging (SMS) service, too.

SMS and text messaging

China accounts for about half of text messages, or Short Message Service (SMS) messages, sent globally. About 25 billion text messages are sent each month in China. Over the Chinese New Year week-long holiday, more than 12 billion text messages were sent. No wonder some people call China the "thumb economy"!

Young people in particular like sending SMS messages because it's much cheaper than making a call. Sending an SMS message in China costs about US$0.01.

Many of your contacts may communicate with you by SMS in China. Where you may expect to receive a voicemail or mobile phone call, you'll likely get a text message instead. Your Chinese contacts can send text messages in both Chinese and English.

Faxing

Using a fax to communicate with Chinese businesspeople is usually pretty reliable. Most large businesses have dedicated fax machines to handle inbound and outbound faxes. Some companies are more organized than others, so faxing documents to China may be more hit-or-miss than what you're used to. Make sure that you follow up with your Chinese contacts to see whether they've received your fax.

Small- and medium-sized companies may have a phone that also does double duty as the fax. If the phone number is the same as the fax, you may need to tell your Chinese contacts to make sure the fax machine is on.

E-mailing and the Internet

China has more than 100 million Internet users. About 80 percent of China's Internet users are under the age of 35 with a large number of them being students. Still, although e-mail is popular among Chinese Internet users, the mobile phone is the emperor!

With so much focus on personal interactions, China's use of e-mail is more limited than elsewhere (especially for older Chinese, who are more comfortable doing business face-to-face and sending documents by fax). You can't convey body language and tone of voice, so when communicating by e-mail, be especially careful to keep the big words and jargon to a minimum.

You can usually get high-speed Internet access from your hotel either in your room or at the business center without a problem, so bring along your laptop to stay connected. Many Western restaurants offer free wireless Internet access as well. Internet cafes do exist, but being in your hotel is a lot more comfortable (and usually much less smoky). The Coffee Bean offers free wireless Internet access in its China stores; Starbucks requires users to buy a prepaid card to use wireless.

Internet regulations in China may prevent you from accessing certain Web sites (for instance, you won't be able to access Wikipedia), which should have little effect on your day-to-day business dealings in China. Your e-mail communication to and from your office and locally in China shouldn't be a problem.

Chapter 12

Sourcing from China

In This Chapter

- Finding and evaluating suppliers
- Concentrating on agreements with suppliers
- Watching out for sourcing pitfalls
- Ordering and shipping

Chinese manufacturing has literally changed the world by lowering prices on numerous goods. In many products and industries, China offers the best combination of low prices and manufacturing capability in the world. That's not to say that China is the lowest-cost producer — it isn't anymore. China isn't necessarily the highest-quality producer, either — that depends on the industry. But China's capabilities in a lot of areas are much better than its low-cost competitors' are.

You can get almost any product made in China. The trick is getting it made well and delivered without incident. This chapter helps you find suppliers and avoid common issues.

Understanding Why You May Want It Made in China

We can name three reasons to source production from China:

- **Cost:** Chinese factories are often able to produce for less because overhead is cheaper and because they can use manufacturing models that are newer and more efficient than in the West. China's low-cost labor can mean savings on labor-intensive goods.
- **Capability:** China is set up for business. It has good infrastructure, qualified engineers, and thousands of companies ready to supply parts or services. China can be a one-stop shop.

Outsourcing, briefly

China offers selective opportunities for businesses to outsource certain functions. For instance, a number of multinationals outsource software development to China, which is where China's strength in outsourcing lies. However, the software outsourcing market in China is highly fragmented, with about 8,000 providers. Only the 15 or so largest companies have more than 150 people. Most firms are Chinese-owned.

China's cost in this area is usually lower than India's, but depending on whom you ask, China is 10 to 30 years behind India in developing its outsourcing industry. The main reason is India's better English capability. As a result, China isn't as strong in business process or enterprise application outsourcing as India is.

China does have a unique feature in the outsourcing market, though. In northeastern China, a number of people are proficient in Korean and Japanese. As a result, China is in a strong position in outsourcing for those markets.

- **Markets:** Your company may want to someday sell in China. Setting up a supply chain in China now can make selling much easier when the time comes.

WARNING!

Just because you can get something made cheaper in China doesn't mean that sourcing from China is a good idea. Your product may cost a fortune to ship. Poor-quality parts or the loss of intellectual property are important intangible costs to think about. Outsource to China only when

Cost in China + shipping + other costs < cost at home

TIP

The best products to source from China are those that require a lot of labor and/or that will be produced in high volumes. In most cases, products that are entirely machine made should be made at home — the machine that makes them will cost the same there as it does in China. Having custom jobs or small batches done in China usually isn't a good idea because China doesn't yet have an artisan class of skilled workers who take pride in producing short runs of quality products. Most Chinese factory workers are best at simple and repetitive tasks.

Working with Suppliers

You can work with two types of suppliers: factories and trading companies. A lot of the decision regarding which way to go depends on your product and how much of a presence you can maintain in China. Whether you go with a factory or trading company, you have to watch out for quality issues.

Finding suppliers

Finding suppliers in China is relatively easy. Finding *good* suppliers isn't! Ironically, China's explosive growth has made good suppliers harder to find because the market is flooded with so many poor operators.

You can find suppliers remotely, but you should always go to China to perform due diligence (DD). Here are a few ways to connect with suppliers:

- **Ask for referrals.** Hands down, the best way to find suppliers is to receive referrals from people you trust. (For tips on networking, see Chapter 15.)
- **Peruse trade magazines for your industry.** Just check out the ads and the companies in the featured articles.
- **Surf Web sites that have a good deal of suppliers from China.** Three of the better-known sites are `www.alibaba.com`, `www.globalsources.com`, and `www.tradenet.com`.
- **Attend trade shows.** China has numerous industry trade shows, and odds are that your industry has at least one trade show per year there.

  TIP

  The gargantuan Canton Fair takes place biannually, every April and October (`www.cantonfair.org.cn/en`). If you're thinking about going to the Canton Fair, plan early! Hotels and flights fill up quickly.

The middleman: Surveying trade-offs of trading companies

Trading companies are middlemen between you and factories. Good trading companies can add a lot of value. They often know the right supplier for your product, manage the supplier, do quality control (QC), and pass along volume discounts. Usually, trading companies have people who speak better English than factories do, and they're most accustomed to dealing with foreign customers.

Perhaps most importantly, a good trading company will make you whole (by giving money back or ensuring you get the product somehow) when you have problems with the order. Even good factories can have internal problems, such as turnover issues, that you're not aware of. A good trading company that specializes in your industry can stay on top of these changes and seamlessly find new suppliers.

A trading company saves the day

A foreign-owned trading company was working on a particularly large furniture project for a new luxury hotel in the South Pacific. The trading company approved a sample for a teak chair from a large Chinese factory. When the factory completed the order of 1,000 chairs, the coloring of the teak was completely off. The trading company suspected that the factory used inferior wood, but the factory vehemently denied any wrongdoing.

Instead of allowing the customer to be inconvenienced by the squabble, the trading company immediately found another factory to produce the chairs. The other factory was backlogged with orders, so the trading company paid a lot of its own money to go to the front of the queue. The second factory then produced the chairs on time and to specification.

Even though the trading company had to find another factory, was out its deposit on the inferior chairs, was out a lot of money to the second factory, and was gearing up to do battle with the first factory, the customer never knew there was any problem!

Some people don't like dealing with trading companies because they (sometimes incorrectly) think they can save their business money by dealing directly with the factories. Not to mention, bad trading companies can cause a lot of problems, too. Many trading companies are fly-by-night operations that won't be able to reimburse you if they have problems with the order. These companies often don't do QC and can end up costing you a decent bit more than dealing directly with the factory would.

WARNING!

If you come across a trading company that first tries to pass itself off as a factory, run! A number of trading companies impersonate factories because they want you to think they control the production process. These companies are usually amateurish and lack the honesty to make you whole in event of a problem.

If you're considering dealing with a trading company, you want to ensure three things:

- It has the financial strength to compensate you for problems.
- It's well run.
- It's not on your home government's "restricted" list.

Operating on a shoestring budget is easier for Chinese trading companies because the registered capital requirements for Chinese firms are lower than for foreign ones.

TIP

Do due diligence (DD) on trading companies. View their business license (see Chapter 17), which shows their registered capital; the more registered capital, the likelier the company is to be financially strong. Visit the trading company's offices and apply a common-sense test. The Chinese are very much into appearances, so if they can't make the company look decent, you have little hope that it actually is. You should also ask for a customer list and do some cross-checking.

Straight from the source: Dealing directly with factories

Factories may be able to give you lower prices than you'd get from many trading companies. Also, starting a factory takes more money than starting a trading company, so the factory you work with is less likely to fold unexpectedly. You must still do on-site due diligence (DD) on factories, however, just as you should with trading companies. The following sections explain what factory DD and quality control (QC) involve.

TIP

Factories in the same locale often produce similar goods at similar quality levels and have similar levels of customer service. If you can't find anyone who knows the particular factory you're considering, see whether people can give you a sense of the reputation of factories in the area.

Completing factory due diligence

Due diligence doesn't do much good if you see the factory when it isn't humming, so tour the factory when it's in the middle of a production run. Make sure your senior technical person participates in the DD.

In most cases, factory inspection isn't rocket science. Here's a basic checklist of items to focus on when you tour a factory:

- **Cleanliness:** Appearances count for a lot. If the workers, managers, or the factory appears sloppy, assume that attitude carries over into their products — especially with electronics.
- **Organization:** See the entire process — from where materials come in to how they're processed into products to how and where they're stored. Think about whether the workflow makes sense and is efficient. If some things don't make sense, ask questions. If you still can't figure out why the factory is doing something a certain way, that's a red flag.

Pay particular attention to where finished goods are stored and shipped from. You certainly don't want any of your order to go missing or be placed on the wrong container!

- **Machinery:** Have someone at the factory tell you about the machines. What exactly do they do? How old are they? What are the brands? Where did they come from? How much maintenance is required? Does the factory have the equipment to cover all stages of the production process? The answers may mean little in and of themselves, but you may understand some important points if you compare factories (which you usually should). Plus, asking questions sends the message that you pay attention to details.
- **Quality control (QC):** Ask to see the data on the QC inspections on incoming materials. You may also want to inspect the factory's suppliers, depending on the type of inputs. Factories can also have QC inspections at various points throughout the production process. Finished goods should always undergo at least some inspection.

  Regardless of how many QC checkpoints the factory uses, the location of the checkpoints and where and how the failed parts are handled should be clear. If that information isn't clear to you on a walkthrough, it likely isn't clear to the workers, either!

  Some factories may have received certain process certifications, such as ISO 9000 and 9001. If you're interested in the factory's certifications, make sure they actually follow the certification requirements in everyday production.
- **Employee conditions:** Make sure the factory isn't using prison or child labor. Ask to see the employees' cafeteria and dormitories. You shouldn't expect the Four Seasons, but the dorms should be clean and orderly. Find out how long the employees have for lunch and how long their shifts are. Ask about what training the employees receive. See whether the factory offers much of a career path for them. Happy employees do their jobs better and are less likely to cause production delays and quality issues through turnover.
- **Location:** You want to understand and evaluate the factory's location for three reasons:
  - **Utility quotas:** Limits on electricity can be especially problematic — particularly for factories in and around big cities. You want to assess the area's utility reliability and whether the factory has backup facilities. Water may also be rationed in certain areas.
  - **Closeness to suppliers:** If the factory's suppliers aren't that close, really pay attention to the inventory — try to figure out whether

- they keep enough raw materials on hand to deal with an unexpected supply bottleneck.
- **Proximity to a port from which they can ship you the goods:** You obviously don't want a backup on the way out of the factory, either.

Doing your own quality control

When a factory is producing your order, being there to do your own QC is best. If you're big enough, you can maintain an office in China that does onsite QC during production runs. These offices can look for new suppliers, too.

Foreign companies that don't have China offices commonly send people to China during production runs. These employees do constant QC at the suppliers' factories, often for several weeks at a time. For higher-end goods, have somebody from your company live at the factory 24/7 during production runs.

WARNING!

Be careful if you send a low-paid employee to do QC — buying off somebody earning only US$300 per month isn't that hard. Inspect the products before they're packed for shipment. Also consider doing a loading and stowage inspection for the first few shipments so you can be sure the goods are properly loaded into the container. When you receive your shipment, check both the quantity and quality of what you receive.

If you're unable to have someone live at the factory during production, note that some companies specialize in QC (as well as factory DD). Some are good, but others may take kickbacks from the factories. You can find QC/DD companies on the same trading Web sites where you find factories and trading companies.

Following Tips for Supply Agreements

The number of large multinationals that don't do a great job with their supply agreements is surprising. You do have to make your agreements as concise and clear as possible (if you hand potential suppliers documents as thick as the Bible, no one will sign them); however, you shouldn't skimp on some areas. The tips that follow don't make for a complete contract in and of themselves. Rather, these are areas where companies often mess up their contracts.

TIP

Avoid using the supplier's contract, which is likely one-sided and full of potential pitfalls. Make sure you negotiate the final contract.

Product description

Closely and carefully describe the product you want, referring to any samples you've already approved (hopefully by mutually signing and dating them).

If you don't yet have approved samples, state that the product must be exactly like (or similar to, depending on the product) the samples that you're going to approve. In that case, write the sample approval process into the contract. Also, make sure you describe the quality of the product. If you have detailed prints and designs, reference them in the contract. The more specific, the better protected you'll be.

Delivery date

You want to specify the date on which the products should be delivered. Putting in a penalty for late delivery — for example, $100 per day late — is often a good idea. You may not want to actually enforce the penalty, though, which can lead to other problems (such as the supplier's cutting corners). However, the penalty is there as a disincentive for late delivery, and you have the option of enforcing it.

Payment terms

The agreement should clearly state what payment terms you've agreed to. Also, as we discuss later in "Placing Orders," your agreement should usually state that the supplier will pay all miscellaneous fees and expenses involved in getting your goods onto the ship. Use the phrase *including without limitation* when specifying these costs in the contract.

Insurance

The agreement should state who will pay for cargo insurance. The terms of sale determine who's obligated to make arrangements for insurance. For instance, if you buy FOB Shanghai (see the upcoming "Purchasing goods via free on board arrangements" section), you're responsible for insuring the goods after they're loaded on board the overseas conveyance.

No toxic substances

Remember that toxic substances can be a really big problem for your business. Your supplier should agree not to use any toxic substances *including without limitation* the ones we mention later in "Including substances that are toxic to your business." Do additional research to find out what other toxic substances you should specify as prohibited.

Indemnification

Ideally, you can get suppliers to agree to broad indemnification. With *broad indemnification,* suppliers agree to protect you against any and all costs, fees, liabilities, losses, and so on that arise from their performance (or nonperformance) under the agreement.

In reality, few suppliers are likely to go for something that broad. You may have to cap liability or limit indemnification to certain situations. You should seek fairly broad indemnification for liability for their using toxic substances, though. In addition, you may want to make them responsible for all costs and legal fees for enforcing the contract.

If indemnification ever becomes a major sticking point in a negotiation, be realistic about how much the supplier can actually afford to indemnify you for. This provision doesn't help anybody if the supplier ends up going bankrupt because of the indemnification.

Binding arbitration

You're almost always better off having binding arbitration clauses in your agreements in China. Protectionism is much less likely, you usually get a more competent adjudicator, and arbitration is more transparent than with Chinese courts. We discuss arbitration in more detail in Chapter 17.

Avoiding Pitfalls When Working with Suppliers

In simple terms, when you're sourcing from China, you're usually worried about losing your money and/or getting bad or late products. Here, we discuss a couple of the more-common problems you can have when sourcing in

China. Also, we go over the issues of intellectual property (IP) theft and toxic substances, which can cost you a good deal more money than your deposit.

Not getting what you bargained for

The most common issue in sourcing is getting products that don't actually match the samples you approved. The best way to protect yourself is to keep evidence of the approved samples. Make sure your supply agreement includes the following approval process:

1. **Request at least four final samples from the supplier.**
2. **Have the supplier sign and date all four samples.**
3. **After you approve the samples, sign and date all of them as well.**
4. **Give two of the samples to the supplier and keep the rest in a sealed box or container (if they're small enough).**
5. **Either have the seller date and stamp the sealed box with its chop (official company seal) or go to a Chinese notary public to date and chop the box.**

   If you have to go to arbitration or court (which we discuss in the "Binding arbitration" section and in Chapter 17), you have evidence of what the approved sample is.

You may also get something other than what you bargained for if the supplier switches materials on you. Do a common-sense check on the price quote you receive. If they're charging less for the final product than what purchasing the raw materials should cost, watch out! Depending on the product, you may want to require that an independent lab certify the materials for each shipment.

Being outsourced: The factory's factory

Another common problem is that your order gets outsourced (in part or entirely) to another factory. Outsourcing is a problem because you've inspected and approved a particular factory, but you have no idea what the other factory is like. As a result, your product quality is hit or miss. When doing DD on a factory, focus on whether it has machines that can produce your product. The only other way to guard against outsourcing is to be at the factory during production.

Losing your brand or technology

You've probably heard that intellectual property (IP) protection in China is difficult. It's true. If you have a good brand, you may put it at risk just by speaking with potential suppliers. After you introduce yourself, they may figure out that your brand is strong and trademark it themselves in China (China doesn't recognize foreign registered trademarks — see Chapter 17 for details). Therefore, trademarking your brand in China before even looking for suppliers is a good idea.

You're also at risk of losing valuable technology or design. One thing that's key to protecting IP in sourcing is compartmentalization (see Chapter 17). Have different factories produce different parts of the product, and make sure that these factories aren't located near each other and that they remain as anonymous to each other as possible. If you do compartmentalize, closely monitor how well each factory adheres to your specs. Otherwise, it may lead to assembly issues, which can in turn lead to the factories' blaming each other for the problem.

If you may be exposing your brand or technology when speaking with a potential supplier, first require them to sign a non-compete/non-disclosure agreement.

Including substances that are toxic to your business

One issue that's becoming big — and can put you out of business — is liability for toxic substances in your products. You can have major liability even if the substances are only in the inks! Here are some elements to watch out for:

- Cadmium
- Chromium
- Lead
- Mercury

These elements are fairly common in cheap toys and goods, so protect yourself in your contract and through testing. Your supply agreement should specifically exclude toxic substances. Your contract should also require the supplier to fully *indemnify* you (be financially responsible) against all costs and expenses incurred as a result of toxic substances in your products.

The Europeans have a toxin-free standard for electrical equipment and electronics called the Restriction of Hazardous Substances (RoHS) directive. RoHS-compliant products cost a little more. Some customers think paying the premium for RoHS products is worth the cost; some don't. You can specify that you want RoHS-compliant products in your contract.

TIP

Test the final products to make sure they don't contain toxic substances. One company that carries out this testing is the Société Générale de Surveillance (SGS Group) (`www.sgs.com`). It has offices throughout the world and can test in China and in many home markets. Each sample usually costs a few hundred dollars to test and takes one to two weeks. Consulting with a product liability attorney in your market to figure out how to best protect yourself against liability for toxic substances (and other product liabilities) is also a good idea.

Placing Orders

This section discusses the ordering process, which is fairly standard. As you and the supplier get to know each other better, you'll be able to get some more favorable terms.

Putting down a deposit

The standard deposit for a new relationship in China sourcing is 30 percent. As a supplier gets to know you better, they may reduce the deposit. In most cases, you shouldn't have to pay the deposit until you've approved the samples; however, if producing the samples is really expensive, you can deal with the upfront costs in a couple of ways:

- Sign a purchase agreement stating that you'll purchase a minimum amount of product if you approve the samples.
- Pay for tooling costs (if they're expensive) but have these costs offset against your first order.

REMEMBER

When you put down your deposit, always be ready to lose it and walk away. Losing your deposit doesn't happen often, but you shouldn't be shocked if it does. If the deposit's large enough, you can pursue legal action — particularly if your contract has an arbitration clause (see Chapter 17); however, a few thousand dollars may not be worth pursuing.

Purchasing goods via free on board arrangements

The most common way of purchasing goods is free on board (FOB). *FOB [origin port name]* means that the seller must deliver the goods on board a ship (or airplane) at the port of origin. If you buy FOB, the factory delivers to a freight forwarder that you choose (see the next section).

You can negotiate to have your suppliers handle freight forwarding arrangements; however, we don't recommend it. Many suppliers will look for the lowest cost, which may lead them to use a fly-by-night forwarder.

Some goods, particularly electronics and chemicals, must be inspected and certified at the origin port, a process that usually takes a day. With FOB, the supplier usually covers all locally imposed fees and charges, including inspection charges. Even though covering these expenses is customary for suppliers, make sure you get that in your agreements!

Suppliers usually want to be paid in full before they load the container (in a new relationship) or upon delivery to the port. You can try to negotiate this point, though. From your standpoint, paying only after you receive and inspect the products is best. A more realistic compromise in a new relationship may be to pay when you can see the bill of lading. The *bill of lading* formally indicates that that the carrier has received the goods.

Pay for the balance of your product through a letter of credit (LC) if the seller agrees. Chapter 10 discusses LCs, which provide additional protection in case of a problem with the product or delivery.

Shipping Your Products by Using Freight Forwarders

Freight forwarders receive your products at the port and send them on to the destination. Finding freight forwarders located in your home country is easiest; they have either offices or agents in China.

When using international freight forwarders, breakage and pilfering don't happen too much. However, testing a new forwarder with a small shipment first is best. Using a forwarder that has its own office at the origin port may also be safer. Good freight forwarders usually differentiate themselves by updating you on shipping schedule changes.

One common issue with freight forwarders is that they often raise rates on you after they have you as a customer. Shipping pricing varies by time of year and availability of space, and forwarders look to take advantage of you especially during peak seasons.

Depending on the season, ocean shipping costs from China to the West Coast of the U.S. are usually between US$60 and US$80 per cubic meter; getting your cargo to the West Coast usually takes three weeks. For rush orders, you can also ship by air. As with other methods, shipping by air is seasonal, with prices generally ranging between US$325 and US$500 per kilogram (2.2 pounds).

TIP

Deal regularly with at least two freight forwarders. This way, you can play them off each other in terms of pricing.

WARNING!

If you cancel a shipment at the last minute, freight forwarders usually charge a US$400 to US$500 penalty. Many suppliers agree to pay this penalty if their failure to deliver on time causes you to cancel. Put this clause in your supply agreement.

Chapter 13

Manufacturing in China

In This Chapter

- Why you should manufacture in China
- Producing for the local market
- Figuring out location and surviving construction
- Getting permission and permits
- Finding and keeping factory workers
- Taking care of quality control

In a broad sense, two manufacturing strategies for foreign-invested enterprises (FIEs) exist: producing for export and producing for the domestic market. Your company may do both. Both producing for export and the domestic market are challenging, and generalizing about how to execute either is difficult because so much depends on individual circumstances.

In this chapter, we're assuming that you already know something about manufacturing (if you don't, you may want to think twice about setting up a factory in China!). We talk about the major adjustments you should make when manufacturing in China. We also assume that if you're manufacturing purely for export, you know who your customers are; therefore, we focus our distribution discussions on producing for domestic markets.

Being Realistic about Savings

The first myth about doing business in China is that manufacturers will save tons of money on labor costs. The average wage of Chinese factory workers *is* a fraction of the wage of their Western counterparts, but remember the following:

- Wages depend on the industry, of course, but even in the West, labor is a small portion of per-unit costs of many products.
- You often find a skills gap between the Chinese and Western workers, so companies may have to throw more workers at a given task in China than they do in the West.
- Manufacturing in China also has a lot of hidden costs, such as electricity shortages and high labor turnover.

Most manufacturers overestimate how much money they'll make initially. You can reasonably expect that during the first two to three years, your company's per unit costs will be the same as in the West.

So why bother? Understand that you can manufacture a lot cheaper in China than in the West but for different reasons:

- Utilities, rent, land, and other operating costs are usually a good deal less than in the West.
- Because you don't have "legacy" manufacturing models in China, you can use newer and more efficient manufacturing methods there.
- Construction costs in China are also much lower than in the West.
- The high concentration of suppliers in certain parts of China helps keep costs down, too (see Chapter 12 for info on suppliers).

Some companies get so fixated on reducing costs that they do the following (it's illegal, and you shouldn't do it): They import fully-depreciated machinery, spruce it up a bit, and declare it at inflated values. They then use the inflated-value machinery as registered capital contributions (see Chapter 7), which reduces how much they need to contribute and makes getting loans easier. Perhaps most importantly, they get the tax benefit of re-depreciating the equipment. Watch out if somebody tries to talk you into doing something illegal.

Considering Industry Development

Think about how developed your industry is before pursuing manufacturing in China. Different industries are in different stages of development. For example, the Chinese steel industry is world-class in terms of quality and capability; the automobile industry isn't really there yet. Foreign investment has driven the development of some industries in China, such as telecom and automotive. Other industries — such as steel and shipbuilding — develop mainly because the government emphasizes them and focuses on building infrastructure to support them.

If you have a manufacturing capability that isn't developed in China, the situation offers both an opportunity and a risk. You can be one of the first in your industry to take advantage of producing in China, thereby giving you a competitive advantage. On the other hand, some of your technology and processes *will* be copied if you're an early mover into China. Also, you're probably going to have to put in a lot of effort training your workforce.

Entering a developed industry may be less painful because the government should have a better understanding of what you're doing, somebody else already lost more IP than you likely will, and you may be able to find workers with some experience in what you do. However, competition will already be tight.

Looking at Manufacturing Challenges for the Chinese Market

You can break manufacturing for the local market into two categories:

- **Manufacturing inputs for goods that'll be exported:** If you're an original equipment manufacturer (OEM) for goods for export, your customers are just as likely to be FIEs as Chinese. You may even be dealing with the Chinese operations of some of your current customers. In any event, this strategy is the less tricky of the two because you ordinarily have less price pressure and may find it easier to differentiate your products based on quality.
- **Manufacturing items that'll stay within China (the pure domestic strategy):** Assuming that you have Chinese competition for the domestic markets (whether producing as an OEM or making finished products), you're likely going to be subjected to more price pressure while finding that your potential customers aren't that interested in paying more for quality. The Chinese are beginning to pay more for quality, but this can be a difficult strategy.

Many successful manufacturers ultimately do a combination. They first manufacture exclusively for export. Then they gradually begin testing the domestic market's waters.

This section discusses some of the challenges of manufacturing for the Chinese market — whether for sale directly to consumers or to other manufacturers — and why you can overcome them.

Struggles to cut costs enough to compete in domestic markets

In most products and segments, the Chinese consumer market is very price sensitive (see Chapter 14). This used to mean that purely domestic manufacturers needed to squeeze blood from turnips to cut costs.

Chinese companies are almost always going to be better at extreme cost-cutting. They're sometimes willing to cut corners in areas (such as working conditions, intellectual property rights, and product quality) that FIEs aren't. Moreover, larger Chinese manufacturers may have costs of capital that are lower than yours because they have strong connections with Chinese banks. The below-cost financing situation is changing, but the fact still remains that a number of Chinese manufacturers aren't under the same pressure that you are to generate a high profit margin.

Highly distributed distribution

Distribution in China is much more complicated than in most Western countries because Chinese distribution and logistics industries are geographically fragmented. Although warehousing and distribution are improving along with China's infrastructure, they're by no means comparable to the West's. You may need to deal with dozens of (if not more) transportation companies. (We discuss distribution in detail in Chapter 14.)

TIP

Think about who your customers are. Try to reach out to potential customers to ask about their delivery requirements. Hopefully, they'll tell you which companies (or types of companies) they use to deliver their goods and supplies. Also, speak with people within your industry to understand the distribution picture. Figuring out the distribution issues takes a while.

Why foreign manufacturers can succeed

The Chinese are becoming more quality conscious in some product categories (see Chapter 14 for details). However, even if you're not manufacturing for high-end mobile phones or other products where the Chinese will pay for quality, you can still find opportunities.

Good service

Many Chinese manufacturers are still not great on the customer service side. Some larger Chinese companies pay more to deal with suppliers that provide them with good service. However, before you start planning to sell your components on the basis of service, expect that you'll need to be in the market for a few years before you get much traction — after all, stability is part of good service.

Quality, standardized products

In many cases, FIEs do standardized products better than Chinese manufacturers do. Pursuing purely domestic strategies is becoming easier because of the small but growing demand for products that conform to international standards (such as the International Organization for Standardization [ISO], the Restriction of Hazardous Substances Directive [RoHS], and so on). Some of the demand is the result of purely domestic manufacturers pushing for higher quality, and some of it's driven by government regulation.

Selecting Your Site

Site selection is crucial to your factory, but it's commonly an area where companies become fixated on one thing to the detriment of their overall business. It plays a large part in determining whether you succeed or fail because it affects (among other things) your ability to receive inputs, ship to customers, and hire good workers.

REMEMBER

Here are keys to site selection:

- Focus on the basics you need from a site as a manufacturer.
- Adjust to the unique circumstances of China — for instance, less reliable transportation.
- Think about how comfortable you are with the local government (see Chapter 8 for info on government relations).
- Look at how to use the regulatory framework — for example, Special Economic Zones (SEZs) and tax incentives — to your advantage.

Hire a consultant to help you select a site. Make sure your consultant has actually worked in manufacturing, though! Some consultants recommend sites where they're friendly with the local government or that have low taxes, even though the sites aren't practical from an operational standpoint. Find consultants through recommendations from people who've done successful startups in China similar to yours.

Looking the part: Appearances can count

Chad Blackwell is managing director of Kunshan Jieyang Arts & Crafts Co., Ltd. The company is located in Kunshan, a small but rapidly expanding city outside of Shanghai. As in many other booming Chinese cities, industrial land is in high demand.

Although Jieyang is a small-to-medium-sized company in Kunshan, it was able to secure a choice parcel for its new factory. Jieyang's new factory boasts an impressive and modern outward appearance that faces the street. In addition to the factory building's attractiveness, Jieyang is putting serious effort into landscaping, including having a lot of grass and a small pond where the parcel meets the road.

Blackwell is thrilled with the parcel because it's located at the intersection of two major roads and is very close to a key highway. He believes that if his company hadn't made the effort to build such a handsome factory, it may not have gotten such desirable land from the government.

TIP

After you have a short list of possible locations, speak with similar-sized FIEs in those locales — particularly those that are more recently established — to get a feel for their experiences. Although you shouldn't start by asking where you can find the most accommodative government, you should make an early effort to ensure that a local government won't do a 180 on you after you've committed your project money. A few short-sighted local governments can be very difficult to deal with after you've paid for your land.

Seeing the big picture when planning your business

One of the biggest and most common mistakes that foreign manufacturers make is to fixate on one thing when planning the business. For example, many manufacturers come into China wanting to set up in the place that'll give them the lowest taxes. Although low taxes are obviously desirable, they should be only one component of your overall strategy. When you focus on one goal, your overall strategy and execution suffer. Remember to look at the entire picture whenever you're making a decision and to choose the option that best balances all your goals.

WARNING!

Don't make the mistake of starting with where you can get the most incentives. Take care of your manufacturing basics first! Don't focus on cutting costs — instead, focus on maximizing profits.

Incentives may go, but the factory should stay

USActive is a Shanghai-based manufacturing consulting firm whose employees have substantial manufacturing experience. Not long ago, USActive assisted an auto components manufacturer with selecting a site for a US$20 million factory near Shanghai. The client signed an agreement with an industrial park to build there. In the agreement, the local government promised the client a number of tax and land incentives. However, shortly after signing the agreement, the *central* government announced some changes to the tax and land laws. The changes greatly reduced the value of the incentive package.

Because USActive had focused on the basics of its client's business, the client was still pleased with the site. The site is in a growing market and is close to potential customers. It's also near key suppliers and major transportation networks. Finally, the area has an ample labor pool, including a good deal of qualified engineers.

Remembering what smart companies look for

You're unlikely to find any one perfect site, so you have to figure out how best to balance the various pros and cons. Here's a list of the key things you want to make sure your site addresses.

Proximity to suppliers and/or customers

Smart companies start by asking where their customers and suppliers are. Setting up in a place that offers the easiest access to at least one of those groups simply makes sense, particularly in China, where transportation isn't always that reliable.

There's a good argument to favor closeness to suppliers over customers: Because China is growing so fast, supply bottlenecks are regular occurrences in many industries. If you locate in the same town as your suppliers, you get several advantages:

- You minimize the transportation time from suppliers.
- You reduce the amount of inventory you have to carry.
- You can develop closer relationships with your suppliers. Hopefully, when supplies are tight, they'll make sure that you're the first to get shipments.

The less skilled your workforce, the higher the quality of raw materials and inputs you need. Keep this idea in the back of your mind when figuring out where your suppliers are. Chapter 12 can help you find suppliers.

If your customers are in China, you wouldn't want to set up in an Export Processing Zone (EPZ). *EPZs* are special zones in China that give additional incentives to export-oriented producers. If an EPZ company sells to a company located in China and outside of the EPZ, the transaction will cost an additional few percentage points of the product's price.

Reliable utilities

Smart companies look for reliable utility supplies. In some parts of China — particularly near major cities — the government rations utilities during peak demand periods. Peak demand for electricity occurs during the summer.

Ideal labor pools

Think about the local workforce. The government is offering all kinds of incentives to "go west." Unfortunately, workers in places like Chongqing usually need a lot more training than workers in the Shanghai area do. (Logistics and transportation tend to be more complex and costly, too.)

Areas that have a lot of laid-off SOE workers offer experienced workers; however, some foreign investors believe that retraining former SOE workers is harder than training laborers fresh off the farm.

Knowing how government can help

Interested local governments can add value by doing a good deal of handholding while you set up. (See Chapter 8 for a comprehensive discussion of developing government relations.) We use the word *interested* instead of *good* because some large local governments may be good in terms of transparency, speed, and fairness, but may not offer small investors as much individual support.

China has a lot of regulatory red tape to deal with (see Chapter 7 and the upcoming section on bureaucracy), but if a local government is really interested in having you invest, officials can guide you through the numerous processes. They can also introduce you to various service providers, such as construction companies.

Avoiding site pitfalls

WARNING!

Here are two big no-no's when you're looking at sites:

- **Going for sites that have electrical poles on the land:** The electrical grid is a state-owned asset, and the local government doesn't have the authority to move those poles at its whim. Therefore, you may end up owing the grid company a lot of money to move those poles. Check into nonelectrical poles on the land, too. Local governments can move some types of poles without a big deal; others take more work.
- **Choosing sites that have people (usually subsistence farmers) living on them:** Local governments used to relocate residents (they supposedly compensated them). However, this is now a hot-button political issue in China. Many local governments are hesitant to relocate residents now. Either way, you should think twice about buying land that could cause controversy with the residents.

Building Your Building

Constructing the factory may be the single hardest part of manufacturing in China. You have to pay attention to a lot of details throughout the entire process. Being overcharged and/or having quality issues with the construction aren't uncommon.

TIP

Some foreign businesspeople believe that there's a fine line between making sure you're not getting ripped off on your factory and pushing too hard on cost control. Their thinking is that the builders are going to make some extra margin one way or the other. Therefore, if you fight overcharges too much, they'll just cut corners to make it up. A good project manager (see "Protecting yourself by hiring a project manager" up ahead) can help you control costs while ensuring quality, but you may still be dealing with builders who are determined to beat you.

Identifying the players

By law, you have to hire at least three different types of companies, all of which must be licensed in China:

- A design firm, which designs the facility
- A general contractor (GC), which is in charge of overall construction; some large GCs can finance the construction
- A supervisory firm called a *jian li* (pronounced jee-en lee)

The *jian li*'s role is technically to oversee the construction work. Some firms are reasonably decent about this; others wouldn't even notice if the structure collapsed. In other words, you're required to have a *jian li,* but don't rely on it to do your quality control — such work's a bonus if it does. Most investors hire a local *jian li* recommended by the local Construction Bureau.

TIP

Because the *jian li* can be unreliable, we highly recommend that you also hire a foreign project management firm or have somebody internal who really knows factory construction and can stay on site throughout the process.

Finding a general contractor

One way to find the general contractor (GC) is to ask the local government for recommendations. Many local offices of the Construction Bureau carry out annual surveys to rank local GCs, so you sometimes get very good recommendations from the local government. Other times, you may receive a recommendation to somebody's friend's company, which subsequently does a bad job.

You have to decide whether to hire a local GC or somebody from outside the immediate area. Your selection of local GCs is more limited; however, a local GC may be able to get permits a little faster because of its relationships with the government. Also, it may have a shorter time rounding up workers because it's familiar with the area. Some foreign businesspeople think that the risk of a GC's taking your money and walking away from an incomplete project is lower if the GC is local. (And in case you're wondering, China has very few foreign-owned construction firms.)

Contracting your GC

Foreign investors commonly have problems in their contracts in several areas. The best thing to do is use your form of contract. Matter-of-factly tell the GC that you'll be using your contract, and make it seem like it's not optional. GC's forms tend to be vague and give them a lot of wiggle room.

REMEMBER

Here's a list of pitfalls to watch out for in the contract process:

- **Translation:** If you use the GC's contract, make sure you get a perfect translation of it. You'd be surprised how many foreign investors get badly hurt because of an error in the translation. It may pay to have a couple of people translate the contract.
- **Negotiation:** If you use the GC's form, they frequently tell you that the contract is standard and that they can't change it. Don't believe them — you can often find room to negotiate the terms.
- **Security:** Insist that the GC give you a performance bond or other security. That way, if the GC screws up or walks away, you can immediately get compensation. Try to shoot for security of at least 10 percent of the construction cost (the usual range is 5 percent to 15 percent). The GC will likely fight you hard on this — just don't give up. Also, the GC is likely to request that you provide security (such as a bank letter of guarantee) for your payment in return, a reasonable and customary request.

If you're building a factory that's new or unusual in China or to higher standards than what the Chinese normally build to, you need to make all these standards explicit from the outset of discussions. When evaluating bids, make sure that the special materials and tasks you require are specifically stated in the estimate. Specify your standards and requirements as much as possible in the contract. Finally, constantly verify that the builders are adhering to your requirements — project managers (discussed next) can be helpful here.

Keep thorough and detailed written records of all dealings with your builders. Don't rely on any handshake agreements — memorialize everything (especially alterations) in writing. Send notes of all meetings and phone calls to the GC (if you send a translation, also make sure it's perfect). Ask them to sign or otherwise approve the notes.

If you're not happy with the completed factory, do everything possible to avoid giving the appearance that you accept it. After the factory passes inspections, any building or completion issue becomes contractual (rather than regulatory). Don't give the GC the ability to argue that you initially accepted known deviations from the contract.

Pay particular attention to flooring and electrical wiring. Although builders may cut corners in a number of areas, these two can be critical. Make sure that flooring is of the correct thickness. Also, make sure that the concrete is proper quality — Chinese builders have a tendency to mix too much sand into concrete. (You may want to ensure that you have a concrete expert on site.) If your floor isn't strong enough, you can end up spending a lot of money on machine maintenance. Watch out for wiring tricks such as changing the gage or putting aluminum wire inside copper casing to make it look like copper. Incorrect wiring can cause a major setback by frying your equipment.

Protecting yourself by hiring a project manager

The biggest problem investors encounter in the construction process is quality supervision. A number of Western, Hong Kong, and Singaporean project management companies are operating in China. Even if you have good *jian li* (hired supervisors), project managers do a lot that *jian li* don't have the capability to. In addition to supervising day-to-day construction, project managers implement financial and quality controls that can end up saving you a lot of money and heartache.

Project managers aren't cheap — they often cost in excess of US$100,000. However, if you're spending over a million dollars on your factory, they're probably worth it. As with anything else, you can find good managers and not-so-good ones. Ask around for referrals before committing.

TIP

If your company has someone internal who really understands factory construction and can be on-site for the entire length of the project, then you don't necessarily need a project manager.

Approvals: Getting through the Red Tape

Certain industries need specific permits. You likely need to jump through these manufacturing-specific regulatory hoops.

Before construction

Before you build, you likely need to take the following steps in this order:

1. **Get preliminary project approval from the local office of the State Reform and Development Committee (SRDC) and get preapproval from the local office of the State Administration for Environmental Protection (SAEP).**
2. **Depending on your company's industry and manufacturing processes, SAEP may require you to file an environmental impact assessment (EIA) report.**

In the EIA report, you need to apply for discharge permits for pollutants that your company will discharge. At the same time, you may be required to produce Safety Assessment and Healthcare Assessment reports — this also depends on your company's industry.

3. **Obtain the Construction Use Land Planning Permit and the Construction Project Planning Permit.**

   The local land bureau issues the Construction Use Land Planning Permit, and the local office of the Ministry of Construction issues the Construction Project Planning Permit. These permits are usually issued pretty quickly — in some cases, as quickly as a few working days.

4. **When you have your final environmental approval, the Construction Use Land Planning Permit, and the Construction Project Planning Permit (and the safety and healthcare approvals, if necessary), apply for the final project approval from SRDC.**

5. **When you have the final project approval from the SRDC, get the Business License from the local AIC.**

   We discuss the Business License in depth in Chapter 7.

6. **After receiving the Business License, get the Land Use Rights Certificate (also covered in Chapter 7).**

   Land Use Rights Certificates can take a few months to obtain.

7. **After you cement the land, you have just one step before beginning construction — getting the Construction Permit.**

   Submit the Land Use Rights Certificate, architectural drawings, and some other items to the local office of the Construction Bureau. This permit usually takes a few weeks to process.

Beginning operations

After you complete construction, the building has to undergo several separate inspections, such as the construction quality, equipment safety, fire safety, and environmental inspections. After it passes the inspections, you receive the Occupancy Certificate. Now you can use the building.

Companies in a small number of export industries need an export permit issued by the provincial office of the Ministry of Commerce (MOFCOM). The Customs Bureau publishes a catalog that states which industries require exporters to have a permit.

Hiring, Training, and Keeping Your Workers

Hiring and retaining good unskilled labor isn't quite as hard as getting good office workers. But despite China's vast numbers of laborers, getting your factory workforce right may not be as easy as you think. You have to deal with a large difference in capabilities between Chinese factory workers and those in the West.

However, if you put the proper training and quality assurance systems in place, you can have a top-notch operation in China. This section discusses hiring and managing workers for a factory setting. For more general labor information, please see Chapter 9.

Encouraging teamwork

The blunt approach to finding factory workers is to go to job fairs or contact the local labor bureau. However, the smart approach is usually to hire shift and production managers first. Then have each manager hire his or her team. (When hiring production and shift managers, you should thoroughly test their mechanical abilities and reasoning. See Chapter 9 for tips on evaluating job applicants.)

Hiring managers who then hire their own teams means that the teams will likely work well together. The downside to teams is that if you lose or fire one team member, you're likely to lose the entire team. Closely-knit teams of workers often stick together.

TIP

Chinese workers tend to have an us-versus-them mentality. Often, "them" is the foreign employer. You can redirect those attitudes, instead having teams who work the same shift compete against one another: Simply give small rewards and recognition to the better-performing team. This technique has the advantage of putting some of the workers' negative energy to good use. Also, this system creates incentives for the teams to handle problems internally instead of having the factory management deal with them.

Expecting skills gaps

Be realistic about the capabilities of your unskilled workers. In the West, unskilled workers usually have some mechanical aptitude. In China, that's often not the case. Unskilled workers often come straight from the farm, where they've had little — if any — experience with machinery (these farms are mostly manual). Workers who haven't had exposure to machines often find many mundane factory tasks challenging.

In addition, unskilled Chinese workers are often educated only through the sixth grade or so. You should expect that the farther you go into China's interior, the less skilled the workers will be (although the labor will be cheaper).

Training

In general, expect a worker to take at least two to three weeks to come up to speed on operating a simple machine. Often, factories have team or production managers train new hires. Training how to use the machines isn't always the hardest part.

Drumming up enthusiasm for your corporate culture

Chinese factory workers generally don't know anything about your brand or your corporate culture unless you teach them. When starting your factory, having more than just machine training is critical. You should have human resources and other people meet with workers and teach them about the culture of your company.

Without selling the culture to the workers, you'll likely have a Chinese-style factory in China that won't help your brand and won't communicate or work well with your home offices. A number of Western companies have had to completely revamp their China factories because the workers didn't receive adequate cultural indoctrination.

TIP

Start up your factory under managers who've been with your company for a long time and who understand it very well. Consider having some of your most senior managers in China for startup and for your several years or so of operations.

Providing safety and environment training

Chinese workers need a lot of training on safety and environmental issues. (We talk more about managing your company's safety and environmental risks in Chapter 17.) Most of your Chinese hires don't understand moving parts or electricity very well. They'll often take careless risks, such as not replacing safety guards on machines or welding without a visor. You need to repeatedly train workers on even basic safety precautions.

Train your workers how to dispose of wastes properly. If you don't explain these things upfront, don't be surprised to find out that workers have been pouring waste into the river or ground. Many of China's environmental regulations are tougher than the U.S.'s, so be proactive about teaching the proper ways of handling environmentally sensitive materials so your workers don't get your company into serious trouble.

Treating your workers well

Worker turnover can be one of the largest hidden costs to manufacturing in China. If you want to keep your workers, you need to treat them well. (For information on workers' legal rights, see Chapter 9.) Here are some areas of consideration:

- **Wages:** The going wage varies by area. The local labor bureau can often tell you the local average wage for various functions. Some FIEs make it a policy to pay a few hundred RMB per month more than the average wage. (See Chapter 9 for info on wages and benefits.)
- **Housing:** If you have workers from other provinces, you may have to house them in a dormitory. Many FIEs that are known for treating their employees well put no more than four workers in one dorm room. They also provide each dorm room with a private bathroom. Some factories reduce the pay of workers who live on site in order to cover the housing costs.
- **Employee appreciation:** Show workers that you care. You can do so in easy ways. For example, when the weather's really hot, you can bring a bunch of sodas and popsicles down to the factory floor to share with the workers.
- **Professional development:** In general, factory workers want the same things that office workers do: They're hungry to learn and develop. When they go to work in your factory, they expect you to empower them and train them in your culture and technology. Hold up your end of the bargain! Give them clear paths to advancement and give them the sense that they can grow with your company.

  However, make sure your workers don't have it both ways. If they want to be paid and empowered, then they have to take on more responsibility. Make your workers maintain their own machines and sweep the floors around them as well as handle other tasks.

Many customers insist on inspecting their suppliers' facilities from time to time. Also, a lot of multinationals insist on privately interviewing their suppliers' workers to ask them about working conditions. First and foremost, customers (especially multinationals) want to avoid damage to their reputations from buying from sweatshops. They also know that worker unhappiness can translate into production problems. If your company doesn't treat its workers well, your clients may find out and go elsewhere!

If your worker turnover hits 20 percent, assume something's wrong at the factory. At that point, you should be closely evaluating your managers to see whether they're causing the problem.

Hiring Quality Control

One of the big issues that Western manufacturers moving into China face is quality control. Because of the skills gap of many Chinese workers, expecting each factory worker to do his or her own QC is almost always unrealistic.

One reason for the skills gap is that unskilled factory workers don't have much mechanical aptitude. Also, they don't buy and use the products themselves. Because they're not also consumers (as Western factory workers are), they generally don't understand the products that well. Because of the legacy of China's previous Soviet-style manufacturing culture, which paid no heed to quality, getting Chinese workers to fully buy into and understand quality may take decades.

Most factories hire workers who are dedicated solely to doing QC. QC workers usually have the same limitations that production workers have. Therefore, you should have a given QC worker perform only one type of test. For example, you can have one worker be responsible for measuring dimensions and another worker responsible for ensuring that a component lights up. The breakdown obviously depends on what you're making; however, your QC people likely won't be able to understand the whole picture well. Therefore, make QC as simple as possible for each worker.

To make your QC efforts as effective as possible, pay close attention to how you provide incentives and disincentives for your factory workers. Docking a worker's pay for individual mistakes isn't a good idea. In a society that values harmony, QC people and other factory workers are unlikely to point out mistakes that'll cost individual coworkers. Moreover, workers can pressure QC people to underreport defects if the defects will cost the workers.

Tie a portion of everyone's compensation to overall quality. If defects are found before shipment to the customer, the penalties should be very light. On the other hand, if the customer returns products because of defects, you should set fairly strict penalties. Spread the penalties across all workers involved in making those products. Use common sense, though — if the issue is with poor-quality inputs, penalize purchasing and QC rather than the workers.

You should usually do thorough QC on inputs. You're likely going to face more quality issues with your suppliers in China than you would in the West. And because of your less-skilled Chinese workforce, you're probably going to need better inputs than you would in the West. For more on working with suppliers in China, see Chapter 12.

Some customers may actually want to review data from your QC processes. Make sure you work closely with your customers to understand what kinds of data they want to see.

The more QC, the better! Test quality throughout the entire process — from deliveries to finished products. For an in-depth discussion of QC techniques you may be able to apply, check out *Quality Control For Dummies* (Wiley).

Chapter 14

Selling in China

In This Chapter

- Knowing Chinese consumers
- Getting distribution right
- Advertising in China
- Figuring out how and when to enter the market
- Selling to customers and other companies

Selling in China is the prize everybody seems to set their eyes on. According to some estimates, China has over 320,000 millionaires (that's in U.S. dollars!), and the number is growing rapidly. Below that tier, China's middle class exceeds 75 million people and is also growing at breakneck pace. Best of all, the Chinese are still figuring out how to spend their newfound money.

In this chapter, we discuss selling. Most of the chapter deals with the Chinese consumer, which is unique in the world. You have to work hard to earn their disposable income, but if you get the formula right, the effort's well worth it. We also discuss selling to businesses briefly here (and in Chapter 13, on manufacturing).

Appealing to the Chinese Consumer

In general, foreign companies selling in China win customers by offering three things:

- Technology
- Superior quality
- A higher-end image

Historically, Chinese consumers were worried about only one thing: price. They never asked "where's the beef?" as long as the price was low enough. The Chinese are now becoming more sophisticated consumers, although commanding a premium can be tough for your product or service if you aren't selling to high-end customers.

You're going to have a very hard time competing on price with Chinese companies, but one of the positives about the Chinese market is that high-end consumers are very willing to try new things. However, don't assume that if you market it, they will come. In order to maintain consistent appeal to Chinese consumers, you have to make a number of adjustments, which we discuss in the following sections.

Knowing your customer

"Know thy customer" is one of the first rules of marketing. The following sections can help you figure out just who may be interested in your product or service and how they'll react to your offering.

Viewing a portrait of the Chinese consumer class

Unlike in the West, most of the money in China belongs to people who are younger than 45. Because of the cultural revolution (see Chapter 3), people older than that generally aren't well educated, live in government subsidized housing, and have spent the bulk of their careers in state-owned enterprises (SOEs). The younger generation is better educated and is more likely to work in private firms, including foreign-invested enterprises (FIEs — see Chapter 7).

Regionally, China's middle and wealthy classes tend to cluster in Beijing, the Pearl River delta, and the Yangtze River corridor.

Understanding different markets, different consumers

Chinese consumers show important regional differences in their buying habits. You may very well need different approaches in different regions. Many factors determine how people will react to your offering, but here are some tendencies that may hold true:

- Northern Chinese aren't quite as price sensitive as other Chinese. They're more likely to pay for convenience instead of shopping around to compare prices.
- Chinese people in the central coastal areas tend to shop around a lot and try to play stores off one another for a better price. They usually go for the best deal.
- Southern Chinese (particularly Guangdong province) are used to getting good products at low prices. They've had access to factory overruns at deep discounts for many years.

You also have to be aware of lifestyle differences among consumers, so do a lot of research on your particular targets in each market you want to sell into. Shanghai, for instance, is generally more avant garde and Western-friendly than Beijing. But contrary to what you may think based on the two cities' reputations, young Shanghainese tend to be closer to their parents and lead more stable lifestyles. Beijing's 18- to 35-year-olds are more attuned to the rest of the world — particularly in pop culture — than are the youth in Shanghai or any other Chinese city. Beijing's youth are also less traditional than in any other part of China, which may explain why Beijing is the center of China's rock and pop scenes.

Getting a leg up by researching your target consumer

REMEMBER

China is a series of regional markets and submarkets. Dig deep to really understand your targets — you may end up revising many of your initial assumptions.

In China, you'd do consumer research the same as you'd do it in the West. The positive for foreign companies is that most Chinese companies don't bother (or don't know how) to do consumer research. For Chinese companies, just throwing ideas on the shelves and seeing whether they sell is usually cheaper and faster. If you're going to compete with Chinese offerings, market research can give you an edge.

In China, doing intercept interviews is usually more effective than doing focus groups (when the Chinese do focus groups, they tend to be a little embarrassed about speaking in front of each other). Hiring interviewers isn't that expensive.

Helping customers show their "face"

The Chinese are inherently suspicious of anything that costs more than average. One way to overcome their aversion to paying higher prices is to sell them a product or service that gives them *face,* or status in the eyes of others (see Chapter 11 for details on face).

REMEMBER

For a product to give face, others must be able to see the consumer with it. For example, a car has the potential to give face; a blender usually doesn't.

A lot of face relates to branding, which we discuss next. In general, if something is perceived as newer, cooler, fresher, more lavish, and so on, it gives the consumer face. Face is a powerful argument in favor of paying more for a product or service; conversely, an expensive offering that doesn't give much face is a tougher sell.

Looking at name recognition: The Chinese and branding

China doesn't have a tradition of strong brands, though the Chinese are starting to become conscious of brand identity. As one foreign sales executive says, high-end Chinese consumers pay for "perceived image."

Where price matters: Cayennes and yams

A single consumer may be willing to pay for image with one type of product but be incredibly price-sensitive with another. One foreign businessman tells the story of the time he was walking along the sidewalk in Shanghai discussing cars with a wealthy Chinese businesswoman. The woman said that she planned to purchase a Porsche Cayenne — a car that sells for over US$100,000 in China — in the near future. When the foreigner asked her why the Cayenne, she replied, "Because it's a good car."

The woman stopped to buy some yams from a street vendor, but when the vendor told her that the price for two yams was 8 RMB (US$1), the woman became furious. She proceeded to shout at the vendor that she never pays more than 6 RMB for two yams.

The woman and the vendor began to argue loudly over the price. After 15 minutes of shouting and negotiating, the future Porsche buyer walked away with two yams. She was quite pleased with herself for having won the argument over 2 RMB (US$0.25).

Building brand loyalty

Building brand loyalty is hard in China, and it takes more than making a customer happy with your product. The flipside of new and cool is that somebody else's offering is soon going to be newer and cooler than yours. As a result, China is probably the most rapidly changing consumer market in the world. You may have to make constant adjustments to your offering just to create the perception that you're leading the market in innovation.

WARNING!

Changing your offering constantly can be very expensive. What you really need to create is the *perception* of change, which doesn't always require costly changes to the substance of product or service.

Another way companies can create brand loyalty in China is by associating with celebrities. In the past, China didn't have many of its own celebrities, so companies were limited to using foreign personalities. Although celebrity culture is still developing in China, the nation already boasts a number of bona fide Chinese celebrities. Chinese celebrity culture isn't built solely around entertainers or athletes — it also centers on successful businesspeople!

Word-of-mouth campaigns supported by company incentives are also effective at creating brand loyalty in China. To encourage personal recommendations, you can offer a customer a discount on the next purchase if he or she refers a friend.

Talkin' to celebrities for endorsements

You don't have to be a massive multinational corporation to land an effective celebrity. For instance, take Talk da Talk, a Shanghai-based company providing activity-based English training to young Chinese professionals (`www.talkdatalk.com`). A few young entrepreneurs started the company in 2003. Cofounders Jim Leu and Rich Chin saw the potential to develop strong brand identity by working with a celebrity, so they approached David Wu, a popular TV personality in China. Wu was intrigued by the idea and agreed to work with the group. He became a significant equity holder in the company and is heavily featured in all aspects of its advertising, marketing, and branding. Despite beginning with a relatively modest investment, Talk da Talk has managed to create a strong awareness in its markets through the partnership with Wu. There is a flipside though — most new customers think of Talk da Talk as David Wu's company! Talk da Talk encourages this association, but it may not work for everyone.

Most companies operating in China are making at best rudimentary use of databasing techniques to build brand loyalty. Building databases of customers offers an opportunity to develop a relationship with them. Foreign baby-product marketers in particular use databases well, often keeping records of parents' and babies' names and babies' ages. Then they market to the parents throughout the children's developmental stages.

Considering nationalism

Until the past few years, Chinese almost always associated foreign products with superior quality. They're not necessarily thinking that way anymore, and they're sometimes willing to forego quality in order to help the domestic company compete against the big, bad foreign competition. The growing "buy China" sentiment among Chinese consumers will continue to be a difficult tightrope for foreign companies to walk in China, possibly reminiscent of what Japanese auto manufacturers faced in the U.S. in the 1980s.

TIP

One strategy for foreign companies is to buy Chinese brands and allow them to keep their Chinese identity. At the same time, you can improve operations through foreign processes and management.

One company that has done extremely well investing in Chinese brands is Groupe Danone SA. Since 1991, Danone has been acquiring stakes in a number of Chinese brands, which very few consumers realize. In fact, one of Danone's investments is Feichang Cola, which goes head-to-head against Coke and Pepsi by trumpeting itself as "China's own cola."

In the cards: Turning low-tech communication into high-tech databases

Although China may not offer you all the databasing techniques you'd have in the West, you can come up with innovative ways to keep track of your customers. Consider the China Information Broadcast Network (CIBN), which delivers value-added Internet services and digital entertainment via mobile phones under its CATV brand. Because China doesn't have the developed credit and debit card system of Western countries, the use of prepaid cards for services (particularly Internet-based) is common. CIBN takes this relatively low-tech reality and does some sophisticated high-tech databasing with it: The company has created a prepaid card that allows CIBN to track and understand its customers, cross-sell goods, and develop new products.

Getting Ready to Deliver: It's All about Distribution!

Distribution is the hardest part of selling products in China. It's regional and highly fragmented, and you have to deal with a wide range of channels and multiple layers. The products that win in China aren't necessarily the best ones; they're the products that get to where they need to be.

Where your products get sold

The retail market in China has been a little bipolar — the formats that have been doing well are either large hypermarkets or tiny neighborhood stores. Although all segments are growing, specialty retail is really taking off now.

Hypermarkets in hyperdrive

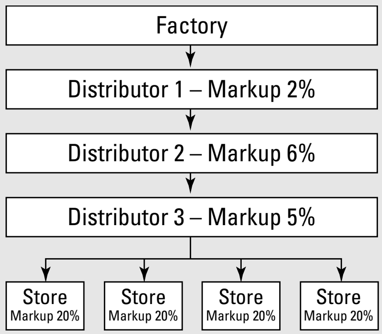
Hypermarkets, such as Carrefour, Wal-Mart, Century Mart, and WuMart, are the largest force in retail in China. Because of their large size, they aren't that convenient to get to; thus, they're destinations. These stores offer better assortment and lower prices because they eliminate a number of distribution layers by functioning as warehouses that take deliveries directly from the port or factories. Hypermarkets often provide a mixture of well-known international and Chinese-branded products.

Spreading the word on distribution costs

Distribution expenses in China are among the highest in the world. China's logistics spending accounts for 17.6 percent of the GDP, as compared to 11.2 percent and 8.5 percent in Europe and the U.S., respectively.

The following chart illustrates the complexity and expense of distribution in China. The markup at each level refers to the markup over the price at which the distributor buys the product. By the time the product gets to the consumer, distribution markups have added about 36 percent to the cost of premium detergent:

$$100\% \times 102\% \times 106\% \times 105\% \times 120\% \approx 136\%$$



Hypermarkets' Chinese suppliers are usually much smaller than their multinational suppliers. The Chinese brands in hypermarkets are ones that Chinese in the local markets are familiar with. Often, these products have special features (such as a particular taste) that make them popular in a particular locale. The Chinese-branded goods are usually commodities, such as sugar and tea, but they're differentiated in some way from their competition. The Chinese goods in these stores come from the relatively small number of Chinese manufacturers that are able to meet the hypermarkets' quality and distribution standards.

Tough-to-beat convenience

After hypermarkets, the second-largest number of retail sales occurs in convenience or neighborhood grocery stores. These stores are often individually owned and independent, but you do see some large chains, such as Lian Hua, Lawsons, Ke Di, All Days, and 7-11, which are usually franchises. The mom-and-pop stores are quite cramped, but they generate business because they're located close to their customers.

Specialty stores

Specialty retail, or focusing on a particular offering or type of offering to the consumer, is a great opportunity for smaller foreign companies — both as a distribution channel and as a business model. Specialty retail is growing particularly quickly because of the increasing incomes of Chinese and because Chinese consumers are looking for alternatives to hypermarkets and department stores.

Three distribution choices

You can distribute products in China in three ways:

- Using third-party distributors
- Partnering with or acquiring a Chinese firm
- Growing your own sales force

You have to be pretty sure you'll be able to sell enough volume to cover the fixed costs of your distribution network, so some companies use the first two techniques until they can establish their own sales force. The following sections go over some of your options.

Hiring third-party distributors

Third-party distribution in China is more expensive than in the West. Unfortunately, this extra expense doesn't usually buy you good service. Most distributors do little more than transport goods. They're often lackluster at selling your product because they don't understand it and don't care that much. They usually don't manage inventory, track shipments, stock products, or merchandise.

Unfortunately, when you ask distributors whether they can do more than just bring products from A to B, they'll *yes* you to death. Although you can find a few good distributors in China, don't believe most third-party distributors.

Even though the third-party distribution picture isn't pretty, using third parties during your first few years selling in China may be a good idea if you want to get off the ground quickly. This strategy is usually best when you're not selling a potentially big mass-market product (for mass-market products, try to have your own sales force from the beginning — see the upcoming "Developing a homegrown sales force" section).

TIP

If you do use third parties during these first few years, you can work on developing your own sales force at the same time. When evaluating a distributor, ask it to provide foreign-company customer references. Here's a list of things to think about when dealing with a distributor:

Sims: Spotlight on exceptional distribution

Effective distribution companies do exist in China. They offer quality market analyses, effective sales, IT support and management, and logistics services. Elizabeth Harrington, CEO of E. Harrington Global, has over 25 years of experience in China business. One of Harrington's clients, Sims Hong Kong (`www.simshk.com`), is among the few Western-style distribution companies in China.

When Harrington helped Sims develop its China strategy, the company was a division of an Asian retail giant. In 2001, Sims was acquired by CITIC Pacific, the Hong Kong–listed arm of CITIC (China Investment and Trust Investment Company), which is a powerful investment arm of the Chinese government. The sale strengthened Sims' capabilities in China. Sims' prior ownership gives it understanding of retail marketing, and the transaction with CITIC Pacific provides it with market access. Sims is one of the few firms that offers a full range of services for its national distribution network.

- Make sure it's not selling your competitors' products without telling you.
- Ensure that it knows your industry, has experience in your product area, and knows who your customers are.
- Speak with your customers (or potential customers) to determine whether they respect and trust the distributor.
- Payment and collection involve a whole new set of risks, so make sure any distributor who handles that area of your business is up to the job.
- Find out whether the distributor buys from you in advance or just takes orders from your customer and has you fulfill them.
- Find out whether it uses modern technology to provide its services.

Don't agree to grant exclusive distributorships — it's neither necessary nor usual in China.

Partnering with/acquiring a Chinese firm for its distribution

Acquiring a Chinese firm for its distribution can make sense depending on the numbers. Basically, partnering is for companies that want to make smaller financial commitments to China. The idea behind partnering with a Chinese firm is that it already has a good sales force and distribution. This method is very much a plunge into China, because you're going to have to integrate and run your Chinese company. In a best-case scenario, the brands you acquire can maintain their Chinese identities (see "Considering Nationalism," earlier in this chapter). At the same time, you can successfully piggyback your foreign brands on the acquired company's distribution network and improve overall management practices at the company.

This model can work, but it's seldom perfect. The problem is that the partner will almost always sell its own products before yours, regardless of whatever assurances the company reps give you, even in a joint venture. You'll probably have to accept that you're a second-class citizen. Also, your partner owns the customers, so if your deal goes south, you're back at square one as far as finding customers goes.

Developing a homegrown sales force

If your company is willing to commit the resources, developing your own sales force is likely the best distribution solution. In doing so, you can take an aggressive approach and look to build a large force overnight. Or you can do it the Chinese way by building gradually and letting your existing sales force's productivity pay for expansion; we talk about this method more in the upcoming "Deciding How You Want to Enter the Market" section.

The right people

Your initial sales hires ideally have sales experience and know your industry. Of course, you're in even better shape if they have relationships with customers. If you're going to grow the Chinese way, take the time to find this type of salesperson.

If your candidates lack experience, look for people who are eager to receive international standard training. They should also be motivated to advance, gaining responsibility and greater face, and to earn a lot of money.

Fact-based selling

The traditional Chinese mentality has been to drive sales based on making their product prices cheap. They look to profit based on high volume. However, most Western sellers aren't coming to China to battle it out for razor-thin margins.

The Chinese also have a tradition of relationship-based selling in which salespeople look to develop friendships with customers. After they've done that, their friends buy whatever they're selling, provided that it's cheap enough. As a foreign company with a quality offering, you're going to have to train your salespeople to sell based on a new set of criteria.

REMEMBER

You *must* train your salespeople to make the case that your product or service sells at a premium because of the number and/or quality of its features. The salespeople also have to be able to make factual comparisons between your product and the competitions'. Try your best to ensure that they understand and believe in your brand. Perhaps loan them the product so they can try it out themselves.

If you're selling very high-end goods, take fact-based selling a step further. Your salespeople have to be able to read customers and sell to them based on what the customers want. This skill is part natural ability, part training.

Training and management

Have two people train each new sales hire. In this model, one trainer is a solid senior salesperson and the other is a fairly new salesperson. The new hire learns from a seasoned employee while the less-experienced salesperson reinforces his or her own training by teaching and gains confidence and face. Sometimes, having someone who's just a little ahead of them in training is valuable for new hires when they need to ask for advice — the old hands may have forgotten what starting out is like.

As for promotions, not all salespeople make good managers. Figuring out whether someone is management material usually takes a few years. Don't promote salespeople to management if they're not suited for it.

TIP

Failing to promote employees may cause them to lose face, so you may want to set up a two-tier track for senior salespeople — one into management and the other into a prestigious sales title. When promoting salespeople into the latter, take them aside and convince them that they don't want to be managers — after all, they can make more money and have fewer headaches if they stay in sales! Maybe give them a bigger desk or some other perks that show they're not just average salespeople.

At the end of the day, it's about pay

The key to getting your sales force to sell is proper incentives. Your pay system must motivate people to sell. However, here are a few things to watch out for:

- Pay for profitability. Don't provide incentives for your salespeople to discount products deeply in order to get volume.
- Pay salespeople only after delivery and customer payment. If you pay them just when they get the order, you're likely to have a lot of fake orders.
- Watch out for your salespeople's paying kickbacks. Don't let them get your company into trouble by marking up prices to give money to someone on the other end. (For more on financial controls, see Chapter 17.)

Trench warfare in distribution

One Western sales executive calls distributing in China "trench warfare." China has significantly more retail outlets than the U.S., even though the retail market is a fraction of the size. Part of the reason for the fragmentation is that the government encourages it. Retail in China is a large employer, which the government likes. Therefore, you're likely going to need to have a lot of salespeople spending significant time face-to-face with the store owners. Competition for shelf space is ugly, and success requires persistence and systemization.

If you want to reach the mass market, you have to deal with a lot of mom-and-pop stores and the hypermarkets (see the earlier section titled "Where your products get sold"). If you're selling to both ends of the spectrum, the varying approaches take a good deal of sophistication.

Dealing with mom-and-pop stores

Selling to mom-and-pop stores takes incredibly detailed process management. Your salespeople have to constantly be at the stores, keeping good relationships with the store-level people. And after your salespeople leave the store, another salesperson is likely to come along and replace your product on the shelf with his or her own. Therefore, your people have to keep returning and putting your product back on the shelf.

Here are ways to make your product more appealing and to build relationships when dealing with mom-and-pops:

- Make sure you give them smaller packaging. These stores are often cramped.
- In addition to having good relationships with the store operators, your salespeople have to use those fact-based selling skills to convince the stores that they can sell your product for more money and make a higher profit margin. (See the earlier section on fact-based selling.)
- Make sure your salespeople work closely with mom and pop to give them a good display and technical support.

WARNING!

At the small store level, you may see a good deal of corruption. Operators may want kickbacks to stock your merchandise. For a whole host of reasons, your salespeople shouldn't play along. If they do, it's a vicious cycle — the required payments will get larger and larger. Eventually, you'll have no profit margin. Also, when dealing with small Chinese stores, don't extend credit — you won't get paid.

Running with the big dogs in hypermarkets

Smaller foreign companies' product prices are usually sandwiched between those of local brands and well-known multinationals. Even though smaller companies' products may cost less than other multinationals', they don't have the brand recognition. Unless your product is widely known or has no real Chinese competition, hypermarkets are a tough channel for a small company.

The hypermarkets look for suppliers that can provide consistent quality on time. If you're a smaller company, you can get into the hypermarkets by explaining why they need to carry your product. Show that there's an unfulfilled demand in their China stores for your product, and they'll often be willing to buy from you on a test basis to fill that hole.

Chain convenience and grocery stores usually have centralized purchasing that has to approve your company as a vendor. Franchisees then have some discretion in what they stock, so they may choose to pick up your product.

Advertising

Chinese consumers are usually receptive to advertising (if done right). However, reaching them through TV and other mass media can be very costly. Fortunately, China offers a number of effective but less expensive advertising alternatives. The following sections tell you how to arrange effective advertising.

Keeping the message simple and obvious

The nice thing for foreign companies advertising in China is that Chinese aren't as cynical about ads as Westerners are. Advertising in China seems to reflect an age of innocence similar to the post-WWII U.S. There's little subtlety in conveying the message in advertising in China. Make the message simple and obvious.

Catering to aspirations of wealth

REMEMBER

Effective advertising in China often caters to aspirations of obtaining a wealthy, luxurious lifestyle (frequently in a nouveau riche sense) — even for mass-market products. Chinese consumers associate a wealthy lifestyle with images of modern home interiors decorated with designer furniture (often in various shades of white), accessorized with grand pianos and gilded objects.

Advertisements promoting premium products tend to be somewhat over-the-top. Cheryl Chong, a former advertising professional with J. Walter Thompson in Beijing, tells the story of a high-profile campaign she once produced as marketing director for a mobile phone company in China. One commercial featured two top fashion models: One picking up a Van Gogh painting at an art gallery while the other drove away in a flaming red Ferrari.

A commercial for an imported alcoholic spirit features two Chinese men in their 40s arriving at a European castle built on an island in a lake. One man arrives by helicopter, the other comes by limousine. The two step out of their respective modes of transportation and solemnly nod to each other. Each man takes his turn handling a bow and shooting an arrow at a remote target in the middle of the lake. After each hits the bull's-eye with his first shot, their menservants pour them glasses of the spirit. The commercial closes with the two archers raising their glasses in a tribute to each other.

Choosing advertising features

Here are some points to remember as you try to appeal to your audience:

- Chinese consumers generally respond better than Westerners to advertising featuring cutesy kids.
- Celebrity marketing is effective in China (see the earlier section on Chinese and branding).
- Sports and music marketing do all right, but they don't generate as much traction as in the West. They're starting to become more effective as Chinese sports and pop culture gathers steam.

Minding the rules: Good kids and Confucians

Don't advertise in a way that conflicts with traditional Chinese values. Generally avoid messages of children disobeying their parents (usually a cardinal sin in Confucian societies) or that stress individualism (although this method can be effective in *some* ads aimed at youth).

WARNING!

Watch out for some legal no-no's in advertising in China. Advertisers can't show a woman wearing anything that suggests that she isn't wearing a bra. They can't show images of the Chinese flag. And claiming that your product is "the best" or making comparisons to the competition is also impermissible.

Getting the message out

You can reach consumers where they live or work or get consumers to come to you. This section explains your options.

Mass media

Traditional mass media in China is similar to that of anywhere else: television, radio, newspapers, and magazines. To gain traction in mass markets, you either have to have a large share of the advertising voice — in other words, advertise very frequently relative to the competition — or your advertising has to clearly differentiate your offering.

The problem is that TV advertising is fragmented and expensive. The only network with nationwide coverage is China Central Television (CCTV), which has 12 channels. Prime-time spots on CCTV go through a highly competitive annual bidding process. If your company wants these, it'll have to go up against the likes of Procter & Gamble, which spends over $3 billion in mass media advertising in China per year. Your other choice is to deal with a patchwork of more than 300 TV networks with over 3,000 stations nationwide. Newspapers and magazines are similarly fragmented and expensive unless an advertiser has a large scale.

Out-of-home advertising

For companies that don't have huge advertising budgets, China is generally ahead of the West for out-of-home advertising opportunities. The best part of out-of-home advertising is that it allows your company to target markets in a cost-effective manner and to reach specific segments of consumers. In addition to billboards, Chinese cities frequently offer video advertising in taxicabs, trains, and elevators. With a captive audience of commuters, these forms of advertising can be pretty effective.

China is also well ahead of the West in another form of out-of-home advertising: SMS (text messages sent to mobile phones). With 450 million mobile phone users, this media platform allows advertisers to send highly-customized messages to the urban communities in each city. eDongcity (`www.2288.com`), which Cheryl Chong founded, was one of the first providers of SMS content marketing in China, and it continues to be one of the largest.

Another widely used form of out-of-home advertising is event marketing. For instance, high-end brands often hold launch parties. Event marketing and management companies maintain databases of high-end consumers in various markets that you can use to build your guest list.

A similar concept is called *roadshow,* which is essentially a series of smaller-scale events conducted at high-traffic venues such as shopping mall atriums, public parks, and campus hubs. Roadshows are effective for advertisers who require a live audience to perform product demonstrations.

Deciding How You Want to Enter the Market

You have to move quickly to keep up with China's consumer markets, but don't be sloppy. We discuss a few schools of thought on how to enter the market. Think about which approach is likely to work best for you.

One absolute is to have your distribution network solidly in place before trying to sell. If you don't have your network set up well before you start to sell, your chances of failure are pretty high. So first dig your trenches and get your (or a distribution company's) soldiers in them. In other words, first determine where you're going to need to deploy your salespeople. Then figure out a system for organizing and scheduling their frequent customer visits. Finally, make sure they're well trained and up for the job.

Building and scaling distribution in third-tier (and sometimes second-tier) cities is easier. See Chapter 7 for more info on location.

Guns blazing

One approach for entering the Chinese consumer market is to target several markets right off the bat, putting all your energy behind the campaign. The rationale is that competition is going to move in like lightning on your customer base, so you need to establish your presence in your target markets immediately. If you've set up a solid distribution network in your markets before launching, you're halfway there.

If you use this approach, you need to think about how you can make potential mistakes as cheap as possible for you. After all, if you make some incorrect assumptions, you may screw up in several markets rather than just one. When you make mistakes on a large scale, they cost a lot more money.

Immediately targeting multiple markets will kill you if you're doing only small volumes in each market because you won't have the revenue to support high overhead costs related to your scale.

Starting with a beachhead

Many companies initially focus on one market, prove the model, and then expand to other markets. The Chinese are always impressed by a person or company that's number one in some aspect, so touting your reputation as being the leader in market A can help you sell in market B. Using this model limits your risk in terms of markets and capital. The smaller scale also makes tweaking the model easier. When you use this technique, establishing your distribution first is still critical.

Putting down roots: Cinkate growin' great

Cinkate, a pharmaceutical manufacturing and sales company in China, is an excellent example of the pay-as-you-go model. Cinkate (`www.cinkate.com`) was founded in 1994 by Dr. James Williams, a leading U.S. surgeon, and Dr. Xiao Fei, a Chinese-born surgeon who trained with Williams.

Williams and Xiao saw the opportunity to manufacture high-quality patented medicines in China at lower costs and sell them into the Chinese market. They started the company with their own funds. Cinkate found a contract manufacturer and then developed its own sales force. Initially, the company focused on only one therapeutic area and two products. As the business developed, they reinvested the profits to fund growth into new products and markets. Over the past 12 years, the company has become one of the leading pharmaceutical sales companies in China. It's highly profitable and debt free.

China has very few national brands, so you can take the view that any competition in other markets won't be too strong for you to knock off when you arrive. Foreign competition, though, may be a different story.

The decision as to how quickly you expand is similar to the initial decision to begin with a beachhead rather than going in with guns blazing. The Chinese way, a pay-as-you-go system, may or may not be right for your business. This method means using the profits from the first market to get a little larger, then using those profits to get a little bit larger, and so forth.

The chief drawback of moving slowly is that your competition can leapfrog ahead of you. China is one of the most competitive, cutthroat markets in the world. Before going slowly, take stock of your company's competitive advantages. Ask whether they're ample to allow you to scale gradually.

Letting others blaze the trails for you

Just as in the West, you may be more comfortable moving into China on the coattails of one of your competitors. With this method, you let your competition develop awareness and demand for what you plan to offer. The competition also educates the government on your business. You sit back and study their mistakes. Finally, you go into China. You may want to go head-to-head in big markets where your competition has established itself, or you may figure that China is a big enough pie that you can each have your own slices without clashing.

For instance, U.S. do-it-yourself (DIY) home remodeling chain Home Depot was content to let its competition get to China first. In 1999, B&Q (owned by U.K.-based Kingfisher) became the first large foreign DIY store to arrive in China. B&Q quickly learned a lot of lessons about China, such as not putting higher-priced items in the front of the store (these intimidated customers into not entering) and having plenty of product samples within easy reach for customers to play with.

Not until December 2006 did Home Depot finally take the plunge into China. Home Depot announced that it would enter China by acquiring Chinese DIY retailer, Home Way. At this point, B&Q had over 50 stores in China. Home Depot appears to be betting that it can learn from B&Q's earlier mistakes. Most interestingly, Home Depot's strategy seems to be to buy those competitors that inevitably spring up when a company begins to develop a new market in China.

Don't be the eighth mover. If the market is saturated, you're likely better off not moving on it.

Selling to Consumers

You can sell to consumers in China in a number of ways. Consumers are getting more sophisticated, and they're looking for more than just hypermarkets and convenience stores.

Retail stores

If you're going to set up retail stores in China, you should expect that Chinese shoppers are as sophisticated as customers anywhere else in the world. Therefore, you should bring your latest store concept to China.

REMEMBER

Don't fall into the trap of making assumptions based on cheap labor. If you think margins will be higher in China, think again. High rent eats up a lot of cost savings. Also, don't rely on cheap labor instead of using sophisticated inventory tracking systems. This tracking is particularly important in China, where you may encounter supply bottlenecks.

The following sections discuss a bit about your retail options.

Making concessions: Renting space from department stores

One retail option in China is the department store concession. Unlike in the West, Chinese department stores usually don't buy inventory themselves. Instead, they rent out parts of their store to individual retailers. In most cases, concessionaires rent out a concession to sell just one brand. The result is confusing to many Western consumers because in Chinese department stores, products are usually grouped by brand rather than by type. This setup makes complete sense to the Chinese, though.

WARNING!

One drawback to renting a department store concession is that you have to float the department store 30 to 45 days on your sales. The department stores you rent from (rather than the concessions) provide the points of sale. Therefore, sorting out your sales and paying you takes the store some time.

Selling items in your own store

As we mention earlier in this chapter, specialty retailing is a particularly attractive opportunity for smaller foreign companies. You can choose from lots of possibilities, but some of the areas that seem particularly promising are stores related to cars (for example, car washes and lube shops), budget hotels, and education-related businesses.

One of the tough parts of retailing in China is that landlords customarily reserve the right to move you out — even though you sign a lease for a certain number of years. What's worse is that landlords sometimes move you out and then try to ride your coattails by opening a similar business in your place. This problem is just one of the realities of retailing in China.

Keeping the customer's experience consistent

One of the problems of managing employees in any industry in China is that they sometimes think they've found a better way to do something than what you've taught then. Without telling you, they may start doing it their way instead. When you're in retail, this can be particularly problematic.

Rick Wang is CEO of RetailCo, Inc. (`www.retailcoinc.com`), which is a company that specializes in apparel and food and beverage retailing. He says that in China, "Training is easy; training for consistency is hard." His favorite example of this is a story one of his associates told him about training Chinese restaurant staff in a five-star hotel. The trainer spent several weeks each in Shanghai, showing the restaurant staff (among other things) how to set a Western-style table — forks, knives, spoons, and all. The staff learned quickly. After a few weeks of reinforcement, they were setting the tables perfectly each time.

The trainer then left China for a couple of months. When he returned to the hotel, he saw that the tables were set perfectly — except for one thing. The spoons were all placed above the plates. He called the wait staff over and asked why they were doing this. They said, "Your system is good, but don't you think ours is better?" The moral of this story is that to keep things consistent and maintain your brand and quality, train your employees. Don't assume that they absorbed it the first time. Train them again. And again.

Even though consumers show little brand loyalty in China, the concession system (see the preceding section) has made Chinese consumers used to shopping in stores by brand rather than by type of product. As some Western retailers have found out, getting consumers to break this habit — even in small stores — is difficult. Therefore, you probably want to set your store up the same way, grouping items by brand, not by product type.

Franchising

Franchising is a very hot area for foreign businesses in China. It's a new concept to Chinese. Many foreign retailers that don't normally franchise are choosing to do so in China. By having a Chinese person operating a store, you may be able to avoid making mistakes due to your lack of knowledge or understanding of the market. Franchising may be the best way for your company to enter second- and third-tier markets if your company isn't committing enormous resources to China.

On the other hand, you want to ensure that your franchisees stick to your system. Franchisees may attempt to change important aspects of the store because they feel they have better ways of doing things. However, when franchisees make those changes, they can hurt your company a lot more by damaging the brand.

Franchising's three barriers

Rick Wang of RetailCo, Inc., developed the three barriers to Chinese-foreign cooperation that we discuss in Chapter 7. He sees that the three barriers are a particularly large issue in franchising:

- **The barrier of mind:** This first barrier is something that both franchisor and franchisee have to overcome. The franchisor needs to get comfortable with transferring its know-how and with operating in a foreign market with a different language and culture. The franchisee should understand why it needs to spend money to help build the franchisor's brand and why it should continue to pay royalties after it has received the know-how.
- **The barrier of trust:** Like the barrier of mind, the barrier of trust affects both sides. The franchisor must trust that the franchisee will be interested in growing with the brand over the long-term. The franchisee has to believe that the franchisor won't leave it high and dry, without much service or support, after it collects its franchise fee.
- **The barrier of discipline:** This barrier refers to the franchisee sticking to the franchisor's system. The franchisee needs to understand the importance of consistency (occasional gentle reminders help, too).

Finding applicants

If you're thinking of franchising your brand in China, you can find plenty of people in China who have the money and desire to become franchisees. However, because China doesn't have any credit bureaus, finding quality franchisees takes a lot of work. For example, when RetailCo recently sought out franchisees for a new footwear store concept, it received about 500 business cards at a single franchise fair. Some people even approached the company with bundles of cash. Through a gradual process of screening and interviewing, RetailCo narrowed the field from that event to just one franchisee — that's right, just one.

You can get the word out that you're offering franchise opportunities in a number of ways, including Franchise China (`www.english.franchisechina.com`) and other shows, franchise brokers, and franchising consultants. The key to selling franchises isn't having a big brand; it's being able to show people that they'll make money with you.

Screening franchisees

TIP

When looking to franchise into a second- or third-tier market (see Chapter 7 for info on tiers), make sure your franchisees have good relationships with the local government. A good business track record in a particular locale is often an indication that a potential franchisee is in good shape.

The most important part of screening franchisees is to see whether they really share your vision and buy into the brand. You can find this information only through multiple in-person interviews. You may also want to avoid franchisees who've already been operating in your field. Their ways and habits may transfer, which hurts consistency.

Protecting your company in the franchise agreement

The most costly problem you're likely to face with a franchisee is that he or she does something to damage the brand. Fortunately, China's franchise laws generally give as much (or more) protection to franchisors as Western countries' laws do. Regardless, you should put some additional protections in your agreements.

TIP

Your franchise agreements should contain provisions that allow you to terminate the agreement for damaging the brand (or for other reasons), just as they would in the West. However, you should also require franchisees to furnish a security deposit against damaging the brand. (The deposit would be in addition to the franchise fee and ongoing royalties.) Your agreement should allow you to take the security deposit if you terminate the franchise agreement for certain problems. It must be an amount that hurts the franchisee to make him or her think twice about going off the reservation.

Most foreign franchisors use five-year contracts with their Chinese franchisees, even though they use ten-year contracts elsewhere. Although such a contract is standard practice in China, some people argue that you should use the same term in China that you do elsewhere. The argument goes that by signing shorter agreements, you're not increasing your company's protection; after all, a franchise agreement should allow you to terminate it in many instances, anyway. On the other hand, you're sending the franchisees the message you don't trust them, which may sow the seeds for future problems in the relationship.

Other franchisee challenges

The biggest day-to-day issue with franchisees is getting them to stick to your system. You need good controls to monitor and work with your franchisees, particularly if they're in different parts of China. Just installing video cameras to monitor stores doesn't work. You need to send a combination of secret shoppers and company representatives in to look at the stores and speak with the franchisees. It's also vital that your company have a strong inventory management and tracking system.

Another issue that can arise later is that a franchisee thinks he or she understands your concept well enough to go independent. You may have a little more leverage to prevent that in China than you would in the West. If your company controls the supply chain to the franchisee, it's probably not a big deal if the franchisee goes independent — he or she will have a hard time competing with you. If you don't have that leverage (particularly because the concept is almost exclusive knowledge and system based), you face the same risk as you'd take outside of China.

Direct-to-consumer

Companies are selling directly to Chinese consumers through media such as catalogs, television shopping channels, and the Internet. Catalog selling has existed in China for over ten years, but market penetration is still relatively low. Catalog sales are concentrated in a small range of product types, such as baby products, books, magazines, and clothing, although you may find opportunities to sell other products through catalogs. One challenge is that getting good prospective customer lists in China can be a challenge. Internet sales are a mixture of stand-alone online stores and Web sites that have many small sellers.

Shipping was initially unreliable, but domestic shipping within China is now pretty good. Shipping collect on delivery (COD) to customers isn't uncommon.

Online payment systems are pretty well established in China. Most customers in China have accounts with banks that have developed electronic payment systems in recent years. Therefore, individuals who have Internet access are usually able to pay for products through online debits to their bank accounts.

Selling services

Service areas that are growing particularly quickly in China include financial services, healthcare, travel, and education. In a number of service areas, Western brands have an edge over Chinese ones — particularly if they're providing services that Chinese perceive to be more complex or more developed in the West.

Selling services to Chinese consumers has a lot in common with selling products. Brands can be quite effective in marketing services in China; however, the service industry hasn't developed as many well-known brands yet. Brand-building strategies are similar for services, except that giving the consumer face with something intangible is harder.

TIP

Provide gifts or attractive membership cards — something tangible that can confer face, especially if it identifies the customer with a high-end service brand.

Treating customers in a way that gives them face is particularly important with high-end consumers. This type of customer service makes cultural sense. For example, place a customer in the seat of honor when dining with him or her. (For more on cultural understanding, see Chapter 11.)

Chinese consumers aren't as sophisticated in evaluating services as Western customers are. Therefore, you have to educate the consumer on your offering. Your salespeople need to be good at fact-based selling (which we discuss earlier in this chapter).

Selling Business-to-Business

You can break down business-to-business (B2B) selling into the broad categories of products and services: The large product categories of B2B sales in China are

- Product components
- Raw materials
- Capital equipment (such as factory machines and telecom equipment)

On the service side, businesses are commonly selling other businesses the following:

- Consulting
- Software/IT outsourcing
- Financial services

Businesses' purchasing decisions are more complex than consumers'. If you're selling to state-owned enterprises (SOEs), you have to sell at multiple layers of the same organization. That's because SOEs have a number of people involved in making purchasing decisions. Therefore, building good and trusting relationships with these people is important.

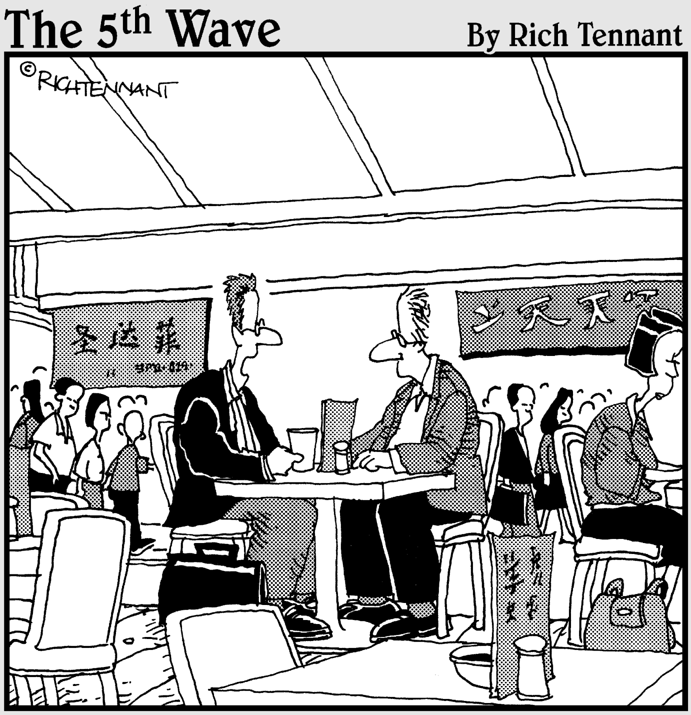
Private companies' purchasing decisions are generally all made by one person — the owner. Don't waste time pitching to middle-level employees. Employees usually have little empowerment in Chinese companies.

In open, competitive industries (such as garment industries), companies are used to and are reasonably receptive to cold-calling. However, in certain industries dominated by large companies that the government highly regulates and protects (such as in oil production), you need introductions to get in the door because they operate in a more “members-only” type of environment.

Here are some tips for courting B2B sales:

- When selling to businesses, have a nice, glossy brochure. Fortunately, you can print them in China for a good deal less than in the West.
- Chinese companies are open to speaking with your existing customers for references. If possible, make that step easy for them and bring them around to meet some of your customers.
- The Chinese are beginning to enjoy traveling. Organizing business/leisure conferences for large customers can be effective, and this method is becoming more common.

Part IV
Building Successful Business Relationships



"I've heard that in China, it's good to have some Guanxi when you go into a business negotiation. Let's stop at a market and pick some up before tomorrow's meeting."

In this part . . .

Here, we take a close look at building relationships in China and show you their value. Business etiquette is important no matter where you do business, but because of China's deep cultural traditions, being respectful and polite seems to take on even more importance. This part explains how to follow protocol and discusses how to avoid behavior that may unexpectedly hurt your dealings with the Chinese. The Chinese love their food and like to show visiting foreigners the many varieties of Chinese delicacies, so we also show you how to enjoy the traditional Chinese banquet that's just another part of doing business in China.

Chapter 15

Fostering Fruitful Friendships: The Art of *Guan Xi*

In This Chapter

- Understanding the importance of relationships to the Chinese
- Making connections with businesspeople and government officials
- Noting why you can't depend solely on *guan xi*

Many Westerners have heard that relationships are critical to doing business in China. In fact, in the West, a great deal of mystique surrounds the way business relationships work in this corner of Asia. Make no mistake about it — relationships *are* important to doing business in China; however, they're not significantly more important than they are in the West. This chapter explains what these relationships are, what benefits they can bring, and how to effectively develop them.

You Scratch My Back, I'll Scratch Yours: Introducing Guan Xi

The Chinese term for relationships, which we use throughout this book, is *guan xi* (gwon shee). *Guan xi* has no literal translation to English, but generally, the Chinese use the expression *you* (yo) *guan xi,* or "you have *guan xi,*" to mean that someone has a particular relationship or is generally well connected. The bottom line is that you either have it or don't — and you definitely want to have *guan xi.*

In some ways, doing business with *guan xi* is similar to the way people do business in the West. *Guan xi* is a more muscular form of the principle that *it's not what you know; it's who you know. Guan xi* is mainly based on trust and the understanding that favors should be returned, which are also important in Western business relationships. However, subtle and important differences crop up between the way these factors work in the West and in Chinese *guan xi*. The following sections help you understand those differences.

REMEMBER

In the end, a good business plan can succeed without good *guan xi* (although you're likely to develop good *guan xi* as you succeed, because everybody loves a winner); likewise, a bad business plan will fail even with the best possible *guan xi*. See Chapter 4 for more about planning for China.

Trusting performance

Parties must trust each other in order to have *guan xi*. (No, they don't need trust because they're doing something illegal and have to trust each other to keep quiet!) The trust upon which *guan xi* rests is broader and more about common sense. For example, if an official with whom you have *guan xi* promises to expedite an approval process, he or she trusts that you have your documentation in order and that your application doesn't contain any surprises.

China has neither credit reporting agencies nor a Better Business Bureau, so good information on potential business associates is hard to come by from official sources. This situation makes *guan xi* that much more necessary for doing business. Trust is an important factor because, as we discuss later in this chapter, Chinese businesspeople frequently recommend their business contacts to one another. If a businessperson provides a reference for somebody who subsequently does a bad job, then the referring person ends up looking bad and his or her *guan xi* weakens.

Guan xi is based on *implied* reciprocity. Many Westerners have the misconception that if you "buy" the right Chinese officials, you can accomplish anything. Although China, like all countries, has a certain level of corruption, officials who can be paid off are the exception, not the rule. That said, expecting something in return when you make an effort on someone else's behalf is human nature.

In practice, people with whom you have *guan xi* will usually help you while expecting something in return in the future. In other words, if the Chinese party thinks you can help in the future, he or she will view the favor as an investment. This practice may be analogous to the scene in the first *Godfather* movie where Vito Corleone promises to help the funeral parlor owner. In the scene, Corleone says he'll help the parlor owner get revenge but that he may someday call upon the parlor owner to pay back the favor. Unlike the Godfather though, in *guan xi,* the Chinese person is unlikely to come right out and tell you that he or she expects something in return.

Calling in favors for a speedy response

Guan xi sometimes can help with relatively mundane tasks. Here's the story of one businessman from Taiwan who's based in Shanghai:

When he moved into his new apartment, he called the phone company (a monopoly) to install broadband Internet. The phone company told him that it had no broadband lines available and that he should call back the next day. The next day the story was the same, as was the day after that and the day after that. Finally, he got so frustrated that he went to the office where the Internet installation scheduler worked. He went to the scheduler's office and pleaded his case. The scheduler unsympathetically opened his scheduling book, looked through it for a moment, and then said, "I'm sorry, but we have no lines available." The businessman left in a huff.

The man then called a friend who had previously told him that he knew people at the phone company. The friend placed a phone call, and within a few days, the Internet was installed!

Repaying favors

Beyond gaining someone's trust, you have to figure out how to repay the favor. The range of possibilities is endless, from sharing a few drinks or dinner to helping an official's relatives find jobs (hopefully not with your company). Some repayment obligations may not be worth the favor you're getting. Carefully weigh what you can do to repay — and are comfortable with — before accepting favors.

WARNING!

Never offer money when asking for a favor. Offering a bribe is highly insulting to all but the most corrupt officials. In addition, bribing or attempting to bribe a foreign government official may violate your home country's laws, such as the United States's Foreign Corrupt Practices Act. *Guan xi* isn't about bribes and corruption; it's about developing long-term mutually beneficial relationships that can help your business grow and profit in China.

Beyond bribes, offering up an obvious quid pro quo when asking for a favor is usually bad form. If you have a commercial arrangement to propose, that's fine. Don't couch it in terms of doing favors, though.

REMEMBER

One of the crucial aspects of developing *guan xi* is to constantly think about how you can help people you know. You shouldn't forget when people do favors for you, and you should try to do even small favors for them without being asked. When thinking about the possible ways to grant or repay a favor, keep the following ideas in mind:

- At the time that somebody does you a favor, she may not have any specific repayment in mind — she may simply feel that you're going places and may be able to help her down the road. Asking whether she can use your help in any way doesn't hurt. She may tell you not to worry about it, but don't take such a denial literally — be ready to repay the favor when you see an opportunity.
- Often you make the repayment over time, though not always. For example, you may know a certain person who'd be a good introduction for your new Chinese contact. To develop *guan xi* with your new contact, introducing this person early in the relationship may be a good starting point.
- Even small favors, such as editing some English for a person's business or advising him on a trip to your country, are appreciated and can help to build your *guan xi*.
- Most Chinese prefer to develop ongoing relationships rather than doing mutual one-off favors. At the start of a relationship, try to think of what your obligations may eventually amount to. Depending on whom you're dealing with, you may not be comfortable receiving favors from a particular person. *Guan xi* obligations are very important, and you risk seriously offending someone if you refuse a later request for help. Therefore, it's vital that you assess who is offering to help you and think about whether you'd really want to help him or her later.

TIP

The best way to deal with a request you're uncomfortable with is to avoid putting yourself in that situation in the first place. If you do find yourself in such a situation, though, refuse *without* using very direct language to help the other party save face (see Chapter 11). In many cases, rather than saying you can't do it, it's better to say something to the effect of "it may be difficult." Then try to think of a compromise you're comfortable with. Of course, you can't make everybody happy all the time.

Developing guan xi in government and business

Many foreigners may find it unusual that, in China, having relationships with both businesspeople and government officials is a good thing. Even maintaining a friendly relationship with a relatively low-ranking government employee can pay off.

The People's Republic: Guan xi with government officials

Guan xi with government officials can be quite helpful in China, especially when you need to navigate the opaque processes and bureaucracies of the Chinese government. If you develop relationships with the right officials, they may be able to

- Advise you in advance about whether you're likely to receive approval (or alternately, tell you what you need to do for approval); this boost can spare you a lot of time and money.
- Expedite the approval process in certain situations.
- Use a favorable interpretation of the law to help you — for example, an official may read the law in a way that gives your business the most favorable tax treatment possible (keeping in mind that the national and local governments have complicated tax schemes to provide incentives for the development of certain industries).
- Tell you about future developments that may be important to your business, such as road construction or possible changes in the law.

Guan xi also may come into play when submitting competitive proposals for a project, such as property development. Having a good relationship with the deciding officials definitely gives you an edge.

REMEMBER

Westerners commonly misunderstand why having good *guan xi* with the government is so important. The main point is that *guan xi* won't get officials to break rules for you. Instead, it may get them to use the rules' inherent flexibility to help you out.

The people: Guan xi with Chinese businesspeople

The Chinese are more inclined to mix friendship and business than most Westerners are. In fact, many Chinese prefer to do business with people they're comfortable with. Otherwise, the Chinese prefer to do business with people their friends can vouch for.

Although using such connections is normal in the West, the difference is that a personal validation that's unrelated to business (for instance, "Zhang is a good guy") may carry almost as much weight as a business one ("Zhang did a great job installing my plumbing"). This idea is an important application of the trust factor of *guan xi;* although the person vouching for Zhang may not know firsthand whether he's a good contractor, she's comfortable with Zhang and trusts that Zhang does a good job in his business because of the way he handles himself in their personal dealings. Therefore, if you develop good *guan xi* with businesspeople, they may refer customers to you. As always, though, remember the principle of reciprocity — you may need to hire at least some of the suppliers that they refer to you.

One of the most common business favors is to give or receive introductions to one's contacts. Asking for an introduction (or for other reasonable favors) is fair game, provided you believe the other person is comfortable with you and will be comfortable with the favor you're asking. You may want to be a bit indirect, though, if you haven't known the person you're asking that long.

For example, instead of asking for an introduction to Ms. Zhu, you may want to ask whether the other person can introduce you to someone who can help you with such-and-such.

TIP

People often provide introductions over a meal. In China, friends rarely split bills — they take turns paying. If someone is giving you an introduction, remember who's doing whom the favor. You should pay for the entire bill if the meal is just the three of you, provided that the person arranging the meal lets you do so.

Developing Your Own Guan Xi

Many people who arrive in China don't have a good sense of whom they should have *guan xi* with. In that case, reaching out to other foreigners who have some experience in where you want to be, or are doing what you want to do, is a good start. They can hopefully give you some idea of whom to create *guan xi* with.

REMEMBER

After identifying your *guan xi* targets, you often need to build bridges to reach them. Along the way, you have to remember two of the cardinal rules of *guan xi:*

- Follow through on your promises.
- Reciprocate.

The following sections help guide you through this process.

Starting from square one: Reaching out

The key to developing *guan xi* is to be proactive. In general, your goal should be to interact with as many people as possible. Don't be afraid of being an obvious networker — in China, most people are networking pretty much all the time. In fact, at many networking events, you encounter Chinese who are "serial networkers," people who pass you their business cards without saying hello or introducing themselves first. Although you don't want to come off as a serial networker, you should exercise good social etiquette (see Chapter 16) and be upfront that you're in China for a particular purpose.

REMEMBER

In your initial contacts, you want to

- Get introductions to people who are involved in your area (industry or geography) of interest
- Get the big picture of whom you should be trying to meet and what resources are available to help you

Growing older, growing *guan xi*

All other things being equal, the older or more experienced you are, the faster your *guan xi* will develop. This concept is consistent with the underlying idea of reciprocity. The more accomplishments under your belt, the more likely you're able to offer the Chinese something of value. Also, as members of a Confucian society, the Chinese are generally more reverent of age than Westerners are. You can see this respect for age in the Chinese leadership, who tend to be fairly aged by Western standards.

The following sections explain how you can reach out — both East and West.

Making contact first with other Westerners

If you're a Westerner who speaks no Chinese, who's in China for the first time, and who has no pre-existing contacts, how do you find people to develop *guan xi* with? Often, the best way is to meet and reach out to people in the Western business community.

In Beijing and Shanghai, the Western business community is quite diverse, from small-business owners to Fortune 500 executives, recent college graduates to people with over ten years of experience in China. Their industries run the gamut from import/export to financial services. In other cities and towns, the Western community is usually more limited — often mostly people involved in manufacturing or import/export.

In most cases, Westerners in China are very approachable. They tend to feel a sense of being "in it together" with other Westerners, so they're often willing to speak with newly arrived Westerners. One way to approach cold-calling (or e-mailing) other Westerners is to contact people with whom you have something in common: for example, alumni of your school, people in a business similar to your own, or people from the same state or province.

Developing Chinese connections

TIP

In addition to talking to Westerners in China, you can begin with Chinese people who are close to the Western business community. They speak English and can often provide a bridge to important Chinese contacts.

You may be able to develop *guan xi* with some government officials right off the bat. If you're interested in doing business in a less developed part of China or in a special economic zone (SEZ), you may find that government officials — especially those who deal with foreign investment — may be more interested in meeting with you. Many of these officials are motivated by bringing investments and jobs to their areas of responsibility. If your project is big enough (or if they're desperate enough), they may want to meet you more than you want to meet them! For more on dealing with government officials, see Chapter 8.

Gathering in mixed company

Many Western countries have chambers of commerce in larger Chinese cities. The chambers of commerce frequently hold networking and socializing events that draw both foreign businesspeople and Chinese who speak English well. The chambers and other organizations also hold industry-specific events. (See Chapter 4 for other places and strategies to start networking.) These events may draw people who are more established and are therefore able to provide you with more assistance.

In the larger cities, networking and socializing events occur every day of the week (usually several per day, actually). You can get information about these events by finding Web sites serving expatriates in those cities or by contacting your home country's nearest chamber of commerce in China.

If a newbie Westerner arrives in a part of China that's off the beaten path, fewer formal networking events and organizations are available. However, the Western business communities will probably be more welcoming. And that Westerner may stand out more, which can make developing Chinese contacts easier.

Beware of people who make claims about how their *guan xi* enables them to do impressive things. Both Chinese and Westerners are prone to exaggerating their connections, usually just to seem more important but sometimes because they want something from you. When dealing with the Chinese especially, telling who really has the *guan xi* and who doesn't can be difficult; however, as a general rule, the more impressive the claim, the less likely it is to be true. Try to avoid committing too much on your end until you figure out whether somebody can really deliver.

Building bridges to your target contacts

As you speak with people and begin to crystallize your thinking about whom you want to develop *guan xi* with (see Chapter 4), visualize yourself as being on one side of a river and your targets on the other. The people who constitute your network become planks in a bridge over the river. With each person you meet, you hope that he or she can introduce you to someone who can bring you closer to the other side. When you're finished building your bridge, the planks near where you started are likely to be mostly Western, while the planks near your targets are likely to be Chinese.

Strengthening ties through food, drink, and social calls

Building the bridge is all about forming and growing a web of contacts. When you meet interesting people, follow up with them by having lunch or drinks, or by stopping in at their offices.

After your initial follow-up, think about arranging group meals with your contacts. Meals are effective relationship-building tools — particularly with Chinese. Chinese-style meals take place around circular tables that have turntables (lazy Susans) on them. This setup allows everyone to share food, which makes the meals friendlier and more interactive. (See Chapter 16 for more information on social dining.) In fact, the Chinese generally prefer to socialize and drink in restaurants rather than in bars. Here are several reasons to arrange group meals:

- They solidify relationships with your contacts.
- They may provide your contacts with valuable connections.
- Your contacts may bring additional people for you to meet.
- You may receive invitations to attend others' group meals, which are fantastic networking opportunities.

Traditionally, sharing alcohol has also been an important facet of developing trust in China. Northern Chinese tend to be the heaviest social drinkers. In major cities, sharing drinks is less a staple of doing business than it used to be; however, many local government officials still like to imbibe heavily from time to time.

A number of Chinese people feel more comfortable with people after they've shared some drinks. Alcohol can also help to minimize language barriers because when people drink and lose inhibitions, they tend to make greater efforts to communicate directly with each other across languages. These efforts are often just attempts at rudimentary English (or Chinese) phrases, such as "Chinese food very good." Such interactions, particularly if one has been imbibing, may be humorous and endearing. Also, the Chinese know that people are more honest when drinking.

If a person refuses to drink much when his or her host is heavily imbibing, the host may lose face. However, as a Westerner, you can get away without drinking much (or drinking at all) more easily than the Chinese can — in other words, your reticence won't be that offensive. If you want to moderate (or eliminate) your intake, it's best to politely tell your host beforehand. Perhaps have a "designated drinker" for your side if you don't want to drink much.

Even if the people you meet while drinking and dining and through other avenues don't seem to be directly involved in your target business, they probably know people who know people; therefore, be open-minded about meeting a variety of people — not just people within your industry.

Dealing with language issues

When a newbie Westerner finally gets to the Chinese part of the bridge, he or she has to deal with the language issue. Certainly, all Westerners in China should know a few basic Chinese phrases, such as *hello, thank you,* and *good-bye* (see the Cheat Sheet at the front of the book). Beyond that, however, you need to use interpreters (see Chapter 2).

Following through on your promises

When seeking to develop relationships, you must remember the two bases of *guan xi:* trust and implied reciprocity. You can't earn trust overnight, of course. Hopefully, you receive introductions from people who can vouch for you; if not, the problem isn't impossible — developing trust will just take more time.

Keep in mind that China isn't the place that the West frequently portrays it to be — cheats are the exception rather than the rule. Besides receiving an endorsement, you have other ways to earn trust as well:

- Diligently maintain relationships and have periodic contact with your targets because familiarity by itself creates some level of trust.
- Keep small promises, such as the promise to call by a certain time. Breaking a promise is a big taboo in Chinese culture.
- Provide examples of how you've done business in an honest way in the past.
- Tell somebody information about yourself or your business that's somewhat sensitive (but not unflattering!).

  You shouldn't lie or exaggerate (or technically, get caught doing so). Damaging your credibility is a problem anywhere, but the news of your misstep may travel more quickly in China, given the reliance on unofficial channels (like *guan xi*) to gather information on prospective business contacts.

Putting your best foot forward

If you represent a large multinational corporation, everyone already assumes that you can do your part — local officials will covet your company's potential investment and jobs. For the newbie lone Westerner, implying that you can reciprocate favors is a bit more complicated.

REMEMBER

Implying that you can reciprocate favors is a lot like interviewing for a job — you want to build your capabilities up as much as possible without creating a potential credibility crisis. Your goal is for the Chinese side to believe that you (or your company) are committed to your proposal and that you have the resources to make it work.

Some Westerners have good access to capital and a strong sense of how to execute their businesses that shows through to people who are considering doing them a favor. For Westerners who are less well equipped, the key is to downplay your weaknesses. Be yourself, but make sure you appear as strong as possible.

For example, if you don't have much money but you know something about investing, you may want to talk some about investing (without overdoing it, of course). Many Chinese would assume that a Westerner who's knowledgeable about investing actually has money to invest. That way, you appear to be in a strong position to repay the favor at some time in the future. Of course, keep working on addressing any weaknesses — continue looking for potential investors and develop your technical know-how.

Chinese hold some favorable stereotypes of Westerners — in particular, they think Westerners have superior access to capital and strong, sophisticated technical know-how. Therefore, consider playing into the stereotypes. For one, looking "Western" helps. That means dressing well — Chinese business fashion is a bit plain, so try to exhibit some business-appropriate flair (think *GQ*) if you're comfortable. Also, Chinese are very brand conscious with high-end items; however, they tend to know only the most obvious names in a given category, such as Rolex and Louis Vuitton. Displaying expensive wrist hardware and clothing accessories is by no means a necessity, but it can help.

Looking at the Limitations of Guan Xi

Here are a couple reasons that relying on *guan xi* can come back to bite you:

- *Guan xi* is great until one of your key relationships changes jobs or positions. The situation's bad if the replacement doesn't know you; it's even worse if she and her predecessor were rivals — then, she may hold your relationship with her predecessor against you! If you were dependant upon the person who changed jobs, you may find yourself in a difficult situation.

- Everybody has bosses. Although your contact may have told you or promised you one thing, his superiors may not approve it. This situation happens often with government officials who misjudge how their higher ups will react. So even though your contact meant what he told you, in a place as bureaucratic as China is, things are almost always subject to somebody else's approval.

REMEMBER

Although good *guan xi* is great to have, make sure you have a Plan B in case your contact doesn't come through.

Chapter 16

Saying and Doing the Right Things: Chinese Business Etiquette

In This Chapter

- Behaving appropriately in business and social settings
- Mastering the fine art of banqueting
- Exchanging symbols of gratitude

With any business dealing, etiquette is key to winning over a new client or partner. The same holds true for China, where a difference in traditions can lead to some awkward, deal-breaking moments. This chapter advises you on the proper way to be polite while in a meeting, explains how to handle the marathon meals known as Chinese banquets, and offers up some useful information on how to behave in China.

Minding Your Business Manners

Some people say good manners make good business, and that's certainly the way things work in China. Good impressions generally lead to good relationships, and good relationships lead to good business opportunities (see Chapter 15 for info on relationships). For the first-time visitor to China, getting to know how to behave can be almost overwhelming. After you get into the swing of things, however, you find that being polite and good mannered is the only way to do business in China.

REMEMBER

Although you may find Chinese people to be reserved at times, they're generally very approachable. Getting the relationships going in the right direction just takes time. So be yourself — honest, business-like, and polite. Follow the lead of your Chinese hosts in China. In no time, you'll be making introductions, giving out your Chinese business card, and impressing the Chinese along the way.

Note: You may want to present a gift at your final meeting or banquet. For more information, see "Tokens of Appreciation: Giving Gifts Correctly," at the end of this chapter. For details specific to business meetings, go to Chapter 11.

Dressing for success

Chinese businesspeople tend to dress conservatively. Here's what men and women wear:

- **Men:** Dark suits are popular for men in China. You should always wear a suit and tie to business meetings and banquets unless you're specifically doing something like touring a factory. Your tie shouldn't be too loud.
- **Women:** Businesswomen tend to dress very modestly in China. Revealing necklines, flashy jewelry, or skimpy skirts aren't appropriate. Lean toward classic designs and silhouettes rather than following the latest trends.

  If you're a seasoned female executive and you'll be leading discussions for your firm, dress more conservatively. The most important things are to determine whether your objective is to blend in or be seen, and to dress right for the occasion.

TIP

Visiting a factory in China is something many foreigners do, so plan to change clothes if your schedule allows. Many times, you won't have the opportunity to swap your business attire for more casual gear, but if you do, women should go with slacks and flat shoes. For men, dress down into casual pants and a nice shirt.

Within reason, dressing a bit less conservatively and wearing more sophisticated clothes than the Chinese do is okay. For men, this may be a lighter shade of suit color compared to a traditional dark suit. Women may opt for brighter colors or patterns (perhaps follow the lead of Vice Premier Wu Yi). Just don't go overboard and get too flashy.

A good-quality watch can go a long way in making an impression with the Chinese. The Chinese are particularly fond of expensive watches because they indicate status, so if you have one, plan to wear it.

REMEMBER

Modesty doesn't mean dressing down. Opt for clothes with good workmanship, and make a statement with the way you're dressed — you want to demonstrate to the Chinese that you're a successful businessperson. The Chinese like to see evidence that you've reached a certain level of success or rank within your company and that you know how to dress accordingly.

Greeting and meeting the Chinese

Meeting the Chinese is more formal than what you're likely used to because you need to give face to the person you're meeting. (For more about face, go to Chapter 11.) You also need to take more time to meet people properly. The Chinese usually greet foreigners with a handshake — a less-than-firm handshake, so don't give them a bone-crushing handshake in return. The Chinese may just nod their head ever so slightly when they greet you.

The Chinese strongly value seniority and want to know who the company's leaders are. Introducing the two most senior executives to each other first is customary. Before people sit down, the leaders generally introduce themselves (unless one of the Chinese people knows you and wants to personally introduce you to a higher-ranking person). Others are then introduced — usually in descending order of rank within the company. Sometimes introductions are repeated at the opening of the meeting as the head executive from each side introduces his or her team one by one.

Get up on your feet and do a proper introduction. Common courtesy in China calls for you to be on your feet when greeting somebody, especially at banquets (see the upcoming section "Enjoying a Chinese Banquet" for info on dining).

REMEMBER

When addressing someone, refer to the person's family name, not his or her given name. The first name you see on a Chinese person's business card is the family name (see the next section for info on business cards). Refer to the person as Mr., Mrs., or Miss, even outside the business realm.

By placing the family name in front of the given name, the Chinese show respect for their elders. Thus, Ms. Li Shu Min is Ms. Li, and Mr. Xu Bao Jun is Mr. Xu (pronounced shoo). They'll likely call you by your surname, too. A safe way for the Chinese to address women is to call them Madame, so expect they may refer to you this way.

TIP

You can win more points by referring to people by their titles, followed by last names. For example, you may address Chairman Wang or General Manager Han.

Presenting your business card

Exchanging business cards in China is almost a formal ceremony in itself. With a little practice, you can master the art of presenting your business card the right way in China.

Before you go to China, have some business cards made up in Mandarin Chinese. Figure 16-1 shows a sample card. At a minimum, they should include your

- Name
- Title
- Company
- E-mail address

You may want to include your mobile phone number(s) on your card. Providing your home mobile phone number is useful so the Chinese can call you at home due to the time difference (they don't usually expect you to take their call at 3 a.m. — don't worry!). If you'll have a permanent China number at which they can reach you on future trips, including that is a good idea, too.

One side of the card should be in English, the other side, Chinese. Assuming that you'll primarily be on the mainland, use so-called simplified Chinese characters for your business cards, not the traditional characters used in Taiwan and Hong Kong. And bring plenty of business cards to China — you'll need them.

Figure 16-1: Each card does double duty in English and Chinese.

Business card translations work best if you have a Chinese contact who can help guide you with the translation. If not, you need to find a reputable translation services company (see Chapter 2 for details).

After you get a translation of your name and/or that of your company name, bounce it off of some native Chinese speakers whose judgment you trust. Translators usually translate people's names, and sometimes companies' names, by using Chinese words that have similar sounds. However, the Chinese names you use should not only sound similar but also have positive meanings — the Chinese frequently compliment a well-chosen name or notice an odd-sounding one. When involving several people's opinions on Chinese names, you'll rarely get a clear consensus on the best name; however, you can usually eliminate the bad ones.

You usually exchange business cards before you sit down to do business or start a banquet. Who goes first usually doesn't matter. It's not unusual to give somebody a business card whenever you first meet — even if the occasion is social.

When you present a business card, use both hands to hold the long side of the card as you present it to the person you're being introduced to. Present your card with the Chinese side facing up. When the Chinese person presents a business card to you, be sure to receive it with both hands, hold it the same way he or she handed it to you, and noticeably study the card for a short while.

Treat a person's business card with respect. Don't just shove it into your pocket after you receive it. To be polite, carefully put the business card away. You can also place the card on the table. This act helps you to remember who everyone is. And never write on a business card that you receive from a Chinese person.

Behaving yourself in Chinese company

Understand that you're a guest in China. In other words, you need to show respect for the way things work and don't work in China. Overinflated egos, overconfidence, and a lack of humility don't go over well in China.

Getting the little things right in China helps you to get the bigger things done later. Here are some things you should know:

- **Talking about controversial subjects:** Avoid bringing up the subjects of politics and religion at all costs. Stay away from any references to Taiwan, the Dali Lama, or the Falun Gong.

Your Chinese host may start discussing political or religious topics with you. He or she may be curious to hear your views as an outsider and may feel more comfortable expressing impolitic views because you're a foreigner. If this happens, tread very carefully. Until you're absolutely certain of your host's views, it's best to discuss many of these topics by praising the government overall while suggesting that certain things can be done better (unless you completely agree with the government, that is!).

- **Being late:** The Chinese are very punctual. Be sure you show up for business meetings and banquets on time. If you may be late, make sure you have a mobile phone number so you can contact your Chinese host.
- **Being arrogant:** The Chinese are very humble people, so acting pompous or arrogant won't get you very far. Check your ego when you check your bags at the airport.
- **Making too much personal contact:** The Chinese people don't engage in much physical contact with foreign visitors: no killer handshakes or backslapping, please. And the only appropriate contact with a Chinese businesswoman is a good handshake.
- **Gesturing the wrong way:** Don't make any unusual facial expressions, and avoid excessive use of your hands while talking to the Chinese people. The Chinese are usually quite reserved in business meetings. Although you don't have to match their demeanor, you shouldn't be flamboyant.
- **Being disrespectful to elders:** Older people are revered in China. Treat them with respect, and your Chinese host will respect you more.
- **Using bad language or getting angry:** Whatever you do, don't use any racial slurs or curse words when you're in front of the Chinese. Getting angry, unless it's part of a negotiating tactic, is a big no-no (see Chapter 6 for info on negotiating).

For details on following etiquette at meetings, see Chapter 11.

Enjoying a Chinese Banquet

The Chinese people have a long tradition of putting on elaborate banquets. Banquets usually celebrate holidays, weddings, special occasions, and business dealings. They're a great way to get to know your Chinese friends in a casual and relaxed setting. Most importantly, they're a fun evening for everybody, so relax and enjoy.

Usually, the Chinese first host a banquet in your honor. It's customary for the visiting foreigners to reciprocate with a return banquet if your travel schedule allows. See the "Returning the favor: Hosting a banquet" section later for planning advice.

Knowing what to expect

Knowing how a Chinese banquet works shows your Chinese host that you know a little bit about Chinese tradition and etiquette.

TIP

Take mental notes about the protocol that takes place during the evening so you can be better prepared to play the role of host at the return banquet.

Arriving at the restaurant

Chinese banquets are generally held in private rooms at popular restaurants known for their good atmosphere, food, and service. Often, the host chooses one of his or her favorite restaurants where he or she knows the management and staff.

Although Chinese banquets can take place at lunchtime, most start in the early evening and last for two or so hours. The Chinese generally take their meals earlier than many Westerners do — expect that a banquet in the evening would start at 6 p.m. and end around 8 p.m.

REMEMBER

Having your group arrive at the restaurant all together at the same time is a good idea. Be on time for the banquet, but don't show up before your host arrives.

After your group is assembled at the restaurant, the leader of your group should enter the room first, followed by other guests in rank order. The highest-ranking host greets the leader of your group. The host then looks after the honored guest during the course of the banquet.

REMEMBER

Arranging the seating

Seating is extremely important at a Chinese banquet. Remain standing and allow the host to arrange the proper seating.

The host first guides the most senior leader of your group to his or her place at the table. The honored guest sits to the right of the host. The other members of the hosting party guide the remaining guests to their appropriate seats at the table.

At the table, the host usually sits facing the door to the banquet room. The remaining guests are seated according to rank in the remaining seats, with the lowest-ranked guest with his or her back to the door. Usually, an interpreter or two are mixed into the seating plan to assist with communication.

On your first banquet with your host, it's helpful and often customary to provide a list of names and rank of your guests to the host before the banquet. This step allows the host to organize the proper seating arrangements for the banquet. Protocol is very important to the Chinese, so make it easy for them to get everything right.

Understanding the table setting

Large, round banquet tables usually provide seating for up to 12 people. At large state banquets or banquets to celebrate special occasions, such as opening a company in China, you may see seating for 100 or more. A large revolving tray, sometimes called a lazy Susan, rests in the center of the table.

Cold and/or hot towels may be available for you to wipe your hands on before and after the meal. Just put the towel to the side of your place setting when you're through with it. Don't be surprised to see the Chinese use the towel to wipe their faces as well. Using the towel for your hands is okay, but we don't recommend wiping your face with it — the towels may not be as hygienic as you may expect.

As for tableware, your chopsticks are to the right of the table setting. When you aren't using your chopsticks, rest them on the chopsticks holder to the right of your setting. You have a plate and a bowl, a small dish for sauces, and a porcelain spoon for soup as part of your table setting. For drinks, you receive a wine glass, a glass for water or beer, and a small glass for liquor.

Serving you the meal

After sipping some Chinese tea, expect to make some small talk, often over snacks such as peanuts (avoid talking about politics or religion — see the upcoming section titled "Keeping conversation light"). The banquet officially begins when the host serves the honored guests to his or her right. At this time, the host makes a toast and welcomes the guests at the table (see "Toasting at banquets," later in this chapter). Wait until the host begins the meal before consuming any food or drinks.

After the host has started the meal, the other members of the Chinese group begin serving the other guests at the table. The food at a Chinese banquet is served family style. No individual portions are provided except for the soup and dessert. Servers bring food courses to the table in what seems like rapid succession of plates and more plates. They're continually replacing your used dishes with new ones.

Complimenting in China

The Chinese people are known to be humble. Their culture places much importance on modesty rather than showmanship. As a result, the Chinese often deny any compliment that you may offer, so don't be surprised if when you compliment your Chinese host, he or she politely declines it. You, too, should expect compliments to be given by the Chinese and be humble in return.

When your bowl or plate gets messy during the meal, you can exchange it for a clean one. Usually, the wait staff refreshes your tableware as needed. Don't worry about flagging down a waiter, but get the waiter's attention if you need to. Simply extend your arm behind your guest's chair, and with your palm facing downward, make a waving motion (you may want to ask a Chinese friend to show you the gesture).

After the first few dishes, guests may help themselves to the food they like. However, you can expect the Chinese hosts to continue to serve you food throughout the meal. You can politely decline to have them serve you, but it often doesn't work!

Eating directly from the serving dish is very rude. You need to move the food item from the serving plate to your own plate before you eat it.

Pacing yourself

A Chinese banquet is ultimately about having too much of a good thing, which in the Chinese culture is an exception rather than the rule. Expect to have too much to eat and drink. To avoid embarrassment, the host provides too much food on purpose. Pace yourself and don't overeat, especially at the beginning of the banquet. Having twelve or more courses of food at a Chinese banquet isn't unusual.

If you clear your plate during one of the courses or finish your soup, you're signaling to the host that you want more food. Make sure you leave a little food on your plate to avoid getting another serving from your Chinese host.

Another way to control the amount of food that gets to your plate is to politely say to your hosts that you're able to serve yourself. If you're successful with this request, you can manage the amount of food on your plate. As a general rule, you're expected to sample all the food. So managing the amount that gets onto your plate is important. If your host insists on serving you, you can leave the food on your plate or in your bowl. Servers clear it from the table before the start of the next course.

Keeping conversation light

You see a lot of toasting and eating during a banquet, but between eating and toasting, you won't talk much about business. Don't expect any high-level business discussions at Chinese banquets, and don't try to start those conversations. Generally, a lot of alcohol flows during a banquet, so it's not an appropriate time to bring up important business matters.

Chinese banquets are all about getting to know your friends better, so use the time to build a relationship with Chinese contacts who can help build your business. Although you won't be talking much business, you certainly can talk about other topics that make good conversation. All the members of the team can engage in small talk, but junior members should let the senior people take the lead. Here are some possible subjects:

- The progress China is making
- How fast life in China is changing
- How people's lives are improving
- Your home country

Stay away from family matters — unless you know your host well — and avoid talking about politics or religion.

Be sure to compliment your host on the fine quality of the food more than once during the course of the banquet. If you particularly like one dish, say so. You'll likely get another helping as a result!

Finishing the meal

You know you're getting toward the end of the banquet when the rice or the noodles reach the table. Then the dessert is served — that's your signal that the meal is (finally!) over. Soon after everyone has finished this course, the Chinese host says some closing remarks or gives a final toast. It's polite for the honored guest to say a few words, too. The Chinese host then stand ups, says a few more remarks, and thanks you for coming to the banquet. Now is the time to thank your hosts, say good night, and prepare to leave very soon.

The banquet ends promptly, and there's very little discussion after dinner. Some members of the Chinese delegation may see you outside to make sure your transportation has been arranged. Other members of the Chinese delegation stay in the dining room and settle the bill.

Saying thank you at the end of the banquet is usually enough. If you see the Chinese delegation the next day, be sure to tell them how wonderful the evening was. If you've had visitors from overseas from headquarters, they may send a note to the host when they return home to thank them for their hospitality.

Dishing up regional cuisine

So many wonderful regional cuisines and local foods are served in China. From the Southwest of China comes Sichuan-style food. It lives up to its reputation for being hot and very spicy. Two of the most popular dishes from Sichuan are twice-cooked pork and kung pao chicken.

To the North, you find Beijing-style food to be blander but very tasty. It's more of a collection of foods from around the country, influenced especially by the Northeast. Noteworthy delicacies include Beijing's wonderful Peking duck, hot and sour soup, and lots of noodles and dumplings.

Cantonese food is the most common Chinese food in the West. It includes dim sum. *Dim sum* involves a wide variety of delicious individual small dishes served Cantonese style in small wooden baskets. Usually, these well-presented dishes include such tasty morsels as spring rolls and pork buns.

In and around Shanghai, you may be treated to some refined Chinese cuisine that's been influenced by bordering provinces. The Shanghainese cooks are particularly noted for their famous drunken chicken dish and wonderful Shanghai dumplings.

WARNING!

Don't offer to pay for the meal or share in the costs in any way — it's not appropriate. You get your turn to host and pay the bill when you hold the return banquet (see "Returning the favor: Hosting a banquet").

Navigating the many courses

Having ten or more courses served at a Chinese banquet is customary. The greater number of courses, the harder the Chinese host is trying to impress the guests. And a more exotic choice of foods is usually a signal that the Chinese think you're worth impressing.

You can get a sense of what dishes will be served by reading the special menu for the banquet that's placed on the table. If it's in Chinese, ask one of your hosts to explain what'll be served. He or she will likely be delighted to tell you about the courses and specialties. Getting this info beforehand is a good way to prepare to pace yourself — you know how many courses are coming your way!

Cold dishes to start

The banquet begins with cold dishes or appetizers on small plates. Usually, servers bring out an even number of cold dishes. You'll likely be served cold luncheon meats and often a cold appetizer such as jellyfish. Take a small sampling of each kind to be polite, even if you can't tell what food is. Asking what the food is before you sample a dish is okay.

If you really have an issue with eating something (such as bull's penis), just leave it on your plate. But you should know that getting adventurous and eating what the Chinese do gives you more face. (See Chapter 11 for info on gaining face.)

Soup for all

After the servers clear the cold dishes from the table, you can expect to get a soup. Usually, the waiter or waitress serves you the soup by ladling it out from a large bowl into individual servings. Don't serve yourself. Selected varieties can include shark's fin soup, crab with corn, and sometimes turtle or snake soup. If you finish all your soup, you'll likely get a generous second serving.

More to come

The main dishes begin to appear after the soup course. China offers many different regional and local cuisines, so you'll likely receive a wide assortment of the hot dishes. The main courses often include

- Chicken
- Roast duck
- Suckling pig
- Fresh-cooked vegetables
- Plenty of seafood, including crab, conch, shrimp, abalone (mollusks), and sliced sea slugs (so-called sea cucumbers)

Don't be turned off by exotic-sounding dish names such as 1,000-year-old eggs and stinky tofu.

TIP

If you can't eat a certain food due to an allergy, for example, be sure to tell the host sitting next to you before the meal begins. The host can then alert the server to your special request.

WARNING!

Some foreigners don't like the texture or taste of some Chinese delicacies such as sea cucumbers. We recommend that you first experiment with this food at another time and place other than the banquet. If you're unsure of whether you'll like something, just leave it on your plate. The servers will take it away after the course is finished.

Try the fish

Usually, fish is the final main course (that may depend on the province you're visiting). Steamed whole fish with a light sauce is a wonderful Chinese delight. You should know that the Chinese eat most parts of the fish from the bony head to the skinny tail. And don't be surprised if your senior leader is served the lips of the fish. Seriously, fish lips are a delicacy! The fish is generally served on the bone, with the tail and head still in place. When the fish course arrives at the table, it's placed with the head of the fish pointed at the honorable guest. You're expected to help yourself to your own small piece of fish. Sometimes the waiters may serve you a piece.

The Chinese never flip or turn over the fish to get to the other side of the bone. Turning the fish over is considered bad luck. Never turn over the fish. Just leave it for the server to deal with.

Pile on the rice

Serving rice toward the end of the meal is customary. (Sometimes Chinese noodles replace rice.) Rice isn't served until the end, so don't ask for it during the meal. Serving rice toward the end of the meal is really a gesture by the Chinese host to make sure you're completely filled up. Your host wouldn't want you to leave a Chinese banquet feeling hungry!

Don't devour too much rice. You don't want to signal to your host that you're still hungry toward the end of the meal.

Have your just desserts

Finally, you arrive at the last dish for the evening. The dessert may be cake, pudding, or fresh fruit. By now, you're probably so stuffed that you can't look at another thing. Even if you're full, try to eat a sampling to be polite.

Eating the Chinese way: Using chopsticks

The Chinese have been using chopsticks for thousands of years. Unfortunately, most visitors to China haven't had quite so much practice. Although using chopsticks isn't a requirement while eating in China, the Chinese people admire your attempts to do so. If you really can't use chopsticks, your host can arrange for you to have a fork and knife, but at least make an effort before giving up.

Consider making a visit to a local Chinese restaurant to practice using chopsticks before you arrive in China.

Figuring out how to eat with chopsticks is pretty easy. The key is to hold chopsticks the right way. Chopsticks are usually thinner at the bottom than they are at the top. Hold your chopsticks near the top and place them between your thumb and your forefinger. Now keep the bottom chopstick in a fixed position while using your forefinger to move the top chopstick to grab the food (see Figure 16-2). With a little practice, you can be an expert in no time.

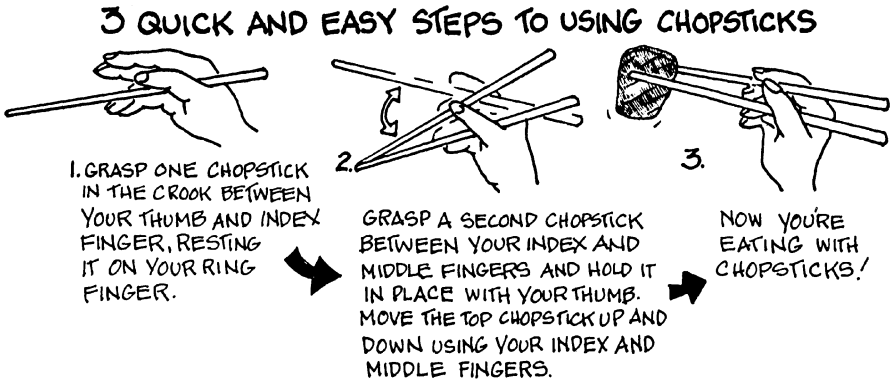


Figure 16-2: How to hold and use chopsticks.

TIP

At an important dinner meeting with your largest buyer back home, you wouldn't be tapping your soup spoon on the table in front of your guests, now would you? Table manners in China are important, too. So here are a few rules for using chopsticks the right way:

- Never point your chopsticks at someone.
- Never use chopsticks for anything but eating your food. They're not to be used like drumsticks!
- Don't stick your chopsticks into the food. In other words, don't spear your food like you're harpooning a whale. Never stick and leave your chopsticks in your rice bowl — it looks too much like the sticks of incense used in Chinese funerals. Such a move indicates death!
- Don't wave your chopsticks around while talking.
- Don't serve others with your chopsticks. Separate chopsticks just for serving others should be available.
- If you're finished using your chopsticks, place them on the chopsticks holder or on the edge of your plate. Never place chopsticks on the table except on a chopsticks holder.
- Try not to drop your chopsticks on the ground — it's considered bad luck. If you do, summon your server for a fresh pair.

Drinking at the banquet

Drinking alcohol plays a major role in a Chinese banquet. It seems to lower barriers between cultures, which can make conversation interesting. Drinking with the Chinese can certainly help build your relationship and trust with them.

The servers keep your glass of beer, wine, or Chinese liquor full during the meal. Plenty of toasting happens at the table, so the servers constantly refill your glass. Just sip your beer or wine so you don't drink too much.

Among the Chinese, the host tends to lose face if he or she drinks but the guest of honor doesn't. For Westerners, this situation isn't necessarily so, but it's best to at least drink a little if your host does. Just hope that your Chinese host isn't a big drinker so you don't have to keep up.

Sometimes, the Chinese may not be drinking what you think they're drinking. Occasionally, the Chinese people you're dining with may substitute something other than alcohol in their glasses. On rare occasions, you may even see the Chinese pour the liquor out of the glass before they drink. (Don't even think about doing this in return!) These tactics limit the alcohol consumed by the Chinese, but not your consumption.

Selecting what to drink

Usually, beer or wine and perhaps a Chinese liquor are offered. In addition to tea, soft drinks and water are also available. You may even see the Chinese mix wine with 7-Up. No cocktails are available at Chinese banquets, though. Usually, Chinese hosts serve some of China's favorite beers. Foreign brands are becoming common, too.

Your Chinese hosts generally offer a strong, clear Chinese liquor served in a short glass to be used for toasting. In Chinese, it's called *baijiu* (buy-geo). The most common Chinese brand of *baijiu* consumed at banquets is Mao Tai, a liquor made from sorghum.

WARNING!

A strong liquor such as Mao Tai can be over 100 proof (50 percent alcohol). Be sure to drink it in moderation if at all. You can substitute beer or wine if you don't like the taste.

TECHNICAL STUFF

When dining in southern China, tap your fingers lightly a couple times on the table with your middle finger after someone fills up your drink glass or tea cup.

Watching how much you drink

The Chinese like to see foreign guests get a little tipsy at banquets, so feel free to let down your guard a bit and have a few laughs with your Chinese friends. However, make sure you don't drink too much. You don't want to embarrass your company. You'll also need to be sharp for the morning meetings the Chinese usually arrange.

If you don't drink alcohol, be sure to tell your host early. Your host may still attempt to get you to drink, but he or she will soon understand that you're really not interested. As an alternative, you can choose to drink tea or a soft drink. You can still participate in toasting even though you're not drinking alcohol.

Toasting at banquets

Toasting at a Chinese banquet is critically important. It starts at the beginning of the meal and continues throughout. The host is the first one to make a toast to the visitors. As a guest, you're expected to make a toast in return, soon after the host toasts you for the first time. Failing to make toasts during the banquet doesn't leave a good impression with the Chinese.

The host holds a glass in front of him or her, one hand holding the glass and the other hand with the extended forefinger under the base of the glass. When people make a toast in China, they generally don't raise their glasses very high but keep the glasses lowered. When you're at a Chinese banquet, don't clink your glass during the toast. Just raise your glass to make a toast.

You can toast with any type of beverage, but it's common to toast with what your host is drinking. The host often says *gan bei* (gan bay), which literally means *dry glass.* You're expected to drink the entire amount that's in your glass.

Make a toast to the group or individuals. At large-scale banquets, the host often visits each table and makes an appropriate toast along the way. You can make toasts just about any time during the banquet, but be sure to let the Chinese do so first. A good time to toast is in between courses. Don't toast when the meal is winding down during dessert — unless the host is still going strong!

Keep your toasts short — don't give a speech. Keep it to somewhere between 10 to 20 seconds. Here are some good subjects that you can refer to during your toasting:

- Friendship
- Future success
- Good fortune
- Good health
- Mutual cooperation
- Prosperity
- Thank you to the host

Understanding Chinese banquet behavior

To be a polite guest at the banquet, knowing how people behave at the banquet table can really help. To avoid any surprises on your side, here's a quick list of some things you should expect:

- **Talking while eating food:** Your hosts may continue to talk while they're eating. Don't be offended and go with the flow.
- **Getting red-faced:** Some of your Chinese friends may get a bit red-faced after a few rounds of toasting at the table. This flushing isn't necessarily because they're drunk — it's a somewhat common feature among Asians to redden without actually getting drunk. Someone on the Chinese side may poke some fun at a colleague's glowing red face, but you don't want to risk embarrassing your Chinese contacts, so don't say anything yourself.
- **Belching and slurping at the table:** Don't be surprised if your Chinese hosts make belching or slurping sounds during the banquet. It's just a way for them to express how much they're enjoying the food and the company.
- **Nodding heads:** The Chinese nod their heads to you during the meal or around the banquet table and flash a smile at the same time. This is just a polite way to check in with you during the course of the banquet to make sure you're enjoying yourself. Nod and smile back. This gesture helps break down language barriers.
- **Eating meat off the bone:** Using chopsticks to eat meat off the bone is a challenge for visitors. It takes a little practice, but you can do it. Using your fingers to grab the meat off the bone isn't polite (though it's becoming increasingly common at less-formal banquets). Instead, break the meat off the bone using your chopsticks, or if you're more skilled with using chopsticks, bring the piece to your mouth using your chopsticks and eat it off the bone.
- **Dealing with fish parts:** Swallowing fish bones can be dangerous, so be careful when the fish is served whole. Try to select a serving that contains fewer bones than another. Choose the easiest piece of food on the platter.

  Try removing as many bones as you can while your serving is on your plate before you begin to eat it. People commonly put their fish serving in their mouths — bones and all. The Chinese remove the bones from their mouths using chopsticks, but if a napkin's handy, you can use it to remove the bones from your mouth. Leave the bones on your plate, which servers remove before the next course.

  The Chinese eat most of the fish on the platter. If you receive any parts of the fish that don't seem appealing to you, simply leave the serving on your plate.
- **Picking your teeth:** Cleaning your teeth using a toothpick during the meal is customary. The Chinese hide their mouth behind a hand while working a toothpick with the other hand. If you choose to use a toothpick, you should do likewise. If the toothpicks are individually wrapped in paper, you know that someone hasn't touched them already.

- **Handling slippery noodles:** As if using chopsticks weren't tricky enough, how do you get 12-inch-long slippery noodles into your mouth? The best way to deal with noodles is to have the server cut the noodles into a manageable length. Your host can arrange this for you.

  Alternatively, get the noodles into a bowl, raise the bowl closer to your mouth, and scoop the noodles into your mouth using the chopsticks. Don't worry if you make a slurping noise. This method is a lot easier, and it keeps your laundry bill to a minimum!

- **Using the rice bowl:** Getting those small grains of rice to your mouth using chopsticks can be a challenge. When in China, do as the Chinese do: The secret is to raise your bowl near your mouth using one hand and to scoop the rice into your mouth using your chopsticks with the other hand (see Figure 16-3).

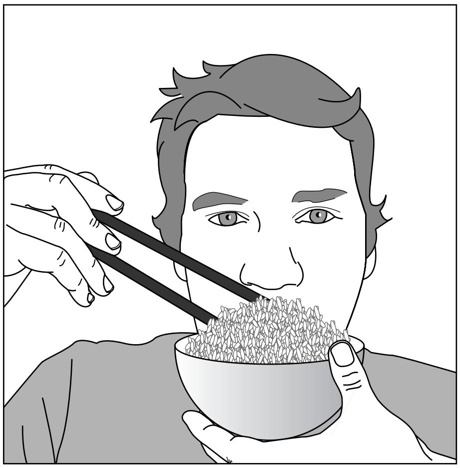


Figure 16-3: Keep the rice bowl near your mouth as you use chopsticks.

Returning the favor: Hosting a banquet

Hosting a return banquet for the Chinese is customary. Just follow how the Chinese hosted the opening banquet and play the role of host to your honored Chinese guests. Be sure to get the seating arrangements right, too.

Hosting a return banquet gives you yet another opportunity to get to know your Chinese business contacts. For the most part, the same people who entertained you will also be at the banquet you host. Therefore, you already know the ranking of the guests and can put them in the appropriate places around the table. If you're having trouble with the seating arrangements, your interpreter may be able to guide you.

Choosing a quality restaurant for the banquet is important. After all, your company is hosting. If you don't have any contacts in China who may know a reputable restaurant, you can always ask your Chinese host for a recommendation. Make sure that the restaurant is conveniently located and not too far away for everybody to get to.

After you've determined the place, make a reservation as soon as you can after arrival. Usually, you hold the return banquet the night before your departure back home. If you don't have an interpreter with you, your hotel can make a reservation for you. Make the reservation under your company name and tell them how many people you have and whether you want a private room.

Plan on providing an appropriate menu — don't make your Chinese friends lose face by providing a more elaborate banquet than the one they hosted for you. Arranging the menu can be a bit tricky for rookies, so you may want to rely on someone locally to help you choose an appropriate menu and price that suits your budget. You should know that Chinese banquets are generally fairly expensive. When you host a Chinese banquet, someone from your group should be at the restaurant about 30 minutes before the start. That way, you can ensure that seating arrangements are organized, check that the menu is correct, and determine what drinks will be served.

As the delicious food comes to an end, so does the banquet. When everyone's finished with the meal, the banquet is over. This is an ideal time for you, as the host, to provide the Chinese with a gift. (We discuss gift giving in China in the next section.) Shortly after receiving their gifts, the Chinese will be on their way. The last thing left is for you to pay the bill.

Tokens of Appreciation: Giving Gifts Correctly

Gift giving is a common practice in China. It's a good way of thanking someone for doing a special favor or celebrating a special occasion, or it may just be a way to cement your relationship with a business contact. Done the right way, exchanging gifts can help build a stronger relationship with the Chinese.

You can give a single gift to the Chinese company or give individual gifts to the Chinese people you're working with. Giving individual gifts is great because it lets everybody participate in the gift-giving ritual. If you give a single gift to the company, the recipient should be obvious to everyone. For example, you can give them a crystal decorative piece representing a significant landmark from your home city — Big Ben, Sears Tower, Sydney Harbor Bridge. Read on for details on the rites and rituals of gift giving.

Deciding how much to spend

Don't choose gifts that are too expensive. You and your company don't want to be seen to be buying favors or business in China. Also, an expensive gift may invite the Chinese to give you a more expensive gift at a later time, which you may then need to one-up, and so on.

WARNING! Check with your home country laws or company policies about monetary limits for gift giving before you decide what to do about gift giving in China. Some companies have strict rules about giving and receiving gifts.

On the other hand, you don't want to buy cheap gifts for your Chinese business contacts. Doing so reflects poorly on you and your company and is likely to insult the people you're trying to get to know better. Giving a modestly priced (US$5 to US$20) gift of good quality is something the Chinese can certainly appreciate. The gifts should be of the same value to everyone — don't give the Chinese leader a separate gift.

Choosing an appropriate gift

TIP Be sure that your gifts weren't made in China (or other Chinese places such as Hong Kong or Taiwan). Providing a gift that's made in your home country and has some significance to your local city or area is best. You can even consider gifts that include your company's logo on it. Bring along extra gifts — perhaps even a dozen — just in case you meet more people than you expect during your visit. Popular gifts to give to your Chinese contacts include the following:

- Calculators
- Paperweights
- Pens (but avoid red ink, which symbolizes severing ties)
- Liquor, especially brandy (as a company gift)

WARNING! Here are some gifts that aren't appropriate. Some of these gifts have superstitions around them or just aren't good to give:

- Clocks
- Food
- Hats

- Handkerchiefs
- Money
- Umbrellas

You can expect to receive gifts from the Chinese as well. They may include things such as scrolls, prints, calligraphy, and other gifts representing Chinese culture.

Paying attention to presentation

The color of the gift wrapping matters in China. To play it safe, use red wrapping paper. The color red is considered lucky in Chinese culture. Hopefully, some of it'll rub off on you! Yellow and pink work well, too. Stay away from blue, white, and black, and don't include a card or use any ribbon.

Also, you may want to consider the significance of the number of gifts you give. Eight is very lucky, and four is associated with death.

Hold off on the gift wrapping until after you reach China — the customs officials may need to inspect your gifts upon arrival.

Exchanging gifts

Exchanging gifts usually takes place after you've concluded your business dealings — usually at the end of the last banquet or at the end of the final meeting with your Chinese contacts before your departure. Never give gifts to the Chinese when you first meet them.

Having the most senior person from your firm present the gift is a courtesy. Give the gift with two hands to the most senior Chinese person and then to the remaining members of the Chinese delegation. Don't be surprised if the Chinese bow slightly as they receive your gift as a gesture of thanks.

If the Chinese visit your company's office in your home country, presenting a gift to them at the end of their visit with you is polite. If the gift, such as a crystal replica of the Empire State Building, is too bulky to fit in a suitcase, offer to ship it back to China as a courtesy.

Always first present the gift in person. Never send a gift to the Chinese.

The Chinese have been known to refuse gifts once, twice, or even three times before accepting a gift. Be persistent, and they'll accept your gift. (Younger Chinese may show more willingness to accept gifts.) Make sure you express your thanks when you receive and accept your gift from the Chinese. Just say that you're most thankful for their generosity and that the gift was certainly not necessary. There's no need to send a thank-you note.

In China, opening the gift in front of the person who gave it to you is impolite, so don't expect your Chinese friends to open your gift in front of you. You should do the same — open the gift later on.

Chapter 17

Managing Risks in China

In This Chapter

- Setting up financial controls
- Managing legal risks and resolving disputes
- Protecting intellectual property
- Watching out for environmental liabilities
- Insuring against risks

The best way to deal with risk is to hire experienced professionals to help implement control programs. Although good help costs money, this chapter should clarify the trade-off between spending a little money now and possibly spending big money later. The first step to good risk management is taking a good look at what you're getting yourself into.

We could write volumes on managing in China, but that's beyond the scope of this book. This chapter gives you the big picture of the risks foreign businesses commonly face. It also gives you some simple strategies to lessen those risks. We cover major areas of risk and talk about insurance options and strategies.

Doing Due Diligence

The best way to manage risk is to avoid it! Basically, look before you leap and carry out due diligence (DD) whenever possible. Basically, *due diligence* means investigating potential aspects of your business, such as partners or assets you're acquiring. How far you go with DD depends on your particular situation. You have to balance the costs and time, along with how much cooperation you can get from the other side, against the potential risks of the transaction.

WARNING!

Liability can come out of the woodwork in China. Consult with professionals experienced in China in the various DD areas to understand your risks before making any decisions on DD.

The basics: Reviewing the business license

When dealing with another company, look at its business license. The *business license* is a document that all companies in China must obtain from the Administration for Industry and Commerce (AIC — see Chapter 7).

You can either ask the company to provide its license or hire a lawyer to check at the AIC in the city where the company is registered. If a lawyer carries out the check at the AIC, he or she can do so without the company's knowledge. The business license reveals several basic pieces of information about the company:

- **Validity:** Find out at a minimum whether the company you're dealing with is validly established and exists.
- **Business scope:** Check the company's business scope to see whether it's operating within it. A company that operates outside of its business scope risks shutdown. (Chapter 7 can fill you in on scope.)
- **Signatory authorizations:** Find out who's authorized to sign contracts on the other company's behalf.

  When signing a contract, the other side's authorized signatory ideally executes it. However, if the person who's going to execute the contract isn't an authorized signatory, you want him or her to either bring along a duly executed power of attorney (that you'll keep a copy of) and/or have the company chop (stamp) the contract. (A *chop* is an official company seal that must be manufactured by a licensed chop producer. For more on chops, see Chapter 7.) Of course, having both the power of attorney and the chop is better than having just one of the two.
- **Ownership:** The business license tells you who the owners are. You may find that the legal owners aren't who you thought they were. In such cases, you need to consult with your lawyers to determine whether this situation can have a material effect on your transaction.
- **Capitalization:** You also see the company's registered capital, which is important for figuring out how well capitalized the company is in case something goes wrong.

  If you don't think the other side's finances are strong enough to protect you in the event of a problem, you may be able to get the owner(s) of a private company to guarantee potential liabilities. This technique isn't foolproof, but it may provide more comfort.

Practicing DD for joint ventures

When you're looking at setting up a joint venture (JV), the DD should be especially thorough. Usually, the Chinese partner contributes assets and/or workers to the JV. You need to have financial professionals confirm that the assets are worth what the partner claims they are (trying to overvalue their capital contributions isn't uncommon). Technical people should assess the assets to see whether they're in good working order and can do what they're supposed to do.

The legal team should check the titles to the assets and see whether any liens against them exist. Assets are sometimes titled to entities or persons other than the JV partner. If the partner is contributing workers, the legal team should also assess whether there are any potential liabilities from unpaid social benefits, improperly terminated labor contracts, and so on.

Doing DD for hiring individuals

How little investigation many foreign investors carry out on people they hire or consider working with is surprising. Rogue general managers (GM) are a real problem in China. Although only a small percentage of GMs are rogues, they cost their employers enormous sums of money by lining their own pockets and damaging the company's operations.

Identifying a rogue isn't as easy as you may think — many of them are able to go from one company to the next without anybody being the wiser until the stuff hits the fan. Rogues can be Chinese or expatriate — nationality doesn't make a difference. When most rogue GMs get caught, they're able to negotiate a glowing reference letter in return for not doing further damage to the company. Make sure you thoroughly check out your GM and other key potential hires (such as financial controllers) before making a hiring decision. You should at least call their references and previous employers.

TIP

If you really want to cover your bases, some firms specialize in conducting background investigations. Among the firms offering this type of service are large Western companies, such as Kroll (`www.kroll.com`).

Controlling Financial Risks

Managing your financial risks involves keeping on top of things such as use of your company's resources and expenses. Unfortunately, many foreign investors don't think about thorough financial controls until something goes wrong. Implementing comprehensive controls at the beginning is a good idea for at least two reasons:

- You don't want your company to get ripped off.
- Having good financial controls in place can help you get good information for your management.

If you're always aware of how much your company's spending for what, spotting trends and problems early on is easier.

To help you understand why and where you need controls in China, we discuss the big picture of Chinese accounting as well as some of the problems to be on the lookout for.

Counting beans differently

China is in the process of adopting modern accounting methods and standards, but it'll take a while before it catches on. Right now, China is playing catch-up. China didn't even introduce a double-entry bookkeeping system until the mid-1990s.

Western systems focus on facilitating management's internal control, so they have numerous income statement accounts. Usually, Western controllers have to thoroughly understand the business and its processes in order to do their jobs.

However, Chinese accounting has historically focused on the balance sheet because the government looks to exert control on businesses through accounting (for example, through capital accounts — see Chapter 10). A result of the system in China is that Chinese accountants have traditionally concentrated on complying with tax requirements, particularly value-added tax (see Chapter 10). They're not used to accounting in a way that reflects economic reality for managers. Compounding that problem is the fact that interacting with the rest of the business isn't customary for accountants and controllers in Chinese companies. Without properly training your accounting staff and implementing good controls, you're quite likely to get internal reports that don't reflect your company's actual performance.

China did just enact new laws that bring Chinese accounting standards mostly in line with International Financial Reporting Standards (IFRS); however, because IFRS is so new in China, finding accountants in China who understand the new standards is very difficult.

Balancing an out-of-balance sheet

Too often in Chinese accounting, a number of items get stuck in the balance sheet. For example, obsolete tooling often sits on balance sheets as an asset instead of being depreciated or written off through the income statement. Also, the concept of warranty reserves is literally foreign in China. In Chinese companies (and FIEs without good controls), overstating assets and understating expenses is therefore very common.

Your company should install a decent accounting system. Training accounting people to make basic use of an accounting system isn't difficult, because the application should handle all the heavy lifting. The hard part is training the accountants to make much more descriptive entries than they're used to. In other words, they should enter "five laser toner cartridges" instead of "office expense." Although this idea may seem common sense to many Westerners, it isn't in China. Generally, in Chinese companies, you'd have to look through physical receipts to figure out that your company bought five toner cartridges.

Jay Boyle is the managing partner of Expat-CFO Services Ltd. (`www.expat-cfo.com`), a company that designs financial controls for clients, performs outsourced accounting work, and conducts financial due diligence. Boyle advises his clients to perform a balance sheet cleanup each year in the fourth quarter. He says that even FIEs with a Western controller and well-trained accountants will inevitably find items stuck on the balance sheet that shouldn't be there.

Exposing shadow businesses

Every company has to deal with unscrupulous employees at some time or another. In China, most FIEs don't have problems with outright embezzlement. Instead, employees more commonly use company assets to line their own pockets.

One foreign businessperson tells the story of a friend who'd recently arrived in China to manage his company's operations there. One day, the new manager exclaimed, "My new secretary is great. She just started, and she's already figured out how to save us 45 percent on our office supplies." Immediately after blurting out that statement, the manager realized the likely truth: The last person was overpaying by 45 percent and receiving a kickback.

Employees may use company cars and trucks to run their own side businesses ferrying people or goods. Or they may run repair shops using parts from the company's inventory. Every now and then, you hear about something a little more bizarre, such as company cafeteria workers' stealing food to sell to nearby restaurants. It's usually the type of thing you wouldn't worry about in the West.

All this theft can easily add up. Sometimes, it can cause extremely serious damage to your company — workers occasionally steal product tags or labels to sell to counterfeiters.

Practicing common-sense controls

Developing controls to cover all your bases is fairly difficult. After all, you have to think about the worst-case scenarios possible in each area of your business. Firms that have experience in designing financial controls in China (such as Expat CFO, `www.expat-cfo.com`) can add a lot of value.

TIP

Here are some good, common-sense measures of prevention:

- Installing GPS devices on trucks
- Checking mileage on cars
- Double-checking supply prices on global online marketplaces such as Alibaba (`www.alibaba.com`) or Global Sources (`www.globalsources.com`)
- Establishing clear guidelines for expense reports and budgets
- Centralizing travel arrangements
- Requiring employees to turn in their boarding pass stubs when seeking reimbursement

Supporting controls through company culture

Financial controls are only as good as the people who implement them. Many Chinese employees aren't used to working in companies that place so much emphasis on accurate reporting and separation of company and personal assets.

Don't let your employees feel that the controls are merely onerous requirements imposed on them. Workers need to understand the benefits of a company that operates on the up-and-up and gives managers good information. This education is really an issue of creating the right corporate culture.

TIP

We highly recommend that a new FIE begin with a controller who has worked for his or her company for a long time. That way, the controller really understands the culture and can bring it to China. If you go with a controller who's relatively new, send human resources out to China for a while to create the culture. This move can improve all aspects of your business, not just controls.

Limiting Your Legal Risks

Legal risk is a pretty broad category in China, as it is anywhere. It can encompass everything from noncompliance with the law to losing control of your company or assets.

Chinese laws are often fairly vague and broadly worded. They can seem more like statements of principles than anything else. Lawyers in China are particularly fond of saying that the devil's in the details. That's because you often can't see the real impact of a law until implementing rules and interpretations come out.

Minimum suggestions: We know what the law says, but . . .

According to Winston Zhao, the partner in charge of Jones Day's Shanghai office, one of the most frustrating parts of doing business in China is how unpredictable the legal environment can be. And by "legal environment," he doesn't just mean the laws; although laws and regulations themselves lead to unintended consequences, the more common issue is in implementation of laws and regulations.

Zhao tells a story from the early 1990s that illustrates how officials' varying priorities can affect their interpretations of the law. At the time, Zhao was assisting a client in setting up a pharmaceutical company in a southern Chinese city. After reviewing the application, some officials called Zhao to tell him that the social benefits the client projected paying were too low. Zhao double-checked the figures and confirmed that they complied with the amount set by law. When Zhao made this point to the officials, they responded that they view the law as only establishing the minimum level. After some discussion, the officials made it clear that the client faced a choice: Either pay a higher level of benefits or go elsewhere. (Incidentally, the client chose to pay the greater benefits.)

Thinking locally

You may frequently encounter situations in which local officials have a good deal of latitude in how to interpret the law. The different priorities and goals of different areas can affect how officials interpret laws. Officials' sophistication varies, too. Some areas have well-educated officials who deal with foreign investors all the time. Other places may have officials for whom your business venture is a completely new concept.

Making matters worse is that an official can sometimes tell you that your application is fine, but when you go for approval, you're rejected. That rejection isn't out of bad faith. It's just that the official you're speaking with doesn't know how his superiors will come out on something. Unfortunately, asking such an official whether the boss agrees with his or her interpretation would be rude. For this reason, you're rarely going to get an official to give you a written interpretation.

Much of the variation depends on location, so you can limit your risk by setting up in places used to dealing with foreign investors. If you're setting up in places like Shanghai, which has thousands of foreign investors, you're going to get a process that's more consistent. However, Shanghai isn't going to go out of its way to get your investment, so you have to balance the eagerness of the local government against its experience with foreign investment. (By the way, don't assume that just because one bureau is really interested in attracting your company, the approval agencies will fall in line. They may or may not. For more on government relations, see Chapter 8.)

Taboo relations

Even a good corporate governance system can become corrupted by unforeseeable events, so do frequent inspections and audits. One of the worst corporate governance situations we're aware of involved a Western wholly foreign-owned enterprise with an expatriate GM. The GM was married with a wife and kids who moved out to China with him, and he lived in a cozy expat compound. The GM began having "relations" with not one, but two — yes, *two* — female subordinates. One of the subordinates happened to be the financial controller. After a while, the controller realized that she could steal from the company without worry because the only person who could catch her was the GM. So the GM stood by and watched her rip off the company, knowing that if he did something about it, his career and marriage would be over. Eventually, he found another job.

Implementing corporate governance

Corporate governance, or ensuring that company managers have the company's interests at heart, has been a hot topic in the West for the better part of a decade now, and the term may seem overused. As important as good governance is in your home market, it's critical when headquarters is thousands of miles away from the operation.

What can go wrong if you have weak governance? In a word, *everything.* Money and property can be siphoned off; the FIE can be violating labor, environmental, or numerous other laws; or the China branch can be competing with headquarters for customers. This section gives some tips for beefing up your corporate governance.

Wholly foreign-owned enterprises (WFOEs) may have even more problems with compliance and embezzlement than JVs do. In JVs, the mutual feeling of slight distrust between the partners acts as somewhat of a restraint. In many poorly supervised WFOEs, the management (usually the general manager) has virtually unfettered power because nobody else is minding the store.

Putting a strong finance person in place

Your general manager (GM) and controller have to work well together. (But you don't want them to work *too* well with each other, either — see the "Taboo relations" sidebar.) Ideally, both come from your home operations, and you know them well.

To ensure proper checks and balances, the finance person, not the GM, should keep the official company seals (the chops). See Chapter 7 for details on chops.

Having an adequately involved board

An active board should do the following:

- **Hold regular meetings.** Most FIE boards in China meet only once per year, which is too seldom. FIE boards should receive and review regular written reports from the general manager (GM).
- **Separate management from the board.** Especially make sure that a manager doesn't serve as chairman of the board. The chairman's role is important in certain crisis situations because some documents require his or her signature. Because bad management usually precipitates such crises, having a manager/chairman can make matters worse.
- **Enact a clear set of management bylaws that the GM and all managers must abide by.** These bylaws should specify what decisions each manager may make unilaterally, which ones require joint management actions, and which ones require board approval. Having various management controls in the bylaws rather than in the Articles of Association (AOA) is preferable because changes to the AOA require official approval.

As we discuss in Chapter 5, the minority shareholder in JVs must have at least one board seat. In addition, JV decisions are all made at the board (rather than shareholder) level. By law, certain board decisions must be unanimous.

Limiting the powers of the general manager and chairman

Place limits on the GM and the chairman of the board. Your China operation should have management bylaws that limit the GM's power. For instance, you may make a provision that the GM can't make certain decisions without board approval. This idea is even more important in JVs because Chinese JV structures typically make the GM the sole decision maker in the organization.

By law, the chairman of the board is the legal representative of the company. Although chairman is rarely a full-time position, the authorities give a lot of deference to the chairman. The chairman is responsible for signing the minutes of board meetings and various important documents. When negotiating JV terms, don't be too quick to cede the ability to appoint the chairman.

WARNING!

In JVs, having controls on the chairman's powers is important if your partner appoints the chairman. You may want to give another board member the ability to convene board meetings if the chairman can't do so. More to the point, though, the JV contract should restrict the chairman's ability to act without written board authorization. Failure to get authorization should result in the chairman's removal and the chairman being personally liable for his or her actions.

Trusting — but not too much

Headquarters should send somebody senior to check out the China operations regularly — at least once each quarter. This person should be able to spend significant time in the office and factory on his or her trips.

One of this representative's goals should be to develop relationships with employees other than senior managers. Employees can then feel that they have a contact at headquarters in case they want to report something. This person should also monitor whether the corporate culture has taken hold. If not, he or she should work with the management to instill it.

If the China side seems to be scheduling an inordinate amount of time out of the office for visitors from headquarters, they may be covering something up.

Conduct legal audits every so often — particularly if you smell something fishy. In such an audit, you engage outside counsel, which works in conjunction with your in-house counsel (if any). The auditors sift through reams of contracts and other documents, looking to see whether the company has undertaken any transactions that don't comply with procedures.

Combating Corruption

Corruption isn't nearly as pervasive in China as many in the West portray it to be. However, as in any other country, it does exist. The Chinese government even recognizes this fact. As in many countries in the world, it's been going on for a long time.

The good news is that China's leaders are working hard to decrease the amount of bad stuff that happens around shady business dealings by dismissing even high-ranking officials suspected of behaving inappropriately. Unfortunately, there's a lot more work to be done.

No matter how your competitors act or how disadvantaged you feel, make sure you play by the rules. Keep in mind that in addition to breaking Chinese law, you may be breaking your home country's laws any time you get caught up in corrupt practices. In this section, we discuss bribery and how to avoid it.

Understanding bribery laws

For most people, there's no safe haven for violating another country's anti-corruption laws. The U.S., for instance, enacted the Foreign Corrupt Practices Act (FCPA), which applies to U.S. persons and companies as well as those doing business in the U.S. If you're not based in the U.S., your home country probably has a similar law. The gist of the FCPA is that if your company (or you as an individual) attempts — even unsuccessfully — to bribe an official of another country, you can face significant fines and/or jail time.

The FCPA and similar laws impose a duty to perform due diligence on third (nongovernmental) parties to ensure that they're not engaged in corruption, either. In other words, if your partner is making payments that you're unaware of, you may be in violation of the law if you didn't make an effort to know about your partner's business practices. You also can't get cute and try to "pay" a consultant who's then going to bribe somebody on your behalf.

WARNING!

The FCPA is concerned with acts that are illegal according to the particular foreign country's written laws. If a law isn't enforced in that country, it doesn't matter — whatever's on the books constitutes a violation of the FCPA.

Keeping government relationships straight

The idea that you can't bribe officials sounds like common sense. But what about special treatment, dinners, gifts, or other things that you may not intend as a bribe but can be viewed as one? And what about employees who are Communist Party members who have relatives who are "officials"? As you can see, China has some special characteristics that make keeping clear on what may or may not be a bribe — and who all the players are — a little harder.

For one thing, your company may be dealing with companies that are partially or wholly state owned. That setup can make employees of those companies "government officials" for purposes of the FCPA and similar laws (see the preceding section for info on law). Also, officials often have family members in business. Regulators may consider these businesspeople to be officials. Under a very broad (but not implausible) interpretation, anybody who's a member of the Communist Party may be considered an official — and there are millions of them.

REMEMBER

As soon as you're dealing with an "official," any kickback or other improper benefit would violate the law. But more subtle items, such as entertainment or paying for a business trip for these people, can also run afoul of the law. Be aware of the risk of giving such items. (For advice on giving gifts to your business partners, see Chapter 16.)

Training for compliance

The most important part of a compliance program is educating all employees. Chinese staff should receive Chinese language instruction. If you have people who're experienced working in your home operation involved in China, they can set a cultural tone of compliance and ethics.

Beyond education, you should have monitoring systems in place. Make sure that money is properly accounted for. Official receipts in China (called *fa piao*) often aren't very descriptive of the services or products received. When dealing with consultants or agents, seek to get details on what they spent your money on. You can also perform background checks on suppliers and consultants to ensure that they're operating on the up and up.

If your company's China operation runs afoul of the FCPA or similar laws, regulators usually take into consideration how much effort your company made to prevent and monitor violations.

Managing donations responsibly

Being a solid corporate citizen in China may entail making donations or grants to the local community. Make sure that all the employees involved in making donations understand FCPA issues.

In many cases, your company donates to a government-run organization. Make sure you give no appearance of quid pro quo in making such a donation (for example, help our hospital, and your company will get a government contract).

If you're making a good-sized donation, have the recipient sign a donation agreement. The donation agreement should be very specific as to the permitted uses of the donation. It should also require that the recipient submit detailed records of expenditures to your company and give your company the right to inspect and audit.

Resolving Disputes through Arbitration

You've probably heard that enforcing contracts in China is difficult. Westerners have the perception that the Chinese courts are protectionist and unsophisticated. True? It really depends on where you're going to court. The court system is getting better, but a number of smaller cities' courts have judges who are ex-army officers with little or no legal training. Therefore, you can be taking your chances in court. So are contracts unenforceable as a practical matter? Nope!

Almost every contract you enter into in China or with a Chinese company should select binding arbitration for dispute resolution. Arbitration is like a private court system. A tribunal of arbitrators — almost always licensed attorneys — hears cases. Typically, arbitration is faster and less expensive than litigation. This section explains the arbitration process.

Understanding arbitration clauses

To select binding arbitration, include a binding arbitration clause in the governing contract. At a minimum, an arbitration clause should specify the following:

- Arbitration body (see the next section)
- Place of arbitration
- Arbitration language
- That the arbitration is binding
- The number of tribunal members and the selection process
- Procedural rules
- That the award may be enforced in any court of competent jurisdiction
- Governing law of the contract, which we discuss later in "The rulebook: Determining governing law" (this point doesn't have to be in the arbitration clause itself but often is)

If you go to the Web sites of various arbitration tribunals, they often have model arbitration clauses. You should always consult with a lawyer before dropping one of those clauses into your contract, though. You usually want to make sure you have some control over the arbitrator selection process or at least state that the parties must mutually agree to the arbitrators. You can specify the selection process in the arbitration agreement. (For small disputes, the arbitration procedures are somewhat different. Make sure your clause reflects the proper procedures.)

WARNING!

In a couple of well-known cases, the Chinese courts took a very formalistic approach to whether an arbitration clause was valid, ruling that they were invalid because of such technicalities as a slight error in the name of the arbitration body. Ask your attorney whether his or her arbitration clauses have previously been enforced.

TIP

If you and the other party have a series of contracts (either directly or through affiliated companies, such as parents or subsidiaries), make sure the arbitration clauses in all the contracts are substantially the same. A given issue can directly or indirectly involve more than one contract. If different contracts mention different forums, then where to arbitrate the issue may be unclear.

Surveying arbitration bodies

China has a number of arbitration bodies. The oldest is the China International Economic and Trade Arbitration Commission (CIETAC, `www.cietac.org.cn/index_english.asp`). CIETAC and many of these other arbitration bodies are generally considered to be impartial and competent. In fact, CIETAC is the world's busiest arbitration body. Opting for arbitration at the Hong Kong International Arbitration Centre (HKIAC, `www.hkiac.org`) or the Singapore International Arbitration Centre (SIAC) is also common.

Chinese companies used to be more willing to go to Hong Kong, Singapore, or elsewhere for arbitration. Although agreeing to foreign arbitration still happens, Chinese companies often prefer not to leave China — particularly for smaller matters. That's usually fine, though, because CIETAC and many other Chinese arbitration bodies are good forums.

Assuming you choose a decent arbitration panel, electing arbitration should ensure that you have an impartial and competent body hearing the dispute. It should also mean that the process is transparent and easier than litigation.

The rulebook: Determining governing law

An arbitration clause isn't worth much unless you choose a governing law for the underlying agreement. In certain situations, contracts must be governed by Chinese law. However, in many circumstances, the parties can opt for any other governing law.

Failing to choose a governing law is a bad idea. Even if the Chinese courts accept that Chinese law prevails, courts in another country that may be involved in the contract (that is, the country of incorporation for one of the parties) may also think that their law applies. All parties can waste a lot of time and money figuring out which law applies. Chinese law isn't the default.

Decide on the governing law at the outset, which can affect how the contract is drafted. The governing law decision should also be tied to the arbitration forum. Try to get a sense of whether the forum you're choosing has a good selection of arbitrators who're familiar with the governing law. For example, finding arbitrators in China who're familiar with Hong Kong or New York law usually isn't too hard. But finding arbitrators familiar with Polish law can be a challenge.

Enforcing the rulings

Say you win your arbitration, and the tribunal has issued an award in your favor for US$1 million. Assuming that the counterparty didn't bring its checkbook to the arbitration and hasn't exactly invited you over to collect, what do you do?

The collection process is basically the same in almost any country: You go to a court that has jurisdiction over the defendant (usually a court where the company is headquartered or has assets) and apply to the court to *enforce* the judgment. The court then orders the losing party to pay the money. If the party refuses, the court eventually orders assets to be seized and sold.

You may be wondering, "If Chinese courts are protectionist, what are the chances that I can enforce my arbitration award?" Good question. Under Chinese law, a court almost always *must* enforce an arbitration award for monetary damages. If a court refuses to enforce an award, it must justify itself to the Supreme People's Court. Courts rarely refuse to enforce awards.

Courts don't have to enforce arbitration awards when they find a defect in the arbitration agreement (or clause) or when the arbitration procedure was unfair. The former problem is more common.

You may note that we're discussing *monetary* damages. In many legal systems, courts and arbitration panels can also order a party to perform a contract ("specific performance") or to stop doing something ("enjoining" that party or issuing an "injunction"). Although Chinese courts can issue these types of judgments, the enforcement of nonmonetary awards from arbitration is much less clear.

If you want to have nonmonetary judgments available to you, confer with a lawyer to decide whether to avoid arbitration entirely or to carve out certain types of disputes from the arbitration clause so they have to be heard in court.

Note: If you lose the arbitration and have to pay the Chinese party, your attorney will advise you when to pay and make an official record.

Protecting Intellectual Property

You've likely heard time and again that you really have to worry about intellectual property (IP) infringement when doing business in China. That's not precisely true — you have to worry about IP infringement in China *before* you even begin doing business there! This section tells you how to protect — but first establish — your IP in China.

Getting IP registered early

A number of laws on the books protect patent, trademark, and copyright holders' rights. However, the main issue is how you get China to recognize your IP. Unlike many systems, China's IP system is a *first-to-file* system (other countries often use a first-to-develop). In other words, who developed the IP doesn't matter — in China, the owner is the first one to file an application for the patent, copyright, or trademark.

Some people from China travel the world looking for IP that they can register in China. They're either looking to make money using the IP in the Chinese market or waiting for the developers to come to China and pay them off. A number of foreign investors have been unpleasantly surprised by raids on their facilities because they were using what they thought was their own IP in China but were unknowingly committing infringement under the Chinese system!

Regardless of whether you think this system is fair, you should register all your IP in China as soon as you read this section — even if you don't plan to do business there. Every now and then, you hear about a foreign company that didn't mind that somebody else registered its trademark in China because they weren't planning on playing in the China market. But then inferior goods manufactured under that trademark started hitting China's markets. Although these companies weren't necessarily planning on doing business in China, they certainly didn't want their brand equity destroyed there, either.

When registering patents in China, the process isn't as simple as translating your home-country patent into Chinese. Certain differences exist in what is and isn't protected. If you care about the IP, don't take shortcuts (although a translation is admittedly better than nothing).

Taking proactive legal measures

After you register your IP portfolio, take both legal and practical precautions to guard against infringement. On the legal side, have your IP attorneys monitor IP filings to see whether anybody is attempting to register something that infringes on your IP. Unlike in some other countries, the IP offices usually don't spot infringement in the applications.

The brochure looked nice: Protecting unlikely forms of IP

In 2006, the management of a high-end American tool company went to China looking to source products or to possibly form a joint venture. They spoke informally with a number of companies in various parts of the country, handing them company brochures and being fairly general about what they were looking for.

They must've really impressed one of the potential partners because after the meeting, the Chinese company immediately went to work researching the American company's market position. The Chinese company found out that the brand is very well respected in the West and stands for high quality. What did the Chinese company then do? It trademarked the brand in China, becoming the rightful owner. This story is partly a lesson in filing as soon as possible, but it also reinforces the need for confidentiality and non-compete agreements for even casual conversations.

We've created a monster: Corporate betrayal

One foreign company originally thought it had found the perfect supplier of metal seat frames — a Chinese company that made a similar product but used different processes. Working with this company seemed to be a good idea because its existing knowledge meant a quicker startup. The Chinese company also knew the market for seat frames well.

After some time, however, the Chinese company added its Western client's frame design to its own product catalog. In one fell swoop, the Chinese company became a competitor.

USActive, which specializes in helping manufacturers set up and source in China, found the Western company a new supplier that had experience in welding metal frames but no seat frame experience. The supplier took longer to get to production, but the chance that it'll become a competitor is much lower.

All employees, consultants, and potential suppliers and business partners should be made to sign confidentiality and non-compete agreements. Such agreements prohibit the other parties from disclosing your confidential information or competing with you. These agreements should also clearly state that your company owns the specified IP. Again, work on this agreement in connection with an attorney who knows the local laws. In order to be enforceable, some non-compete agreements need separate compensation (apart from salary) to the party agreeing not to compete.

If you suspect that infringement or trade secret theft is taking place, you have options in addition to suing to enforce your IP rights. You can ask the authorities to pursue criminal and administrative actions against the infringer. China has criminal penalties and fines for infringing IP or competing "unfairly" (which includes a lot of IP misuse). However, you usually need to deliver the authorities the entire case — evidence, identities, time and place to raid, and so on — in order to get them to take action. They're not usually in the business of conducting investigations themselves. Some investigative agencies in China specialize in tracking down IP infringers and gathering the evidence.

Practicing realistic precautions

TIP

Yes, China has plenty of legal protections for IP. However, any stroll down a crowded street in a major Chinese city can tell you that something's still missing. Enforcement is still a major issue (although it's getting better). Therefore, you need to take practical measures to protect your IP:

- **Don't let anyone see the whole picture.** Get different components manufactured at different factories, preferably in different areas. This setup adds to the management challenge, but some companies (such as USActive, `www.us-active.com`) can help manage these relationships. Compartmentalize as much as possible, even within your company. Make people sign in and sign out valuable information, and consider leaving any particularly valuable IP at home.
- **Guard your tools and equipment.** Some companies who partner with Chinese companies think giving their partners the tool designs so they can buy the tools themselves is a good, cost-saving idea; it usually isn't. If you don't keep track of your tools, your workers or your partner can use them to do extra production runs, competing with you on the market. The tools should be available only during production runs. When you're not using them, either lock them up or remove them from the factory. As Paul Stepanek of USActive says, "Your tools are your jewels. It is essential to own and control them."
- **Don't partner with potential competitors.** As we discuss in Chapter 12, partnering with a company that sells the same type of products as you do can get you some (but usually not great) distribution; however, when you partner with a company that makes competing products, the partner can take your technology and practices and start selling without you. Factor any worries about IP leakage and competition into the decision of whether to partner for distribution.
- **Keep your distance in joint ventures.** Naturally, when operating a JV, you have an increased risk of having IP infringed. Such infringement usually happens more often in the less-developed areas. One way to cut down the risk is by not establishing the JV very close to the Chinese partner's operation. If the facilities are located close together, having important information pass to the partner is more likely. The same thing can happen when the partner's employees are working in both the JV and the partner's company.

Managing Environmental Risks

Most FIEs take the view that although some Chinese companies may be able to push the envelope as far as environmental compliance goes, complying with the law in this area is generally best. China's getting more serious about environmental compliance all the time. Even minor malfeasance can result in enormous potential liability for your company.

Surveying environmental crime and punishment

China doles out several types of punishment for violating environmental standards:

- **Jail:** If your company does something extremely egregious to the environment, your legal representative and other senior managers can go to jail. This result is rare.
- **Curtailing or halting operations:** The authorities can order your company to curb production or shut down, usually temporarily.
- **Inability to expand:** When a company gets to a point where its site can't hold any more contaminants by law, it may not be allowed to expand the business.
- **Fines:** Fines are common. They don't usually exceed 100,000 RMB.
- **Cleaning up:** Your company may have to remediate your site if it uses up its pollution quota. Also, China's law is moving toward U.S.-style liability, in which a company can be liable for pre-existing pollution on a site.
- **Bad publicity:** Some cities, such as Shanghai, are putting environmental offenders' names on the Internet. If you look at these sites, you may be surprised to see the names of a number of multinationals. This penalty creates the risk of damaging your reputation — particularly if your company is large and well known.

In addition to pollution limitations that the law imposes, the authorities measure your company's pollution against the estimates contained in the Environmental Impact Assessment (EIA), which you have to complete as part of the application process for most manufacturing businesses (see Chapter 13 for details). In addition to being a prerequisite for construction, the EIA is important because it's your company's commitment on pollution levels. If the pollution exceeds the amounts in the EIA, the authorities may prohibit expansion and/or require your company to somehow fix the situation.

Practicing more than good intentions

FIEs can easily end up violating environmental standards unintentionally. Generally, FIEs focus more on worker safety. Although worker safety is quite important, don't take your eyes off environmental issues. Here are the three areas where FIEs commonly have to watch out:

- Hazardous waste management
- Wastewater treatment
- Chemical management

Flushing money down the toilet — and into the water table

Even a small gap in training can have multi-million-dollar consequences for your company. Dr. Yong Wang heads Environmental Resources Management (ERM, www.erm.com), one of the world's leading environmental consulting firms, in China. ERM has a number of clients in China that engage it to periodically assess how they're impacting the environment. Yong tells the story of an FIE's routine environmental audit that uncovered a big problem — trichloroethylene (TCE), an odorless, colorless solvent, in the water table. The concentration exceeded standards by 2,000 times. When ERM investigated, it traced the cause of the pollution to a single incident. One of the factory workers had disposed of two liters (a medium-sized soda bottle's worth) of TCE by flushing it down the toilet. That single flush led to the company's reserving several million dollars to clean up the TCE!

Be especially careful with hazardous waste management. First, you need to implement proper segregation, transportation, and storage procedures. China doesn't have many licensed and qualified hazardous waste disposal companies. If your disposal company doesn't do its job properly, your company may have to pay to remediate the disposal company's land! Know whom you're dealing with for waste disposal.

FIEs can easily have problems from employee mishandling of pollutants and chemicals. Unless you thoroughly train employees, don't expect them to know how to properly store and dispose of substances. As the nearby sidebar illustrates, even a small mistake can create a huge problem.

Getting help

Monitoring your impact on the environment and staying in line with the law is a lot of work. This section discusses when to get some help and how much the bills may run.

Purchasing land

To guard against environmental offenses, you need to understand the state of the land before you purchase it. You almost certainly want to conduct a Phase I investigation of your planned site. Environmental consulting firms such as Environmental Resources Management (ERM) do site investigations. This step can tell you whether the land has any preexisting environmental conditions that can affect your business. For a 10,000 m^2 parcel, this investigation usually costs around US$5,000.

Completing the Environmental Impact Assessment

By law, you need a licensed company to perform the Environmental Impact Assessment (EIA). The EIA can vary a lot in time and complexity. After submitting the EIA, the consultant has to answer questions and concerns from a locally convened panel of experts. Depending on the level of comments, the EIA may need significant revisions. In 2006, the State Environmental Protection Agency rejected 30 percent of initial EIAs.

WARNING! Many companies don't account for the potentially significant costs and delays involved in the EIA process. Make sure your planning factors in possible issues here. The time to prepare and receive approval for the EIA can vary from one month to one year, at a cost of roughly US$5,000 to US$50,000.

Maintaining pollution controls and legal compliance

Especially if you're opening your first factory in China, you need help from an experienced environmental consulting firm to design proper pollution controls and training programs. Conducting periodic audits to benchmark progress is also a good idea. You need to monitor how your usage affects pollution concentration. Audits generally cost US$5,000 to US$10,000.

You should ensure that your consultant keeps you up-to-date on changes in environmental laws and regulations that affect you. As in many areas of Chinese law, environmental regulations change rapidly. The direction of change is definitely toward strictness.

Insuring Your Business Risks

China is a risky place to do business, and the risk is more than the possibility of losing capital in a failed market entry — or someone knocking off your product and selling it for a fraction greater than your cost. Just think about the physical risks to your business in China: typhoon, flood, earthquake.

TECHNICAL STUFF The earthquake risk alone is enough to make you shake in your boots. Northeast China's Tangshan earthquake of 1976, which registered 8.2 on the Richter scale, leveled the city and killed about 250,000 people. The government rebuilt the entire city.

You can't prevent natural disasters, but you can make sure your company's finances don't end up in ruins. The Chinese market has opened up to foreign insurers in recent years. You can now choose from a good selection of companies and products to help your company with its insurance needs. This section goes over some of your options.

Controlling the insurance program

Chinese companies commonly want to control the insurance program instead of allowing you to take an active role, especially in joint ventures. But your company's insurance arrangements are too important to leave to someone else to manage. And you never know whether the Chinese people you're dealing with want control of the program because they have some financial interest in mind.

Make sure your company controls the insurance program — even if it may come in at a potentially higher cost. The Chinese tend to look at insurance as an expense instead of focusing on the real benefits insurance can deliver.

Getting insurance advice

Some of the largest insurance brokers in the world now have a presence in China. The large commercial brokers are good resources for risk management and insurance services for larger firms. For small- and medium-sized firms operating in China, be sure to contact your insurance agent or broker back home for assistance. Your professional insurance advisor can review your business risks in China and help you develop the right risk and insurance management program. Such a program usually includes periodic inspections or surveys of your physical premises in China.

Knowing your choices of companies

More and more insurance companies are now licensed to do business in China. As a result, competition has heated up, and more companies are trying to differentiate themselves from competitors by creating more insurance products for the local market. The result is that the insurance market in China is becoming increasingly sophisticated, which is good news for companies looking to protect their China operations.

Many foreign companies have entered the Chinese market over the last ten years or so, mostly from Europe and North America. You can find Japanese companies in the China market as well as a handful of insurance companies from elsewhere.

Some companies tend to stick with insurance companies from their home country, although you can choose from plenty of other good companies that have a track record of fair dealings. Most foreign insurance companies in China have global brands and strong reputations.

Reputable Chinese companies are in the market, too. Some foreign companies are quite satisfied with the products and services that Chinese insurance companies provide. Chinese companies can be competitive on price — if not cheaper — than foreign insurance companies operating there. At the end of the day, your professional insurance advisor can guide your company on the pros and cons of dealing with specific insurance companies in China. For more info, see the previous section titled "Getting insurance advice."

Looking at basic types of insurance

In this section, you find a handy list of the types of insurance available to small- to medium-sized firms in China. This list isn't exhaustive by any means. You should know that not all insurance companies carry the same products. And of course, you should consult your professional insurance advisor on all matters related to your company's insurance program in China.

Property insurance

Property insurance includes the following:

- **So-called All Risks property insurance coverage for your plant, office, or warehouse:** It covers building, machinery, stock, and so on. (Of course, exclusions are in every insurance policy!)
- **Business interruption or consequential loss insurance:** This insurance covers your company for loss of profits caused by business interruption as a result of fire or other type of peril.
- **Money insurance:** Money insurance includes coverage for a loss of cash due to, say, a burglary.

Liability insurance

General liability insurance protects your company from losses involving your premises as well as your operations in China. Other liability policies may be available:

- **Product liability:** Protects your company from awards for injuries resulting from products you sell or manufacture
- **Employers' liability:** Covers liabilities to employees for work-related injuries
- **Directors' and officers' liability:** Protects executives of your company for any personal liability while performing their jobs

REMEMBER

Like most countries, China's laws require certain insurance. One such policy is third-party automotive liability insurance. Be sure to consult your professional insurance advisor to ensure compliance with China's insurance laws.

Transportation risks

Transportation risks coverage protects your goods in transit by sea and air. A separate policy can be arranged to cover your local transits by truck in and around where you do business in China.

Sourcing risks

Even if your China activities are limited to sourcing from China, you're potentially exposed to real business risks in China. What would happen if your sourcing partner's plant were to burn to the ground tomorrow? Could your company recover from a disaster like this? Is your sourcing partner insured at all? If so, what's in it, if anything, for you? If your company does its sourcing from China, you need to take a close look at the way you manage your business risks in China.

A little-known or -understood type of insurance called *contingency business interruption* can protect your company from an interruption in the business of your supplier. It may be able to help your company protect your profit or revenue caused by certain events outside of your company's control.

Specialty insurance

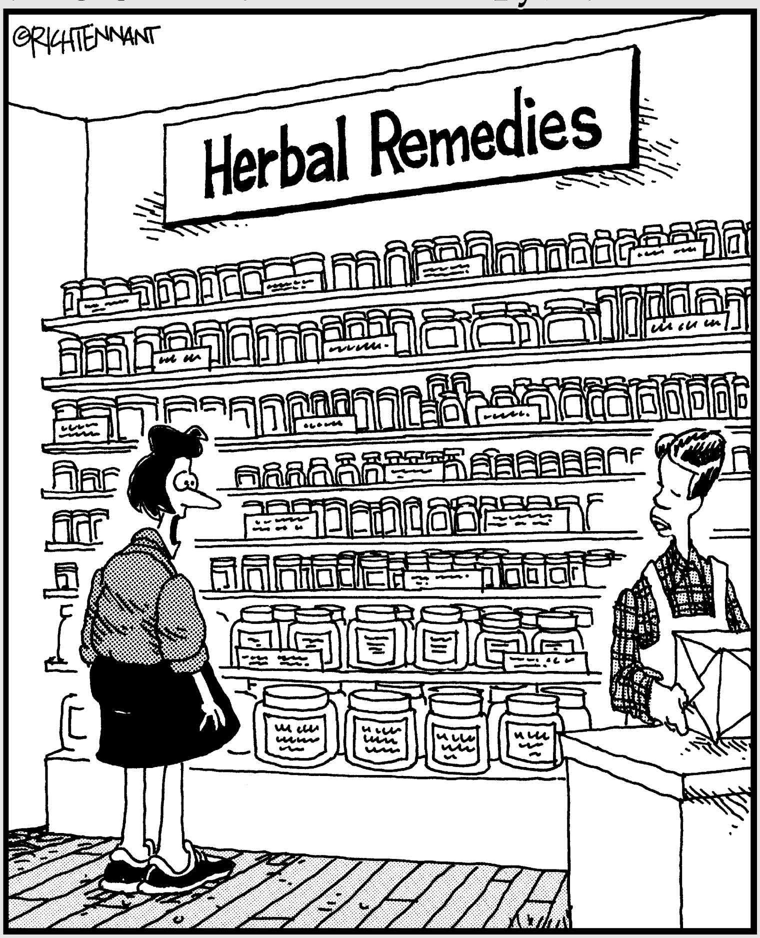
More-sophisticated types of insurance coverage may also be available to your company. These types may include political risk, *trade credit* to protect your receivables, *supply chain* coverage against potential disruption, and more. The availability of these products to your firm really depends on the size of your company. Many of these more-specialized coverages have minimum premiums that may be out of reach for small companies. Talk to your professional insurance advisor for details.

Companies also offer many kinds of specialty insurance for manufacturers. *Construction insurance* is available to protect your building while it's being built. *Machinery breakdown insurance* covers boilers, production machinery, and so on.

Many insurance companies provide small- to medium-sized firms with bundled products for property, liability, local transit, money, and so on under a so-called *package policy.*

Part V
The Part of Tens

The 5th Wave By Rich Tennant



"Is there an herbal remedy for culture shock?"

In this part . . .

In the great tradition of top ten lists, all *For Dummies* books conclude with The Part of Tens, which provides lists of tips, need-to-know info, and generally fun things to do. We begin by listing ten clauses you should make sure your lawyers include in your various contracts. We then list the ten best places to go to when you have some time off. Finally, we point out the ten things that can keep your company on the path to profitability in China.

Chapter 18

Ten Clauses You Want in Your Contracts

In This Chapter

- Important clauses for all your China contracts
- Key clauses for more specific needs

Many companies end up in disputes because the purchase orders or contracts aren't specific enough. Regardless of the type of contract, describe what you want from the other side in as much detail as you can. Handshake agreements don't usually work well — especially in China.

This chapter provides a checklist of clauses that are applicable to most contracts (as well as a few clauses that are for specific situations) to better prepare you for discussions with your legal counsel. You may also be able to get a better idea of whether your counsel is doing a good job of representing you. Note that this chapter doesn't tell you how to adapt one of your standard agreements to China, and it isn't a substitute for retaining a lawyer experienced in China to draft your contracts.

Governing Language

The *governing language clause* determines which language version of an agreement is the official version in the event of an inconsistency in the two language versions. This clause is important because translation errors happen much more often than most people know.

TIP

In the case of joint venture (JV) contracts, many authorities are reluctant to approve an agreement that reads Chinese isn't the governing language. If the other party won't agree to English or another foreign governing language, you should specify that both language versions are equally authentic and controlling. This idea seems paradoxical, but that way you don't automatically lose the dispute because of the inconsistency. You can also try to augment this clause with a reference that the agreement was concluded based on discussions in a foreign language. That way, arbitrators may give more weight to the foreign language version in case of a conflict.

Telling the other party that you want English (or another foreign language) to govern the contract often leads to their insisting on Chinese being the governing language. The subtle approach — writing that both language versions are equally authentic and controlling but based on English discussions — is more likely to work when the parties haven't argued the governing language point yet.

Arbitration Clause and Governing Law

When you need to settle a dispute, arbitration is usually cheaper and faster than carrying on lawsuits. Chinese courts almost always enforce arbitration awards, so arbitration is definitely the way to go to secure your right to recover monetary damages. (However, you usually don't want arbitration if you're seeking nonmonetary damages, such as an injunction or specific performance.) Selecting the proper arbitration panel is obviously key. That the clause be drafted precisely is similarly important. We discuss arbitration and arbitration clauses in detail in Chapter 17.

Specify a *governing law* — which country's law applies to the agreement — in the contract. Governing law should be one of the first considerations the parties discuss because it affects the way the contracts are drafted. Chinese law must govern some types of contracts (such as Sino-foreign joint ventures), but in most other types of agreements, the parties may choose the governing law.

TIP

Try not to choose something too quirky, or you'll have a tough time finding arbitrators versed in that law. Some people wrongly believe choosing the law of "neutral" countries such as Switzerland or Sweden and using them as arbitration forums is a good idea. Choosing either law is fine *provided that the lawyer drafting the documents knows Swiss or Swedish law*. Otherwise, stick with something that you and the attorneys have knowledge of. Also, the historical neutrality of certain countries has no relationship to their merits as arbitration forums.

The People's Republic of China (PRC) contract law isn't anti-foreigner. The issue is that it's not as comprehensive — the law has holes and gaps. For many run-of-the-mill agreements, PRC law should be fine as your governing law (although you need to confirm that on a case-by-case basis with an attorney).

Confidentiality/Non-Compete

Get parties to sign a confidentiality/non-compete agreement before you even have informal talks — you don't want to inspire the Chinese party to go off and do the same business that you do!

In addition to all potential suppliers and other partners, the following people should sign confidentiality/non-compete agreements:

- All employees
- If you're doing a JV, all your partner's employees who'll be involved in working for the JV

If you're planning on providing any valuable technical information to a Chinese supplier, you may consider doing due diligence to see whether their employees are bound by confidentiality/non-competes. We discuss these issues in Chapter 17.

Force Majeure

Force majeure ("greater force") clauses excuse performance because of circumstances beyond the parties' control, such as acts of God, wars, terrorism, and so on. The clause is designed to cover those unknowable or improbable events that aren't part of normal business.

Indemnity

Indemnity is an agreement that the other party will cover all expenses and liabilities in certain situations. In the West, parties are often adequately insured, so indemnities can be quite broad. Many Chinese parties don't have good insurance, so you're likely to get more resistance on the indemnity provisions from them.

You have to balance the need to protect your company against the risk of breaking the deal. Keep in mind that because of the lack of insurance, you can reasonably expect only so much indemnity out of most Chinese parties. The agreement does neither of you any good if the Chinese side goes bankrupt because of its indemnity obligation to your company. Nevertheless, protect your company through indemnity as much as you can under the circumstances. We discuss indemnity in Chapter 12.

Written Modification Only

Written modification only clauses make sure that all contract modifications are in writing. As we discuss in Chapter 13, this concept is particularly important in construction contracts. Written modification only clauses usually accrue to your benefit, although be sure that you abide by this provision yourself. If you verbally agree to a modification, write it out and execute it with the other party.

Sovereign Immunity Waiver

Most countries allow the government to have *sovereign immunity,* which means that people can't sue the government for damages unless it waives the immunity. The sovereign immunity waiver is only for when you're doing business with the government, quasi-governmental bodies, or state-owned enterprises (SOEs). For instance, you'd want to use this waiver if you were to execute an investment agreement with a local government or government company. Typically, the contract guarantees various benefits and incentives for your company.

Most lawyers don't consider this waiver an ironclad guarantee that you can enforce a judgment or arbitration award on a governmental or quasi-governmental party. It's pretty untested, actually. However, this provision is better than nothing, particularly because it provides a disincentive for bad behavior.

Reps and Warranties

Reps (representatives) and *warranties* are statements that a party makes about itself or its property in a contract. For example, a party may represent that a certain asset isn't subject to any liens. Reps and warranties are standard in many more-complex types of agreements. Having at least a few basic reps and warranties in most (if not all) of your China-related agreements is a good idea.

Somewhere, the agreement should contain (in reps and warranties, termination, or elsewhere) a provision that allows you to terminate without penalty if the other party breaches a rep or warranty. Sometimes, you can specify that you're entitled to compensation for the breach of a rep or warranty.

The reps and warranties you need depend on your circumstances. You should discuss this idea with your lawyer. At a minimum, the counterparty should represent that

- It's duly authorized to enter into the agreement.
- It's duly organized under the laws of China (or some other jurisdiction).
- It isn't violating any law, regulation, rule, or policy by entering or performing the agreement.

Conditions Precedent

More-complex arrangements, such as JVs, can have a number of moving parts. You want to ensure that you commit as little money and effort as possible until you're reasonably certain the deal will move forward. When you're able to identify certain milestones that need to be achieved in order to progress (such as receipt of a business license or land-use rights), you can use them as conditions precedent to actions on your part. In other words, you can state that the JV must obtain land-use rights before you contribute the remainder of your portion of the registered capital.

Cross-Termination

Every agreement should have a termination provision (unless it's indefinite, in which case that should be explicitly stated). A *termination provision* typically specifies the length of the agreement while allowing one or both parties to cancel under certain circumstances (for example, with 30 days written notice). Along with a termination provision, you want a *survival provision* that states certain clauses will continue to be in effect after termination. Survival commonly covers confidentiality/non-compete provisions and record-keeping obligations. (We discuss confidentiality/non-compete clauses earlier in this chapter.)

Cross-termination clauses are necessary in situations in which the parties have multiple agreements. For example, it's common to set up a joint venture and then for the individual partners to sign agreements (usually as customers or suppliers) with the JV. Well, what happens to those other agreements if the JV contract is terminated? The more complex the web of contracts becomes, the more crucial it is to ask, "If contract A is terminated, what do I want to happen to contracts B through F?" Work with your attorney to game out these scenarios and draft the appropriate cross-termination provisions.

Chapter 19

Ten Fun Ways to Spend Your Downtime in China

In This Chapter

- Getting to know some of China's best tourist attractions
- Seeing the traditional sights in and around the major business centers
- Going inland to see some wonderful places to visit

China has so many wonderful places to visit — limiting the list to just ten in this chapter was really hard to do! All you need is some spare time from your busy business schedule. (But try to avoid the major tourist sites during Chinese holidays — the locals like to tour the sights as well during their time off.) With a few exceptions, most of these places to visit are near the major business centers. So join your company colleagues and have some fun by taking in the sights together.

Climb the Great Wall

At nearly 4,000 miles long, the Great Wall is the longest manmade structure in the world. It has a long history, too — the Chinese began building walls on their borders more than 2,000 years ago. In some sections, you can take a gondola, ride a "toboggan," or even zip-line down from the Great Wall!

The wall is about 45 miles due north of Beijing. For busy businesspeople like you, hiring a private car or minivan and heading out to the Great Wall on your own may make good sense. Ask your local Chinese contacts or your travel agent back home to help you make the necessary arrangements.

The vendors who hang out at the Great Wall can be annoying, and they don't have a very good reputation. They've been known for keeping the change, even when you ask them for it! Just try to avoid them if you can.

Some sections of the Great Wall can be dangerous, so be careful when you're scrambling about the steep inclines. Bring a good pair of comfortable shoes to wear (and an extra layer of clothing from fall through spring). The last thing you need is a visit to a hospital before finding yourself in a first-class seat going home, with your propped-up broken leg as your souvenir! You wouldn't be the first person — or the last — to go home that way.

Wander through the Forbidden City

The Forbidden City in the central part of Beijing is right on Tiananmen Square. The emperors of the Ming and Qing dynasties lived there. The Great Hall of the People and Mao's mausoleum are on the square as well. You can wind your way through some impressive imperial buildings and the grounds. A good audio tour is available, too.

Start on the south side at the main entrance to get the best experience when entering the main gates and then snaking your way through the many courtyards. You can easily catch a taxi (except when it's raining) when you exit from the north side of the Forbidden City.

Avoid the Forbidden City (and other Chinese tourist attractions) on Sundays. This centrally located tourist destination can be overrun with locals, out-of-town Chinese, visiting overseas Chinese tour groups, and foreign tourists from all corners of the world.

Enjoy the Peacefulness of the Temple of Heaven

In Beijing, you can marvel at the beauty of the Temple of Heaven and its large surrounding grounds. The structures are certainly some of China's most magnificent architecture — the Imperial Vault of Heaven is a real jewel box. Built in the early part of A.D. 1400, the Temple of Heaven's massive grounds are surrounded by a wall. The temple was originally used for sacrifices to the heavens during the Ming dynasty. For people with limited time for touring in the capital city, this is an excellent tourist stop while in Beijing.

TIP

The traffic in Beijing, like many other large Chinese cities, can be a real nightmare. Be sure to leave some margin of safety in your travel schedule.

Roam around the Summer Palace

Situated around Kunming Lake, the Summer Palace grounds were a resting place for the Chinese imperial family in the late 1800s. Wandering around the lake provides gorgeous views of the surrounding scenery. The gardens are reminiscent of those throughout China. Some of the featured attractions include Longevity Hill, the Long Corridor, and the famous Marble Boat. The Summer Palace is about ten miles west of Beijing.

TIP

Avoid the Summer Palace on Sundays unless you really want to be a part of a large crowd.

Take In the Ming Tombs

About 30 miles northwest of Beijing lie the 13 tombs of the Ming emperors (1368–1644). Only two of the Ming Tombs have been excavated and are open to the public. Each of the tombs is tucked away in a hillside in this quiet and lovely valley. All are linked by a road called the Sacred Way, or the road leading to heaven. The Sacred Way has a display of beautiful human and animal figures carved from stone.

TIP

Have your hotel make you a special boxed lunch for the trip so you can enjoy a quiet picnic on the peaceful grounds.

Stroll the Bund in Shanghai

The Bund — in Chinese, *wai tan* (pronounced why tan) — is the area along the Huangpu River near the center of Shanghai. It was part of the old international settlement area, occupied by foreign residents in the 1800s and early 1900s.

The mile-long stretch along the riverfront is one of the more interesting architectural sights in the world. On the Bund side of the river are the stately old European bank buildings; across the river is the ultra-futuristic landscape of the city of Pudong.

The Bund is best viewed after dark, when the historic buildings on the Bund are basked in lights from Pudong. After strolling the Bund, consider having dinner or drinks there — it offers many excellent options. For dining, try Laris, Jean-Georges, New Heights, and M on the Bund; for drinks, check out Glamour Bar, Vault (in Laris), and Attica (which is an enormous club). The Pudong side of the Bund also offers some great views. Our favorite bar/restaurant for views in Pudong is Jade on 36 in the Shangri-La Hotel.

Tour Suzhou, the Venice of the East

A famous Chinese saying goes like this: "In heaven, there is paradise; on earth, there are Suzhou and Hangzhou." Filled with many beautiful gardens and lovely wandering canals, Suzhou is perhaps the most beautiful city in China. The Humble Administrator's garden is absolutely magnificent. It's one of the four classic gardens in Suzhou and is considered one of the finest in China. Suzhou is just a train or car ride from Shanghai.

Hangzhou is also a magnificent place to visit. The famous West Lake is well worth the trip there. Hangzhou is a little over 100 miles from Shanghai.

Visit Historic Xi'an

Xi'an (pronounced shee-an), one of China's ancient capital cities and a major tourist destination, is located in the central part of China. It's now the capital city of the Shaanxi province and one of China's top ten cities in terms of population.

The city's rich history spans more than 3,000 years. Xi'an is the home of the terracotta army soldiers and horses commissioned by China's first emperor, Qin Shi Huang. (A farmer discovered the site as he was digging a well in 1974.) While in Xi'an, consider taking the time to see the ancient city walls and the Goose Pagodas as well.

Appreciate the Enchanting Beauty of Guilin

Guilin, famous for its scenic limestone formations, is one of the most picturesque places to visit in China. Its stone peaks — which seem to reach for the sky — are truly magical. Getting to see the countryside outside of Guilin can be interesting for visitors — you get a glimpse of what rural life in China is all about. Guilin is located in southern China and is best reached by plane.

Consider taking a guided boat trip down the Li River to enjoy the magnificent views of the natural scenery. You'll see peasants farming the terraced hillsides, water buffaloes roaming around the paddies, and cormorant fishermen (who use birds to fetch fish!) working their trade.

Cruise the Yangtze River

For visitors to China with some time to spare, you can find nothing quite like a trip on the Yangtze River. The river is the longest in Asia — nearly 4,000 miles long! It stretches from the mountains of southwest China to the mouth of the river — just north of Shanghai. The scenic views from onboard the cruise ships that ply the river are simply wonderful.

Many cruise ship options are available. Check with your travel agent for the package that suits you best. You can also visit the Three Gorges Dam, the world's largest hydroelectric dam.

Chapter 20

Ten Ways to Stay on the Path to Profitability

In This Chapter

- Planning ahead and protecting your company
- Keeping your company on the right track
- Making sure your company is firing on all cylinders

Sometimes getting your business to scale in China and making profits seem harder than climbing the Great Wall! We've come up with ten ideas that can help your business succeed. These points are good advice for first-time businesspeople considering doing business in China. If your company has already started in China, read through this list and see how many points already apply to your business.

Respect China but Don't Be Awed by It

China is quite different from what you're used to, but that doesn't mean you should throw out what you know about business. You have to strike the right balance between insisting on your best practices and allowing for Chinese variations. You can bring a number of good business practices to the Chinese market — practices that may be in short supply in China.

However, don't be arrogant and think you can transplant every aspect of your business model to China. Just know that some things will and should transfer; others won't. You have to figure these things out for yourself.

Develop Your Business Plan

Business planning in China is another way to help your company stay on the right course. These plans prepare you to deal with China's complex, shifting markets. Here's how:

- You describe goals and objectives. In a place where approval processes and other tasks may be unfamiliar, you set out plans to divide responsibility and ensure that everything gets done.
- You do in-depth, targeted research to size up the competition, analyze your financial situation, and describe your markets.
- You anticipate problems and come up with possible solutions — before problems happen. Being prepared for contingencies and changes in the marketplace — whether through new laws, new competitors, or failed deals — puts your company in a better position to respond in a way that's best for your business.
- Having a written document that lays out your plans can help all your businesspeople send a consistent message to the Chinese.

See Chapter 4 for more info on business plans.

Decide between a Wholly Foreign-Owned Enterprise and a Joint Venture

Today, many more companies are going the wholly foreign-owned enterprise (WFOE) route than joint venture (JV) option. Either can work for your company, depending on circumstances and goals.

In some respects, you can think of JVs as the faster way to start up — particularly with getting distribution, having a factory and workforce, and making your way through the approvals process faster. But you do run into a lot of trade-offs that can be apparent in the medium- to long-term. You need your partner's consent for many key decisions. Plus, you increase the chances of intellectual property (IP) leakage.

Starting a WFOE usually takes longer to get your operations going, and you have to figure out a lot more on your own than with a JV. However, you never have to worry about dealing with a problematic partner.

Chapter 7 can tell you more about JVs and WFOEs.

Tailor Your Products for Local Markets

National brands don't rule the Chinese marketplace as in much of the West. China is a blend of markets, so getting local in China can have a big payoff.

TIP

Make sure the products you intend to sell in China meet the needs and wants of the local market. Conduct appropriate market research to help you tweak your products for China, and don't neglect the regional variations in your marketing and sales plans. (See Chapter 4 for info on research.)

Do Your Due Diligence

Always perform due diligence when evaluating the capabilities of a potential supplier or partner. Some people in China suggest that companies should conduct due diligence twice. Although we don't think that suggestion is appropriate, you must be very thorough — even ruthless — in your research.

You can perform different types of due diligence — for example, financial, legal, technical, background, and environmental. If your company has the technical capability, you should be able to perform technical due diligence yourself.

Legal due diligence can cover a wide range of items, from asset titles to legal compliance. You can do minimal legal due diligence when evaluating a potential business arrangement by going to the Administration for Industry and Commerce (AIC) and looking at the business license of the other party. The license can tell you who's authorized to sign contracts for the company and who the owners are (which may differ from what you've been told), and it can give you an idea of the company's financial strength. Most other forms of due diligence require professional assistance. See Chapter 17 for details.

Make Sure Your Company Is Properly Protected

Many foreign companies take on too much business risk in China — sometimes without even knowing it. They usually find out the hard way, through unexpected losses to their business.

Make sure your company — and not your Chinese partner — controls the risk management and insurance program. So when you're negotiating with a Chinese partner, tell them that proper insurance coverage is important — so much so that you want to make the arrangements. (If you plan to share costs with them, be sure to get that point in writing from the Chinese side.) You want to make sure your company assets, any legal liabilities, and potential future profits are properly protected. Chapter 17 can tell you more about risk management.

Instill Your Corporate Culture

Instill your corporate culture in your China operations. Without a serious effort to imbue employees with your culture, you'll be almost certain to have a number of problems ranging from difficulty working with the home office to internal control issues. Give your employees a sense of responsibility for the success of the entire operation, and get them to buy into the idea of having controls.

The best way to instill the culture is to appoint a general manager (GM) who's been with your company in its home market for a while and thoroughly understands (and can convey) its culture. If you don't have such a GM, definitely send human resources people over for long-term assignments to work on the culture.

Take Charge of Quality and Financial Control

Many foreign firms have been burned in China due to the lack of quality controls — especially in the manufacturing process. If your company's profitability is dependent on a supplier in China, make sure you have a permanent company representative on the ground in China. Chapter 13 can tell you more about quality control.

Take control of the financial function as well. Be sure that a company representative based in China manages the finances. This person should act as a check on the GM's authority. See Chapter 17 for more info on corporate governance.

Find Professional Help When You Need It Most

Even if you have good people within your firm, you're going to need outside consultants and other professionals to perform certain key functions. For example, China's tax laws are quite complex, so you'll need a competent tax advisor to help you. These helpers can range from external auditors to companies that specialize in background checks on employees.

TIP

Don't bring in a team of consultants or professionals from a firm in your home market and then get a firm in China to tack on the "China-particular aspects." China isn't an "aspect" of the assignment — it *is* the assignment. Inter-firm cooperation rarely goes smoothly as a result.

Although many internationally recognized professional firms are in China, you should do your homework before approaching them. As we discuss in Chapter 4, the quality of the service you receive in China (even from well-known firms) can vary drastically, depending on the individuals handling the assignment. Ask around for recommendations for particular professionals (whether at large firms or not) who do good jobs. Make sure that the firms you use assign professionals who bring a good balance of China and Western experience to your project.

Stay on the Government's Good Side

Complying with the laws of both China and your home country is a must. Make sure that the managers running your business in China are in compliance. Internal audits are a great tool for doing so. Also, formally educate your Chinese team about laws and get signed letters of compliance. (See Chapter 8 for more info on government relations.)

On a more personal note, figure out which government organizations and officials can help your business. Develop strong relationships with them. And don't ever cross a government official; you may regret it later.

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