

Understanding Opportunity in 中国

A culturally intelligent approach to market entry into China



TRANSTECH^{USA}

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Cultural Intelligence is key!

In China, a venture can fail for many reasons. Many times what went 'wrong' is very difficult to understand and therefore difficult to learn from. To make informed decisions on what your next move should be in your China ventures, you need a healthy respect, awareness, and understanding for the local dynamics plus a high level of business experience, which in combination is one definition of cultural intelligence. Without cultural intelligence you are truly gambling with your time, money and possibly your career.

A little perspective....



Ancient map of the Middle Kingdom and its view on the world from 1763 re-drawn from a map dating from 1418

China in mandarin = Zhong(1) Guo(3), literally translated = Middle Kingdom (Center of the Universe)

Culturally China has been developing for over 4,000 years with many amazing inventions to their credit, highlighting their ingenuity and creative spirit including: Gunpowder, Paper, Moveable block printing, and the Compass just to name a few.

Other than the Japanese, every group of invaders who have entered China adopted Chinese culture as their own and the Chinese culture survived....even thrived!

Historically – the dynastic cycle of 'change' is inevitable when a leader/ruler loses their 'mandate of heaven'.

Definition: The Mandate of Heaven belief purports that Tian (Heaven) blesses the authority of a good or just ruler, but is displeased with a tyrannical ruler and withdraws its mandate from them, leading to their overthrow and the transfer of power to whichever new ruler would rule best, usually the key leader who successfully overthrew the old dynasty.

- In general terms this makes the Chinese very pragmatic and opportunistic
- This also creates a long-term view and a level of patience uncommon in most other parts of the world
- In addition this tends to foster an underlying confidence for many that despite the ebbs & flows of short-term rulers, central government politics and governance, the natural and 'local' Chinese way of doing things will survive and grow

Not unlike the 'West', most Chinese prefer to do business with people they know & trust

- There are 55 regional or minority sub-groups within China, most are regionally influential
- Each sub-group has a variation on their version of spoken Chinese which developed over the ages until modern times and travel capabilities connected geographically separated groups. This development is not unlike the different regions of the United States, from Maine to Alabama, from California to Alaska & Hawaii all with their own very unique local culture and customs.

The above perspective is helpful as it relates to understanding some of the cultural history and variance within China. Over the last 30 years since China re-opened their doors to world China has been very quickly transitioning from a pure supplier of low cost manufacturing and labor to a financial, fashion, technical, and biological leader. Unlike many places in around the world China is changing faster than you ever imagined, especially the larger metro-markets in the eastern half. The Beijing Olympics offered a 'new' view into China for many. China is evolving faster than anywhere else in the world and as a result has a huge appetite for goods and services....just what those goods and services are, how to identify what they are today versus what they need to be, how they are sold today versus how they will be sold tomorrow, how they are distributed today versus how they will be distributed tomorrow...

A Culturally Intelligent approach to business due diligence in China

Making good decisions on your next business venture, task, or assignment is what most of us are 'paid' to do, regardless of your role and level of responsibility. Whether you are a President of a large company or the cashier at the local fast food drive-thru, we get paid to use our brains. Not to joke on the topic of robots, but the complexity and variables involved in most of our jobs is the only thing keeping us from being replaced by an automaton. Interestingly, when faced with some of the most complex and, truly foreign business decisions, like entering the various new markets of China for the first time, many companies seem to put their combined strategic brain on hold and turn into robots.

They simply are not being intelligent about how they have gone about identifying what their true opportunity may be and instead stumble blindly forward, whether that is attending the next trade show or meeting with business cards in hand, or surfing the internet and hoping to find the perfect partner.

Not taking the necessary steps to indentifying your opportunity and associated risks is fraught with danger, most unknown or under-appreciated by the un-initiated until a great deal of time, money, and possibly careers are wasted. To use an old acronym with a China twist, be S.M.A.R.T. about how you approach your specific China opportunities.

'Guan Xi' pronounced 'Gwan Shee' literally translated means 'relationships'. In the context of doing business in China it has a far richer and encompassing meaning of also expressing an obligation of one party to another, built over time, by the reciprocation of social exchanges and favors

Be **S.M.A.R.T.** using these approaches will help reduce uncertainty and risk, save time and as a result if done correctly will help build a successful business in China::

Specific: What are you really trying to accomplish? A beach-head for future growth, lower cost of production

Measurable: \$, Units, Licenses, Relationships, Customers, Suppliers, etc...

Attainable: Certain areas of the Chinese economy remain virtually off-limits to non-Chinese companies: e.g.: telecommunications

Realistic: There are no short-cuts, understanding your environment, leveraging resources, and developing/maintaining the relationships with 'Guan Xi'.

Time sensitivity: Not 'Western' time, but 'Chinese' time

To apply the above concepts to an example, consider you are looking at China for the first time as something other than a tourist destination. Before you can execute on a strategy, you need to develop a go-to-market roadmap which will include comprehensive and intelligent research, starting with a macro view, re-focusing to a more micro perspective at each step in the process. From a best practice viewpoint, this is truly a multi-phased business due diligence process that should include:

Deep market and competitive research

Assessment of your true opportunity as it relates to the market and competition

Develop Go-to-Market strategy

Execute

Performing the necessary and arduous process of detailed business due diligence in China is where many companies need to focus the most and therefore are likely to need the most assistance today. The many cultural, language, and distance barriers that exist are stumbling blocks to most researchers, but that does not mean research cannot or should not be performed. This last statement is a repeat theme from the beginning of this article due to the frequent business blog postings focused on China offering multiple examples of people and companies not using basic common sense when approaching business in China and ‘paying’ for it in one way or another. Maybe it is as a result of the sheer ‘foreignness’ of attempting due diligence in China that many seem willing to gamble by skipping this important and multi-phased step when picking who they are going to try to do business with in China. The sheer size of the various combined China markets can overwhelm some strategists as well...especially when you consider the that there are over 40 metro-markets in China with over 5 million population, a workforce of over 800 million, and a population of over 1.3 billion. Most people research fairly carefully where they are going to purchase their next car or HDTV, does a new business venture in China not deserve a high level of due diligence?

Moving on, assuming you have followed the appropriate business due diligence steps above and you have identified a filtered list of potential partners, the natural next step a western company normally wants to initiate is the financial and legal due diligence. In China, the best practice is to first initiate detailed commercial due diligence due to the lack of clear public accounting and financial reporting rules. This is a validation process that should be followed in as much detail as you have the time and resources to complete. By validate we mean to review a potential partner(s) to ensure they are what you ‘think’ they are or what you have been told they are. A few areas to consider in your due diligence effort should include:

- How sustainable are their customer relationships? What do their suppliers think of them? How good is their supply network?
- Competitors need to be scrutinized in detail. Not just the many private owned enterprises (POE), but the new more agile and well funded State owned enterprises (SOE).
- Do you really know who the folks are running the business you are thinking of putting so much time and money into? What is the background on key management?
- Take any emotion out of the decision process by verifying:

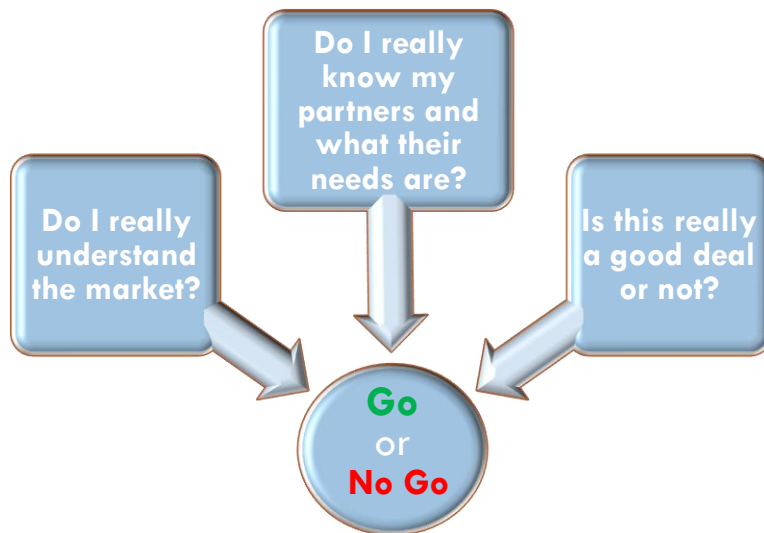
Commercial due diligence should be done through anonymous interviews throughout the target's value chain

In M&A due diligence a common finding is off-book assets and undocumented commercial practices that can impact valuation and integration

- a. Basis of business and rollout
- b. Claimed competitive advantage
- c. Claimed political 'connections' and 'access' (Guan Xi)

A typical approach in the United States and Western Europe is performed with your business card in hand, announcing who you are and likely your intentions at the time of introduction. In China this is not always your best strategy for a couple of reasons. A lack of cultural intelligence requires most foreigners to trust their Chinese target before they truly 'know' them to supply accurate financial data & metrics, or to properly translate local and national business laws and licensing requirements. As stated previously, cultural, language, and distance barriers make business due diligence in China very difficult for most. In many places around the world on-line research is typically a good place to start for most, but on-line research has limited true business due diligence value at this time in China.

The best business due diligence is performed 'in-person' via face-to-face dialogue. This requires local knowledge, local access, and local communication skills. Due diligence performed for an 'anonymous' client works very well in China, the results are more accurate and open. Due to the 'anonymity' element, this type of due diligence obviously cannot be performed by corporate executives. Research conducted by corporate resources does not typically provide a successful acquisition of quality data...in general the data shared in these instances is highly modified in anticipation of what the China partners believes to be a beneficial outcome for them (higher valuation, higher contract value, etc...)

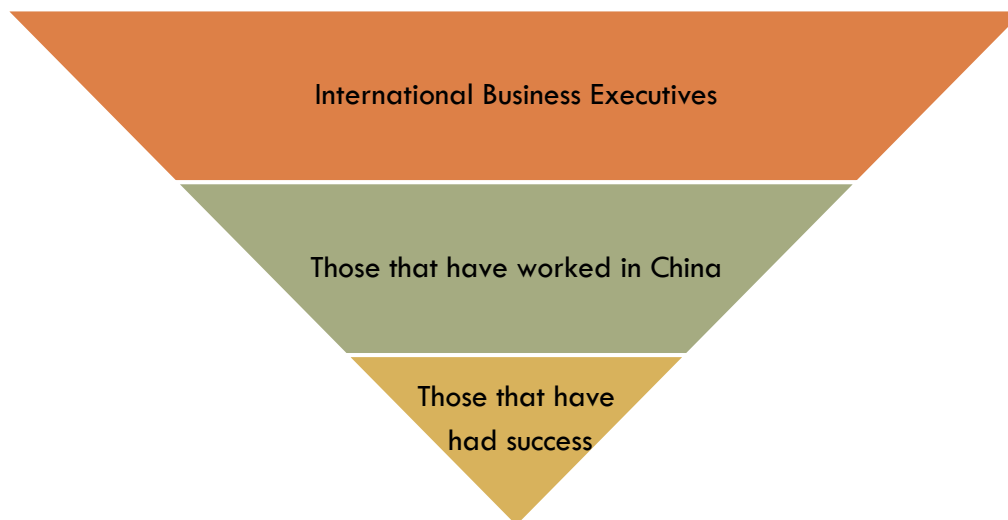


Understanding your venture partner's motivations are critical. An example of a set of unique motivations was the deal between Lenovo and IBM. While many analysts, articles and blog postings noted the deal as an example of an impending threat of highly capitalized Chinese competition in the global M&A space taking over, Marshall Meyer, a professor of Management at Wharton, does not agree. He believes it highlights more weakness than strength, not so much from a balance sheet perspective but from a skill-set perspective.... "Lenovo, the computer company, is no longer a Chinese company. In fact, the company is controlled by Western investors, at least temporarily. Its management is increasingly

Western,” he says. “It took this path because it had no choice. Dell was challenging it severely in its home territory, and it had to play global chess.”⁵ Every deal is unique; opportunities can be very different than what you may expect.

Due diligence in China is unique and requires a tailored approach

Approaching China as a newcomer is daunting. Language and cultural barriers are typically high. Almost every 'western' business protocol has a variation or twist within China that takes years to understand, and are mastered by few.



There are several different approaches to business due diligence and strategy development in China. They each have their pros and cons:

- **Hire a large consulting firm** with a well established 'China' practice, but they are often 'valuation' focused. They tend to be very expensive and provide only a high level tactical perspective. Most importantly they like to operate within the realm of predictability and are therefore difficult to manage to a varied outcome.....which is very typical in China.
- **Hire a market research firm.** They tend to be relatively inexpensive, but cannot provide much specific guidance with their 20,000ft viewpoint.
- **Explore with internal resources alone** or through a trade show visit. This is the least expensive and most often initial first step into China. Success using this approach is very sporadic and usually ends in failure. Lack of experience can cost you money, time, and your IP with no easy recourse

- **Work with TransTech USA.** TransTech provides a complete suite of solutions that will help you build a comprehensive go-to-market strategy underpinned by culturally intelligent business due diligence. These include:
 - Proven methodologies
 - Client-focused common sense approach
 - A team of highly experienced business people and partners
 - Deeper, more mature market understanding developed over a 25+ years focus on China, with an extensive network on the ground in China
 - Ability to filter, sort, and process the China market to provide clear actionable data
 - Provide the vital bridge between Chinese business acumen and culture with that of the US

Whichever approach you take, be S.M.A.R.T. about it. Do your home work and listen to your instincts and don't be afraid to ask for help....no matter how far along you are in your discussions. As Kent Kedl who has lived in Shanghai for the past 20 years often says *"In China anything is possible...but nothing is easy!"* I couldn't agree with him more.

About the author:

Matt brings a unique combination of cultural intelligence and strategic business development with strong financial and business technology translation capabilities. He brings deep experience on market expansion and commercialization with over 15 years in senior exec positions within the CPG, Tech, and Pharma industries. Throughout his career, Matt's professional and cultural passion has remained on China. Since the mid 80s Matt has at different times lived, worked and studied in China and is fluent in Mandarin.



His experience has provided a depth of China knowledge and a strong and proven local in-China network of contacts and resources that is truly exceptional. In addition to business development, Matt brings significant expertise at translating linkages between current and future operational, commercial, and financial performance to the use/leverage of technology.

Resources:

1. Kent Kedl, Founder/Owner, Technomic Asia, <http://www.technomicasia.com/blog/>
2. Peter Bryant, Founder/President, TransTech USA
3. Suzie Upton, Best friend and beautiful wife of 21 years
4. Cover art: <http://www.hnzcrts.com/En/>; [http://abduzeedo.com/daily-inspiration-117](http://abduzeedo.com/daily-inspiration-117;); http://images.businessweek.com/ss/05/12/china_wonders/source/1.htm; <http://www.expo2010china.hu/index.phtml?module=hirarchivum&oldal=4>
5. <http://knowledge.wharton.upenn.edu/papers/download/BCGChinaReport3.pdf>