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Why China?

The last few years have seen a tremendous growth in the number of US companies establishing operations in China. There is no doubt these business decisions will have a profound impact on US China trade for years to come.

However, what is missing from this migration to China is the long term strategic impact these moves will have not only on the participating companies but the US in general. China represents a tremendous growth opportunity for US companies if the strategy is sound and implemented correctly. Yet many US companies are rushing to China the same way that the gold prospectors of the mid 1800's rushed into California, that is blind and overly optimistic! Success in China requires an iron clad vision and strategy that is consistent with a company's overall business strategy.

Common Pitfalls in a Chinese Strategy

Let's examine some of the common pitfalls that companies fall into by not properly developing their Chinese strategy:

1. *We established our operation in China to provide low cost global sourcing.*

Global sourcing is an issue that is driving many companies to establish lower cost manufacturing operations in order to compete. China can provide companies with very attractive sourcing alternatives. However, let's look at the impact of this strategy. If the strategy is cost based only companies run the risk of a sharp upswing in the Chinese Yuan. The Yuan (RMB) has stayed pegged to the US dollar at a rate of 8.3 to 1 since 1994. This has been the policy of the Chinese government. There is increasing pressure from the G8 and other countries for China to float the Yuan against the US dollar. Most observers feel if the Yuan were to float it would rise sharply against the greenback. Estimates are the Yuan would rise 10% to 30% against the US dollar. This would put upward cost pressures on those operations that established operations in China for global sourcing only.

A China procurement strategy makes sense when dealing with commodity products. However if the US Company is a niche market player, China may not be the ideal location for sourcing. Smaller based economies such as Australia, New Zealand or Ireland may offer similar cost advantages since their manufacturing sectors are set up for niche volume production.



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Another important overlooked concern is the protection of a company's intellectual property. According to the Intellectual Property Alliance, China's software piracy rate was as high as 92% in 2002, the highest in the world.

2. *Our customers are in China and we need to be their too.*

This is a dilemma for many companies. In order to be considered as a preferred supplier to large multinationals, these companies are being directed by their clients to have operations in close proximity to the clients operations in China. This can be a very expensive and resource consuming venture. The key is to develop a global strategy that takes these customer requirements and turns them into business growth opportunities.

Riding the customer's coat tails can provide advantages to the supplier in terms of support from the customer. Companies that take advantage of this requirement will use the operation as a launching pad into the Chinese domestic market.

However, if a company views a Chinese operation as a distraction or a burden they will create a mindset within their organization that their China operation is a drain on their main business: In other words a cost center versus a profit center. This will result in the organization not fully supporting the Chinese operation, thus, creating incoherent strategies and possibly conflict with other parts of the company.

3. *We made connections with some Chinese business people that opened the door for us in China.*

Many times opportunity comes knocking on the door. Companies that haven't thought of China or have done little due diligence will be approached by Chinese businesspeople offering to help them set up operations in China. These opportunities are usually discovered at conferences, trade junkets or cocktail parties.

The key to remember here is who these people are representing. If they have established partners in China most likely they have the interest of their partners in mind and not necessarily your business. This doesn't mean one cannot establish an effective relationship with them and their partners. However, it does require the US Company to fully understand the dynamics of the relationship before entering into a program.

Another overlooked factor is that unlike the US where business people have contacts nationwide China is more provincial. Chinese agents tend to have well established contacts in one region or province. This tends to limit the US companies options. If a US company is looking to enter into China, they may be better served by working with intermediaries that have relationships in various parts of China. This will ensure the US



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Company that the region they establish their operation is best aligned with their strategic objectives.

4. *China is too big of a market for us to ignore.*

There is no doubt that China offers a tremendous opportunity for US companies to expand. China's business is booming and consumer spending is on the rise. However there are many market characteristics that need to be analyzed before jumping into China. Here are some examples to consider upfront:

- A. The buying power of the average Chinese is not the same as that of the average American.
- B. The value proposition for products and services may be significantly different in China compared to the United States.
- C. The time to create a brand image in China will take longer than most companies estimate.
- D. Indigenous competition will develop rapidly once a product's value proposition is established in the market place.
- E. Market channel development may require significant resources to successfully launch and support products.
- F. Government restrictions to distribution particularly in the retail industry.

What's a Company to do?

We've discussed some of the pit falls in doing business in China. How can a company successfully enter China? The most important thing is to have a clear vision of what China means to one's company. What will doing business in China accomplish?

- Increase revenue?
- Entrance into the Chinese domestic market?
- Operating platform to launch into the rest of Asia?
- Component sourcing?
- Enhanced corporate image?

Once the vision for China is established, the management team needs to embark on a strategy that is aligned with the overall corporate strategy. The desired outcomes from the company's China strategy will determine how to implement the strategy. The success of a company's implementation will be proportional to its upfront due diligence.

Here are some points to consider when conducting due diligence on China:



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- What organization structure fits the company's needs?
 - Manufacturing facility
 - Sales office (if government allows it)
 - Agents or distributors
- What are the company's financial objectives?
 - How will the venture be financed?
- How will the company protect its intellectual property?
 - Use the Coke Cola model?
- How will earnings be repatriated?
- What are the company's alternatives to investing directly into China?
 - Joint ventures with Chinese companies
- What is the realistic time horizon for seeing success in China?
 - Will the management team be around to see the rewards!

The intent of this paper was to share some thoughts about “Why China?” This paper was based on our experiences and observations of companies entering this market. We welcome your comments along with your experiences in dealing with China.

About Mountain Global

Mountain Global is a global business development and management services company focused on helping small to mid size businesses to successfully launch their global strategies. We can help your business to develop their global business whether it's in China or any other part of the world. We have over 50 years of global business development experience.

Bob Thilmont is President of Mountain Global. Bob has over 25 years of experience in the Automotive, Industrial and Power Generation industries. He also has over 10 years of global business development experience in Asia Pacific, Mexico and Latin America. He managed the Australian operation for Woodward Governor Company. During his Australian assignment he started up an operation in New Zealand. Prior to Australia, Bob established distributors for Woodward in Mexico, Venezuela and the Caribbean.

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