Sweet and Sour: The Realities of Doing Business in China

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Good afternoon. As I was contemplating what to say today, I was reminded of a story about an American businessman delivering a speech in Japan with help from a local translator. The translator's version of the speech was as follows: "American businessman is beginning speech with thing called joke. I am not certain why, but all American businessmen believe it necessary to start speech with joke. He is telling joke now. But frankly, you wouldn't understand it, so I won't translate it."

As the American continued to speak, the translator told the audience: "He thinks I am telling you the joke now. The polite thing to do when he finishes is to laugh. He is getting close. Now!" At which point the audience burst into laughter and gave the speaker a standing ovation. Following the speech, the American businessman went up to the translator and said: "You are the first translator who knows how to tell a good joke."

This story actually comes from a book called 'The Do's and Taboos of Hosting International Visitors'. In the interests of disclosure, I have never read this particular book. Rather I highlight this story because today I want to talk about a similar subject: the do's and taboos of doing business in China. The reasons why some companies get it right and others do not.

Common misconceptions

One reason many foreign companies struggle in China is that they view the Mainland as a single market. The reality, of course, is that China is a collection of markets - with emphasis on the plural.

Any foreign business person who drools over the prospects of selling to the land of a billion-plus buyers is overlooking one key fact. They are overlooking the fact that mainland China comprises 23 provinces, five autonomous regions and four municipalities directly under the central government. There are also numerous special economic zones, open coastal and border cities, export processing areas, bonded zones, provincial-level economic and technological development zones and new and high-technology development zones. The preferential policies of some of these special zones will gradually disappear. However, the complexities of doing business in such a large and diverse as well as rapidly changing country will not.

A second misconception: some foreign companies seem to think that China's consumers are there for the taking. And they are so eager to get increased access to the Mainland that they can hardly contain themselves.

I recall, for example, reading the comments of one executive who said his two most important questions about China were "which month" and "which day" his company would get the necessary approvals to do business. He went on to say: "If I get four questions, then the third question would be at which hour, and the fourth at which minute we will get our license."

The reality is many of China's domestic firms are and will continue to be strong competitors both at home and abroad. Consider the area of financial services. The pessimists predict that many of China's domestic banks will have a limited life span once foreign banks get national treatment. There is no denying that domestic banks in China do have some difficult issues to deal with. There is also no denying that they recognise their problems and are trying to resolve them. The recent injection of billions of dollars of new capital into two of China's large state banks is a case in point.

HSBC, for its part, does not want to compete head-on necessarily with China's large domestic banks. They have very large networks that are impractical not to mention impossible to match. They have a strong base of customers. They are becoming increasingly advanced in terms of technology and services. And they continue to prove themselves as being very adept at observing, borrowing and modifying best practices. To be successful, we will have to find niche businesses that we can do well.

A third and somewhat related misconception is that China is there for the taking over. The reality is that even under the influence of WTO obligations, China's large domestic organisations are not about to become the latest offerings on the merger and acquisition menu.

Again, let me use the banking sector as an example. China's domestic banks may be facing pressure to improve their risk management practices, increase their levels of efficiency, reduce their non-performing loans, and generally become more competitive. However, foreign banks need them more than they need us. Consequently, I do not expect to see any so-called 'big deals' involving foreign financial institutions taking over large domestic banks. I do expect, however, to see more foreign banks following in the footsteps of HSBC and taking minority stakes in domestic financial service providers.

Simply put, there are no shortcuts to building a business in China. Companies have to work hard, even if they have been there 139 years like HSBC. And they need to be realistic. The biggest returns from HSBC's investments in domestic entities such as Bank of Shanghai and Ping An Insurance and from our operations in China in general will be in the coming decades. To put it another way, whoever is sitting in my chair 10 years from now will begin see the real benefits of what we are doing today.

A fourth misconception held by some is that China's WTO membership will some how translate into all companies being treated equal. The reality is that even long-time members of the WTO still do not treat all companies equally. And regularly, many end up in front of tribunals in Geneva arguing about such issues.

Personally, I believe China is working very hard to live up to its commitments and to operate within the rules of the WTO. The country has been trying to trim down bureaucratic red tape in recent years. And I think they have done an admirable job. One-stop service counters for foreign investors have been set up for example. That said, I also believe that Chinese government officials are actively looking for ways to exploit the WTO rules for the benefit of local Chinese industries. In short, China is already acting like every other country on the WTO membership list.

It is also worth noting that China's legal environment is improving. Domestic and foreign investors are now better protected than before. However, the enforcement of judgements still has room for improvement. I recall one survey, for example, which found that only one-third of foreign investors' successful arbitration cases actually received 75 to 100 per cent of their awards. In other words, two-thirds did not get what they deserved.

Another misconception about China is that the country will be unable to overcome its multiple challenges. The reality is that China does have a number of challenges. But then what economy doesn't?

In China's case the challenges include creating more jobs, spreading wealth more evenly, reducing bureaucracy, eliminating corruption, and allocating incoming capital more effectively. Also on its list of things to do: eliminating regional protectionism. Reducing inconsistencies between international agreements and domestic legislation, as well as between different government departments and between central government and local government practices. And in the longer term creating the optimum conditions for full convertibility of the RMB.

Personally, I am optimistic that China can and will overcome these challenges. The reason for my optimism is twofold. First, China has already proven it is very adept at making the difficult transition from a command to a market economy. The second reason for my confidence: China has another advantage that no other developing market has had. China has Hong Kong. A city that, as you are aware, possesses considerable expertise, financial and otherwise.

Another common misconception about foreign companies in China is that they are not making any money. The reality is that yes China is a challenging place to do business.

And yes, there are numerous examples of companies and the people who lead them going to China and apparently leaving their common business sense at home. Foreign companies entering joint ventures with domestic entities that have no connection to their particular business but seem to offer a short cut to the right approvals. Foreign companies investing millions and then having to sell their stakes for nominal amounts - the equivalent of 15 cents US in one case. Or having to leave factories idle for extended periods due to disputes with local partners.

There are, however, numerous foreign companies which have been very successful in China. Eastman Kodak, for example, now lists the country as its second largest film market after the United States. Groupe Danone SA, a French food conglomerate, has built a billion-dollar business in China. In fact, a recent poll of some 250 foreign companies in China found that three out of every four were profitable. And 10 per cent even went as far as to describe their China operations as "very profitable."

Clearly many companies expect to be successful in China if levels of foreign direct investment are used as a barometer. In 2003, the country was the second largest recipient of FDI behind the United States. A total of US$53.5 billion of FDI flowed in China during the year. To put such a flow into perspective, that is equivalent to approximately US$146.6 million per day - each and every day of the year. Or roughly US$2,035,768 in the time it has taken me to deliver this speech.

Given the aforementioned misconceptions, it is safe to assume that not all this capital will provide the expected returns. Nor will all foreign companies be successful in building a business in China. But many will. The successful companies - and by the way HSBC intends to be one - will be the companies that are realistic not idealistic. Reasonably patient not irrationally exuberant. The companies that have the right perspective, namely a long-term focus and not a short-term agenda.

Conclusion

One final comment. I actually arrived in Australia yesterday from Mexico, where I was attending an HSBC Group Board meeting. Mexico is one of the countries that has been significantly affected by China's rise as a low-cost manufacturing powerhouse. Mexico is also a country with a rich and colourful history.

Back in 1519, for example, a Spanish explorer by the name of Hernán Cortés gathered some 500 men on 11 ships and sailed to Mexico. Cortés had visions of conquering the Aztecs and creating a vast new Spanish empire. However, as two prior expeditions had failed, he knew success was far from guaranteed. To ensure his crew would not be tempted to abandon their quest, Cortés had all the supplies unloaded upon arrival. Then he ordered the entire fleet, expect for one small ship, to be set on fire and destroyed. From that point on, his crew knew beyond any doubt they could either march with him or be left behind.

Today, there is - once again - a smell of burnt wood in the air. Many companies are heading to China with visions of tapping into an increasingly affluent consumer market. Conscious perhaps that some previous attempts have failed or fallen short of expectations. Well aware that as China opens its doors to foreign competition, there is no turning back.

Simply put, if foreign companies want to be successful in China in the future they must establish a presence now or risk being left behind. And that, Ladies and Gentlemen, is the ultimate reality.