



# China: the New Economy

## Cultural Aspects of Successfully Forming Partnerships

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*The Illinois Information Technology Association was very fortunate to host Wolfgang Fürniß at its International Roundtable on December 2, 2005. This writing is a summary of my notes made while listening to Dr. Fürniß' presentation in an informal, interactive round table format. I have done my best to faithfully capture the discussion, and I alone am responsible for any errors. The session was extremely valuable, and I share it here for your benefit. To read Dr. Fürniß' extended bio and the ITA's event announcement: <http://www.illinoistech.org/calendar.aspx/149>. To reach his consulting firm on the Web, go to: <http://www.alsus.com>*

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### **Summary of the ITA Roundtable, 2 December 2005, Chicago, IL USA**

Dr. Fürniß first went to China in 1981, when it was a much different country than it is today. Among many of his other accomplishments, Dr. Fürniß negotiated the first 100% Wholly Owned Foreign Enterprise (WOFE) in China for SAP. He has been involved with numerous ventures in China ever since. He shared his experiences with round table participants in an interactive format; however, the focus was on explaining key aspects of Chinese culture without knowledge of which a foreigner has very little chance of succeeding in China.

### **Sobering Statistics**

| Of Joint Ventures in China*  | Of the Failures  |
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| <ul style="list-style-type: none"> <li>• 60% fail</li> <li>• 30% succeed</li> <li>• 10% unknown</li> </ul> | <ul style="list-style-type: none"> <li>• 50% fail due to a lack of "basic understanding" of Chinese culture</li> <li>• 30% fail because (western) managers failed for personal or professional reasons</li> <li>• 20% fail for market or business reasons</li> </ul> |
| * In 2004, there were 5 million joint ventures in China, 30,000 in Beijing alone                           |  |

These numbers reflect that 48% of western/Chinese joint ventures fail due to cultural or managerial reasons. Therefore, by developing a firm understanding of Chinese culture, you will significantly enhance your chances of succeeding in business relationships where most others fail.

### **Understanding Chinese Business Culture**

For most westerners, the Chinese culture, including business, is significantly different from their cultures in several important ways. It is eminently possible to form and grow rewarding business relationships in China, but one must be prepared to learn. The first step is to think about yourself and your culture. You need to understand yourself and your culture; self-awareness is a necessary asset in understanding another culture. To understand why Chinese do something one way, it helps to understand why your culture does that thing in its way. This personal understanding will serve you well in making deals with Chinese business leaders.



## **Forming a Venture in China: the SAP Example**

When Dr. Fűrniß led a team that was involved in making the Chinese venture for SAP in 1992, the team came to realize that Chinese business executives were "solution focused" to the extent that they did not appreciate the differences between hardware and software. The team was required to conduct an extensive education process to enable them to understand the roles of hardware, software and services in the total solution, within the context of their businesses. This was necessary before they could explain the value proposition of SAP software, which is a customizable package. The prospective customers did not believe in the concept of software packages at first. Of course, this was an educational process for the SAP team as well.

Separately there was the issue of what kind of company to build. There were many examples of companies that brought in western management to lead Chinese employees. Over time, Dr. Fűrniß discovered that they needed to build a Chinese company. Their goal was to build a capability to win, serve and retain Chinese customers, so they had to develop a deep understanding of the cultural context of their activities. They observed that the model of western-educated managers and Chinese employees did not work terribly well. Creating an entirely Chinese company was the way to go. They ended up with roughly 25 western employees and 6,000 Chinese, with the western employees having the role to transfer knowledge from SAP's global experience serving customers and working with their Chinese colleagues to discover how to impart that knowledge so that it could be applied in a Chinese context.

To create the company, they headed to Beijing University's IT department, where Dr. Fűrniß formed a relationship with one of the key professors. SAP created a two-year training program for students, after which they were usually employed at the company. In return, the professor served as their best recruiter, always looking for the brightest students to refer to the program.

The next question was, "How does one manage a Chinese company?"

## **Key Cultural Constructs and Principles**

A basic understanding of Confucius goes a long way because his teachings 2,000 years ago still epitomize the following social and cultural constructs of the Chinese culture and psyche. If one does not understand them, one has virtually no chance of developing and retaining the confidence of Chinese business partners and customers.

### **Leader/Follower Relationship**

The leader/follower relationship is a cornerstone of the attitude toward authority in China. The president/manager/executive looks out for the company and its employees and (lower) managers. Followers do not question their leaders' decisions in the same way that western employees do. No one can lose face, be openly embarrassed or questioned. There is an intricate system for asking questions without causing someone to lose face; it is very indirect and happens through trusted intermediaries. Each party has his role in honoring this relationship: the leader is duty-bound to take care of his followers, and his personal integrity is at stake in how well he fulfills this mission. The follower does not openly question the motivation of the leader.

Meetings have a very different flavor in China because no one can lose face, so overt conflicts are avoided at meetings, where someone would lose face if a conflict materialized in an open forum. Therefore, discussion around conflicting points of view takes place before meetings, often through trusted intermediaries. Western managers must increase their ability to observe and learn. They must be patient and develop trusted relationships, so they can conduct these "behind the scenes" negotiations, Chinese-style.

This should not be confused with "consensus decision making" of the Japanese ilk.

By the way, the Communist Party in China plays a very important intermediary role in business relationships. Because the Party has officials at all levels of provincial and federal government who are



deeply embedded in industry, cultural institutions and universities, forming trusting relationships with them is of utmost importance. In most cases, Party leaders are committed to helping western-Chinese business ventures succeed because such ventures strengthen the economy of their jurisdiction. Usually, their role with foreign business ventures is apolitical. They are often an ideal intermediary and excellent place to start.

### **Respect**

This is another construct that is closely connected with authority. The son respects the father, the elderly are respected by youth, the wife respects her husband, the subject respects the prince and friends respect each other. This way of thinking, feeling and being can seem like an impenetrable web of relationships to outsiders, and foreigners must allow time to learn. By the way, these webs of relationships have little/nothing to do with company "organization charts"; they transcend them. When negotiating a deal, you may not know who the decision maker is. When Dr. Fürniß was negotiating the SAP WOFE in 1992, he had to meet with six different partners in six days. There was an old man observing, who said practically nothing. SAP later learned that the separate meetings had been arranged to enable the Chinese team to look for consistency (and therefore integrity) within SAP's message. It turned out that the old man had the last word. In China, it is often the person that says least who has the most influence, which is another paradox for western managers, who often equate speaking with authority.

### **Danwei**

Danwei is loosely translated as "unit where you live" (or "work unit") and has had a profound influence on Chinese culture. It is somewhat related to family as well, especially when the family works together (about half the Chinese population have agrarian-related jobs), and Chinese actively consider four generations when speaking about family. Danwei provide social services like health care and education; they take care of their members' needs. In return, Danwei exercises social control over its members (in Communist China, it had to approve marriages and travel and work assignments, but these restrictions have lessened greatly since the Deng reforms). To be expelled from Danwei would be a catastrophe.

Today, the employer has assumed many Danwei overtones. The point is, to Chinese workers, Danwei is a multidimensional construct that carries emotional, social and economic connotations. Today, people are much freer to work where they want, but this is relatively recent. Within this context, the relationship with the Danwei is critical to a worker's well being. People are terrified of being fired because it would be similar to being expelled from one's family. As a foreign executive, you should attempt to build relationships with relevant Danwei.

This explains part of the difficulty the Chinese government has with shutting unprofitable state companies; layoffs would be an utter catastrophe and very disruptive for the population. Even today, sixty percent of the people in state companies are not profitable.

Chinese culture, because it is very hierarchial, depends on the structure to work. People have a hard time with structural ambiguity.

### **Guanxi**

Guanxi is a central concept in Chinese society that refers to one's personal network of relationships in which one can prevail on others to perform a favor or service and, depending on the nature of the relationship, others can prevail upon the person. When seen in the context of the "Leader/Follower Relationship," it is clear how important Guanxi is. Above all, Guanxi refers to the amount of influence one has. Guanxi almost always refers to one's personal influence. Building Guanxi is an end in itself. To better understand the concept, it is important to realize that a Chinese person's sense of self is based on his position and role within various groups; the western sense of the individual is largely a foreign concept. In fact, most speeches begin with an "individual disclaimer," an apology for how poor a job the person is going to do in speaking because he wants to disavow any self-aggrandizement as an individual.



The group is everything. Another very important rule is that, if you owe a Chinese a service, you must offer the service because he will not ask you. You must offer to help.

### **Ren**

Ren can be loosely understood as "love your neighbor as you love yourself" and is closely related to the Chinese appreciation for harmony and personal integrity. If a foreigner is regarded as "having Ren," he has attained the highest level of confidence possible. He can be trusted to observe and honor the Chinese sense of harmony and fairness. It is the highest aspiration for a foreigner.

## ***Business Culture***

### **Decision and Deal Making**

The above cultural elements notwithstanding, Chinese have a tradition of tough negotiations and haggling, and they are much more outspoken than Japanese. However, the context of what makes a good deal is different from most westerners'. There is no concept of "shareholder value"; rather, what is important is how well the deal will further the relationship. Deals are usually seen as ways to build relationships, not as ends in themselves. If you think about it, you might appreciate how different this orientation is from western business practices and how this difference could easily scuttle a deal. Chinese usually take a long-term view, which is diametrically opposed to Americans' notorious short-term perspective.

To negotiate successful deals, you will have to set expectations on your team's side that it will take time. You will have to invest as much time as needed to build the relationship and get the deal done. Dr. Fūrniß was once asked what SAP's deadline was for a certain deal. Having learned from experience not to give a date, he replied that he wouldn't leave until the deal was done. When you say that, you will prove it, at least once! Often the most important meeting will be scheduled as time is running out, to gain negotiating advantage.

As suggested above, when conflicts occur, you will hear about them indirectly, through a business partner, government official or other intermediary. Chinese are very hardworking and studied. They prepare extremely well and will usually want to talk through details in several cycles. Westerners usually have a linear checklist thought process for negotiation, which does not bode well for deals with Chinese business leaders. You must increase your alertness, have an open mind and ask questions.

### **Agreement and Contracts**

As implied by the cultural principles, one's personal integrity is what pulls together Ren, Guanxi, one's position in the Danwei and one's respect in general. Therefore, Chinese have a lot at stake when they enter into relationships, which are generally considered to be long-term relationships. Keeping one's word is a cornerstone of personal integrity. This principle follows through in business dealings. Chinese attempt to form a relationship that will transcend the deal. This is more important than the legal system.

Lawyers are not at the negotiation table and should not be a proxy for their clients in negotiations as they often are in the U.S. They handle paper work and contracts after everything has been decided. You can appreciate the obvious conflict here: in the U.S., the law is the highest authority and agreements generally recognize that. In China, one's word and personal integrity carry the day. Coming in with a lawyer may well imply that you do not trust his integrity.

Regarding contracts, Chinese generally like to write them as general frameworks that can adapt to changing conditions. They prize flexibility. With this in mind, the Chinese penchant for repeatedly asking questions, as well as the extended negotiation sessions, is understandable because one is giving one's word based on that understanding.



## **The Legal System and Intellectual Property**

The Chinese legal system for business and economics is quite well developed in major areas, but it is underdeveloped in most other areas compared to most other western countries' systems. Arbitration services are decent and often conform to international standards.

Of course, intellectual property is a huge concern of western companies that do business in China. In China's legal system, IP activity is high. As one could guess, the most effective deterrent against theft of any kind, including IP, is for the western managers to develop trust with the company's Chinese workers. This will instill the workers' loyalty to the company. In addition, developing good relationships with government officials is a must. They can, and do, intervene on your behalf. By the way, Chinese who step out of line are dealt with severely. Chinese are often not very forgiving to those who violate social codes and rules.

## **The Chinese Market**

Of course, before embarking on a venture in China, you need to be comfortable with your goals and to set expectations accordingly. What kind of investment do you want to make? Are you only seeking cheap labor, or do you want to also market your products/services to the emerging market in China and Southeast Asia? How much do you want to invest in terms of time and money?

Contrary to what many westerners believe, China is a very sophisticated market. Based on cultural habits and how things get done, people are very attentive and curious. They are very motivated to do well. They prepare for meetings extremely well, they work hard and they are very talented. They will be a tremendous force on the world stage.

Any company that is a global player must have a China plan; it is not a question of whether to invest in China, but rather when and how much. China is the door to Southeast Asia. Japan was during the 1980s but its influence has waned. China is a crucial part of the intellectual development of the global economy. For technology especially, it is crucial. People in Shanghai and Beijing are the most experienced and sophisticated.

Chinese business and government leaders are very motivated to engage the world. They still think about the mistake of the Boxer Rebellion (1900) in which foreigners were persecuted, and they have learned from it. The armed forces are a huge factor in the economy; they have ventures in many industries such as shoes and clothing as well as heavy industry and manufacturing. They have not been in automotive, though, and the way in which they approached the automotive segment is instructive. They negotiated 50-50 joint ventures with VW and GM to get started. This arrangement produced a dynamic that is sometimes referred to as the "concubine economy" because each JV partner vied for approval and attention as concubines once competed for the emperor's favor. After learning from the venture, they began manufacturing automobiles on their own. The Chinese learn quickly and will let foreign partners profit in the early market, while they are on the learning curve. They will become strong competitors in the future, so it is important to factor this into the business strategy.

In software, China is on the same level as the U.S. in terms of engineering knowledge but not in terms of experience, but this will change soon. In 2003, in a related segment, 90% of the mobile phones in China were imported. In 2005, 70% of mobile phones in China are Chinese.

The average yearly income for a Chinese family is \$555 (U.S.), which makes it about #140 in the world. However, growth is fast and will accelerate as Chinese companies become more sophisticated and market higher value-added goods and services globally. China has a burgeoning middle class, which is still quite modest in terms of percentage but which is large in absolute terms. Luxury makers of all types are aggressively entering China because they realize that China's newly wealthy class, although a small percentage of the population, is already larger than that of many of the G-7 economies.



## **Opportunity**

In terms of geography, an excellent entry point for new foreign ventures is Szechwan. Many of the business leaders in Shanghai and Beijing are no longer as hungry as they were, and wages are climbing rapidly. Traditionally, the northeast was the center of heavy manufacturing. However, Chengdu (Szechwan) is a burgeoning high tech center that is hungry for foreign investment. The government began developing the high tech center there in the 1960s because it would be geographically protected from invasion. Most of the military and industrial research and development is there. There are 150,000 engineers, whose salaries are one fourth of those in Shanghai and Beijing. Another place of opportunity is Fuchou, near Taiwan.

## **Women in Business**

Traditionally, the husband was in charge outside the family, where the wife was the authority inside the family. Mao promoted the idea of equality, and now both men and women work outside the home. They usually hire nannies from their home regions (assuming they have moved to the city) for their children.

On a somewhat humorous note, Chinese Vice-Premier Wu Yi is said to be "the only man in government" because she is tough as nails. She is given some of the most challenging assignments (currently bird flu), which she handles with aplomb. To have a woman in such a visible role in Chinese government shows the profound changes that are afoot in China today; however, the change is just beginning.