

WHAT AMERICAN MUST KNOW TO BE EFFECTIVE AND PROFITABLE IN CHINA
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PROFITABLE IN CHINA**

Thesis Paper

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Abstract

This is a research paper about how America companies can expand successfully into China by knowing Chinese culture and past economy. Two important cultures are Confucianism and *guanxi*. The paper constrains examples of companies who expanded well and bad in China. In the end, few recommendations are given for America companies wishing to expand.

Introduction

Due to the development of China, more and more American companies are expanding into China. How can an American company successfully accomplish this expansion in China?

To better prepare American companies to expand into China, one needs to know China's culture and the management differences between Chinese and American companies.

There are two aspects of China's culture which take important roles in business:

Confucianism and *guanxi*.

Confucianism

Chinese culture is closely associated with Confucianism. The specific aspects of the Confucian altar are roundness, symbolizing the continuity and structural completeness of the family; harmony within the family and the broader society; and fluidity, or the capacity to change while maintaining solid traditions.

The Confucian ethic suggests that regardless of where they live or how rich they are, Chinese share an abiding belief in hard work, stronger family ties, frugality, and education. This same constellation of virtues defines much of what Westerners have labeled the Protestant Ethic, but for the Chinese, these attributes are not musty relics from their culture's past but compelling rules to live by today.

Roundness stands for the continuity and structural completeness of the family; it symbolizes that the family is the basic, distinct, and enduring feature of the Chinese

culture. According to this rounded viewpoint, what is crucial is that the Chinese have descendants who can worship them and provide them with food and sacrifices; under such conditions they will lead contented lives in the afterlife.

All of the efforts of the living are directed toward obtaining a rounded family in which the descent line is preserved. Male children, who are obligated to perform ceremonial and ancestral rites, are preferred over female children. This approach has led to inequality of the sexes. The Chinese businessman frequently works alongside his wife or she will handle office matters while he is in charge of external relations. This pattern has limited the growth of many Chinese businesses, as only the wife and other family members are given positions of authority. Sometimes the husband and wife rarely see each other because of his external activities, but this behavior is acceptable when the husband is working hard on behalf of the family, and this perspective leads the Chinese to take a long-term perspective on problems and issues that they face. Unlike Americans, most of whom feel that a long-term plan involves a projection of 3- 5 years into the future, the Chinese tend to be comfortable with plans that are expressed in 10, 20 and even 100-year increments.

Guanxi

What is *guanxi*? The word simply means relationships. People often highlight the building up of *guanxi* or relationships in China as the single most important skill for businesspeople to develop while doing business in China. Many businesspeople talk about the secret to doing business in China by saying that “it all boils down to *guanxi*.”

Guanxi is not everything, but if not fully understood, *guanxi* can work against you and your company.

Chinese society is neither individualistic nor collectivistic, as are other family-based ethnic groups, but based on *guanxi*. Penetrating the layers of *guanxi* is like peeling an onion. First come connections between people and their ancestors, then between people from the same village; then between members of the family, and finally between the family and close associates who can be trusted, such as the competent executives who are not family members but who actually run the factories. All of those relationships are considered to be continual in nature, and obligations go far beyond what can be put into a contract. For example, a Chinese businessman will help household servants establish their own businesses after they have served the family faithfully for several years.

The relation-based system of the Chinese, in which roles are differentiated, is quite different from the more collectivistic and undifferentiated system of the Japanese, which helps to explain why the Japanese seem to favor the development of corporations such as Sony while Chinese seem to favor family-centered businesses. In the Chinese system, family ethics are always based on relationships between particular individuals such as fathers and son, brothers and sisters, parents and children, husbands and wives.

Comparing American and Chinese companies, the World Bank recently reported that two thirds of the publicly traded companies in Asia are controlled by a single shareholder, very often the founder, but the comparable figure in United States is just 3%. Of course, many of the Asian companies are Chinese family businesses.

The lifeblood of a Chinese company is *guanxi*. In fact, when a number of leading Hong Kong businesspeople were surveyed, and *guanxi* often ranked the most important business practice they felt they needed to develop to be successful in China. As a high-context culture, Chinese are less concerned with what is written in the contract than the actions that people take to meet their obligations as they emphasize *guanxi*. Actions like the way one communicate, one's reputation in the areas and so on. For example, some people have confused the practice of real *guanxi* with giving short-term favors and playing the back door game. If that person had real *guanxi* he would likely not have to really need to entertain bribes or pay offs in the first place. *Guanxi* peddlers are often no more than paid lobbyists who have no clue nor really care about your business objectives, rather what they can get out of the deal for themselves.

Form John Chan's view: *guanxi* is a relationship built on a practiced form of respect and obligation that adheres to Confucian hierarchical values where favors are given and received only when there is mutual benefit involved and in accordance with how people conduct themselves based on the five sets of formal relationship set out by Confucius: Man and the state; Man and his wife; Man and his siblings; Man and his children; Man and his friends. Each relationship has its own set of social rules and conduct. If one side benefits too much, then it is the obligation of the other to correct it or not to proceed with taking with the benefit, since it is always the obligator who loses face when things are not balanced.

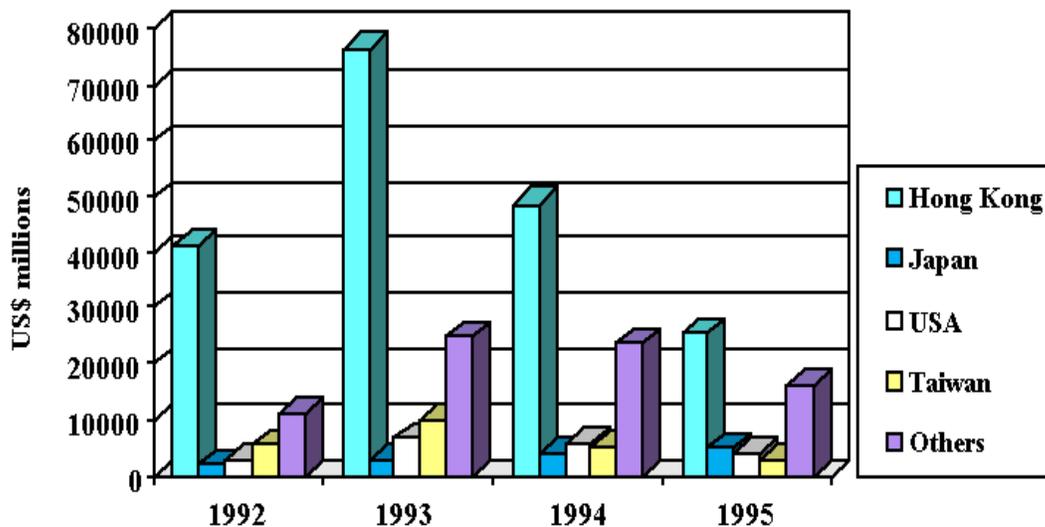
Even *guanxi* has limitations: it is developed slowly and excludes many individuals who might provide new business opportunities and it is at odds with the strong movement throughout the world toward contract-based business transactions championed by many

nations, particularly the World Trade Organization. However, in China *guanxi* still plays the most important role in business.

Economic

Economic is important to know when one wish to expand into China. The following two graphs summaries the economy of China and the foreign direct investment in China which will give investor a sings of where to expand in China. In response to the open-door policy formulated in 1978, inward foreign direct investment (FDI) in China has grown appreciably. The share of FDI from Hong Kong, Macao and Taiwan reached a peak in 1992, at around 70 per cent (Table 1). In recent years, however, the ethnic share in total FDI has decreased while the US has increased. Also, the US has a huge market to increase Foreign Direct Investment in China.

Foreign Direct Investment in China



Unit: %

Year	Hong Kong/Macao	Taiwan	Japan	US	EU
1986	59.22	-	11.74	14.54	7.96
1987	69.08	-	9.50	11.36	2.28
1988	65.60	-	16.11	7.39	4.92
1989	61.24	4.56	10.50	8.38	5.53
1990	54.87	6.38	14.44	13.08	4.23
1991	56.96	10.68	12.20	7.40	5.63
1992	70.03	9.54	6.45	4.64	2.21
1993	64.91	11.41	4.81	7.50	2.44
1994	59.75	10.04	6.15	7.38	4.55
1995	54.64	8.43	8.28	8.22	5.68
1996	50.95	8.33	8.82	8.25	6.56
1997	46.46	7.27	9.56	7.16	9.22
1998	41.64	6.41	7.48	8.58	8.75
1999	41.35	6.45	7.37	10.46	11.11
2000	38.92	5.64	7.16	10.77	11.00

Source: <http://www.chinafdi.org.cn/english>

(Table 1: Share of Major Source Countries of Realised FDI in China, 1986-2000)

Besides of knowing China Culture, in additional, foreign investors have also chosen the right region to invest in. In 2000, eastern regions had over 87 percentage of total foreign direct investment; Guangdong had the largest FDI. Investors have tended to invest in eastern regions since there is a larger market there than in other regions. If new America companies would be better expand starting in eastern regions, an example about KFC successfully expand will be discussed below.

Unit: %

Year	1985-89	1990	1995	1997	1998	1999	2000
Eastern Regions	87.9	93.1	87.7	85.9	87.2	87.8	87.8
Beijing	9.9	8.1	2.9	3.5	4.8	4.9	4.2
Tianjin	3.6	1.1	4.1	5.6	4.7	4.4	2.9
Hebei	1.5	1.3	1.5	2.5	3.2	2.6	1.7
Liaoning	3.6	7.5	3.8	4.9	4.8	2.7	5.1
Shanghai	9.5	5.1	7.8	9.4	8.0	7.1	7.8
Jiangsu	3.7	3.9	13.9	12.1	14.6	15.2	15.9
Zhejiang	1.6	1.2	3.4	3.3	2.9	3.1	4.0
Fujian	6.9	9.3	10.9	9.3	9.3	10.1	8.5
Shandong	3.5	5.4	7.2	5.6	4.9	5.7	7.4
Guangdong	40.7	46.1	27.6	26.1	26.5	29.2	28.0
Hainan	1.8	3.0	2.9	1.6	1.6	1.2	1.1
Guangxi	1.7	1.0	1.8	2.0	2.0	1.6	1.3
Central Regions	6.9	4.0	9.2	10.7	9.8	9.4	9.2
Western Regions	5.1	2.8	3.1	3.5	3.0	2.8	3.0
Total	100						

(Table 2. Regional Distribution of Realised FDI in China, 1985-2000)

Methods of Research

The major research method I used is literature searches and internet surveys which were all readily available materials. Those materials included relevant trade publications, public books and on-line data bases. Since it was too expensive to gather primary data , literature research over the web and library was the major research material I used.

The goal of this research paper was to let foreigners know how to do business better in China. First, I looked into China culture which influences Chinese people doing business: Confucius and *Guanxi*. I looked into the location and past economic when investor look for expanding. Second, I researched to find examples of foreigners who did well or bad in China. Lastly, after looking into the examples and culture differences, I came up with some recommendations for the foreigner wishing to expand a business into China.

Result

Richard Tomlinson, a former senior Boeing engineer and who now runs a software development company between China and the U.S, has been in China for about three years and is married to a local Shanghai woman who works at an American law firm. He said he had many people take him out for dinner and the next week ask him if he can get them a visa to go to the States. I totally agree with John Chan who said he was under no obligation to try and get them visas since the reciprocation was clearly out of balance and

that individual should have been ashamed for asking in the first place. Mainland Chinese might simply be following a double standard, believing they could get away with not following the “proper rules of conduct” simply because Tomlinson was a foreigner. The main point is this practice does not represent real *guanxi*.

Wang Lei, a locally educated lawyer who worked with MOFTEC (The Ministry of Foreign Trade and Economic Cooperation) from 1986 to 1996 and was a negotiator for China’s entry into the World Trade Organization in Geneva, has been a partner at both international and local law firms and now spends most of his time advising clients on exactly what he is an expert at how to navigate and interpret China’s complex bureaucracy and laws. Given China’s entry into the WTO and his background as an actual WTO negotiator representing the Chinese side, he knows how to effectively manage governmental *guanxi* by developing capabilities in-house (Chan 2003).

Employees with a good sense of the company’s objectives are best able to ensure that the company is able to navigate through the complex bureaucratic web to meet its goals.

Another effective way of working with the Chinese bureaucracy is to find a good local Chinese partner. The main point of this practice is to develop real *guanxi*.

Conclusion

The real factor that will determine whether one is able to run a profitable business remains in a company being able to develop the best products and services that meet the local needs, using the Chinese way of doing business. There are few recommendations

about what US companies can do to be effective and profitable in China, but sensitivity to Chinese cultural values like *guanxi* is essential

Recommendation

Firstly, doing research about locations and whether one's products and services fit the Chinese market and marketing strategy. A great example is Kentucky Fried Chicken. McDonald's has the largest fast food market share in US, but KFC came to China and took the largest market share. When KFC expanded in Hong Kong in 1973, all the restaurants closed down in 1975. After 12 years, KFC remarketed in mainland China. KFC opened its first restaurant in Beijing in 1987, then 10 in 1992, 100 in 1996, 1000 in 2004, 2000 in 2007 and 2500 in 2009. I have to say KFC has had huge success in China. One main reason for KFC's huge success is that KFC did valuable market research when choosing its first locating by evaluating the population, government, environment, and *guanxi* with the government. KFC choose Beijing over *Tianjing*, *Shanghai* and *Gaungzhou* because Beijing is the capital city with lots of travelers. Locating in famous travel destinations guarantees the stores will have fixed amount of customers. KFC combined US tastes with Chinese tastes and made changes to the menus to better satisfy Chinese customers. In addition, KFC operates as franchise restaurants in China, which makes it much easier to expand in the Chinese market.

Secondly, Keeping up good relationships and understanding Confucianism will be a plus. *Guanxi* contains the Confucian elements of respects, hierarchy, obligation and face. Since *guanxi* is at the heart of almost all business transactions in Chinese society, one should

add practicing *guanxi* to the list of six universally action steps for a foreign executive operating in China to follow. Although *guanxi* is that it is difficult and takes time to develop, and people have been successful in China without having to practice it religiously. Some people think of *guanxi* as simply a reciprocation of favors through a network of contacts. Worse still, other think you can “buy” *guanxi* and often complain when it doesn’t seem to work. One of the key elements not clearly understood by foreigners is the importance of “respect” in the context of Confucian values, which contain elements of hierarchy, obligation and “face.”

If real *guanxi* is built up properly sense, *guanxi* could very well prove to be the most valuable tool for a person to have in China. But the foreign executive is unlikely to learn this ancient practice quickly as it often takes years of understanding and practice to master. Over time, foreigners are as capable as anyone of learning the art of practicing real *guanxi*.

For example, Laurence Brahm, an American lawyer, political economist and writer, is a great practitioner of *guanxi* and a significant contributor to *China Streetsmart*. Brahm has been in China since the 1980s and now has excellent *guanxi*, enough that he could ask Prime Minister Zhu Rongji and other top government officials to contribute to the book (Chan 2003).

In Chan’s book, he mentions that after interviewing average foreign executives on this important subject, many did not really seem to understand that *guanxi* is more than a reciprocal act, also contains the Confucian elements of respects, hierarchy, obligation and face.

Last not least, Employees with a good sense of the company's objectives are best able to ensure that the company can navigate through the complex bureaucratic web to meet its goals. Another effective way of working with the Chinese bureaucracy is to find a good local Chinese partner.

Most of the companies not doing well in China today are the result of originally flawed business objectives and plans, which need first to be identified and accepted before a proper resolution can be found. The process requires both the China management team's ability to accurately identify the issues with the original strategy and the head office to begin pointing fingers if either side does not do an adequate job. To set up a successful operation requires keeping leadership team intact from the initial stages to the ongoing business operation. Given the importance of relationships in China and the benefits derived from close government relations in helping the company navigate the complex and capricious commercial laws and regulations, having a senior leader who knows the history of the company will help tremendously.

Lastly, it is important to understand the different professional views of management among Chinese and Americans. For example, in American companies, employees choose jobs depending on their interests and needs; in contrast Chinese employees choose job mainly because they need them to support families and themselves, and personal relationships tend to help one get the job. American companies need to put employees' benefits first and maintain good relationships with them so employees will be thankful for the good treatment and continue working for the company. This is an idea from Confucius.

Overall, expanding in foreign country is difficult and the four recommendations will be better prepare companies expanding into China.

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