
Opening the Doors for Business in China

by Jeffrey E. Garten



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*Washington's inconsistent foreign policy magnifies
the risks for U.S. companies in China.*

OPENING THE DOORS FOR BUSINESS IN CHINA

BY JEFFREY E. GARTEN

***Big Dragon
China's Future: What It Means for
Business, the Economy, and the
Global Order***

Daniel Burstein and Arne de Keijzer
New York: Simon & Schuster, 1998

***The Rise of the Chinese Economy:
The Middle Kingdom Emerges***

Greg Mastel
Armonk, N.Y.: M.E. Sharpe, 1997

"China watching," said Nicholas Kristoff, former Beijing Bureau Chief of the *New York Times*, "is the only profession that makes meteorology look accurate." Neither China nor the United States understands the other, and the result is a totally unpredictable relationship. As undersecretary of commerce for international trade in the first Clinton administration, I saw firsthand how quickly the relations between the two countries could change.

In February 1994, I went to China to help several U.S. companies gain

commercial contracts. The trip seemed fruitful, but when I returned I came under severe criticism even from within the administration for not vigorously voicing U.S. concerns regarding China's respect for human rights. Then, a few months later, President Clinton decided to divorce the issue of human rights from the issue of granting most-favored-nation trading status. The environment in Washington underwent a sea change, and in August I returned to China on a high-profile trade mission led by Secretary of Commerce Ron Brown that included some 20 chief executives. We considered the trip a success, having pushed forward corporate transactions worth billions of dollars. Many critics of earlier trips spoke approvingly of this "commercial diplomacy," suggesting that trade and finance would perhaps become major thrusts in our foreign policy toward China.

A year later, the pendulum swung again. Under enormous congressional

pressure, and in the face of Beijing's protests, the administration granted the president of Taiwan a visa to visit the United States. Soon afterward, China was lobbing missiles close to that island, and the United States moved warships into the nearby straits. Concerned about incurring

Washington has lacked a common framework for thinking about China.

Beijing's wrath, U.S. companies in China sent distress signals to Washington, and I sought permission to visit the country in order to learn how to minimize the damage to our commercial relationships. The administration hesitated before reluctantly allowing our delegation to go to China.

Reflecting on those experiences and on numerous internal debates within the administration, I can now see that Washington's vacillation arose from the absence of a common framework for thinking about what China was becoming and what ties the United States really wanted with the world's biggest emerging market. U.S. business, however, has generally not exhibited such uncertainty. It is true that some companies such as Levi Strauss have pulled out of China, citing human rights concerns. Other companies, such as Chrysler, have pulled the plug on unpromising projects. And U.S. investments in the country are minuscule compared with those in Europe or elsewhere in Asia. In fact, U.S. companies invested less than \$5 billion in China between 1993 and 1995, compared with more than \$43 billion in Belgium and \$30 billion in Singapore.

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Yet numerous companies are tying much of their future strategy to operations in China. China's economy has been growing at an average annual rate of nearly 10% and soon is likely to become the world's second largest. The country's need for foreign capital, products, and services is so great that estimates of China's future demand are meaningful only as gross orders of magnitude. Boeing expects China to account for one-tenth of all its aircraft sales in the next decade,

General Electric already has more than 20 projects there, and other prominent companies such as IBM, General Motors, Microsoft, AT&T, and Goldman Sachs are pulling out the stops to gain market share.

U.S. companies would benefit substantially if Washington would maintain greater consistency in its approach to China. U.S.-based competitors are often preferred over their European and Japanese rivals in China, due largely to their superior technology, globally recognized brand names, and greater willingness to share technology and train local management. But no other government handicaps its companies as the United States does, with its plethora of foreign-policy goals directed at China, including nuclear nonproliferation, support for human rights, protection of intellectual property, and protection of the environment. Chinese importers never know whether supplies will be subject to embargo from the United States. Americans, in large part, appear to be unreliable partners.

Even when U.S. companies are free to sell their wares, they can suffer when the Chinese government ostentatiously awards large contracts to their rivals in order to send a political message to Washington. A more subtle problem also emerges, as I found out when I asked U.S. executives whether the Chinese government had penalized their operations because of the crisis over Taiwan. Not directly or overtly, they said, but with every incident of foreign-policy intervention, the second- and third-echelon bureau-

crats became weary of befriending U.S. companies. License approvals, so necessary in China, became more difficult to get, and telephone calls were not readily returned. It is no wonder that the United States' share of the Chinese market has actually declined between 1987 and 1995 relative to that of both Japan and the European Union.

Can the U.S. government and U.S. companies collaborate better to minimize such setbacks? Two new books help show the way by describing the range of issues that China presents for government and business executives. Clearly and engagingly written, both books highlight the importance of China's rise, and both see economic reforms continuing there. Although they disagree on how the United States can or should try to shape China, the books effectively advocate active and sustained U.S. engagement.

In Search of an Effective Framework

Of the two books, *Big Dragon* casts the wider net. It forcefully argues that Washington risks creating an environment that focuses on China as a threat—both as a political and military adversary, similar to the former Soviet Union, and as an adversary in trade, similar to Japan in the 1980s. The two authors—Daniel Burstein, an author of several books on global business challenges and a senior adviser to the Blackstone Group, an investment bank, and Arne de Keijzer, a consultant on business in China—believe that this confrontational approach is deeply misguided. They say it runs contrary to U.S. interests, which would be better served by making such a rising nation into a partner for dealing with global issues. And that approach is self-defeating, they say, because China is too big, powerful, and proud to bend significantly to outside pressure. In the authors' view, what China does will be determined almost entirely by what happens inside the country, with the United States' influence effective only at the margins.

The authors skillfully navigate through the minefield of tensions

inherent in relations between the United States and China in order to find a formula for avoiding potentially contentious problems and for establishing projects with benefits for both countries. They enliven the analysis with useful historical references and mind-stretching scenarios concerning changes in the global energy market, conflicts over Taiwan and Tibet, and the different ways the postcommunist political system in China could evolve.

The book is cautiously optimistic but not wide-eyed about China's future. While expecting China to evolve into a hybrid system of authoritarianism, democracy, socialism, and capitalism, it recognizes the range of internal problems that could befall the country: environmental disasters, political struggles both between cities and countryside and between the central government and provinces, and tensions between the emerging entrepreneurial economy and the vast parts of China still under state control. The book also acknowledges the difficulty any government faces in being able to manage these challenges without recurrent setbacks of major proportions. The authors' journalistic style translates into a thoughtful discussion about problems and possibilities, eventually arriving at a sensible and balanced prescription. Americans, the authors conclude, cannot expect to know how China will develop and need to accept that the Chinese will always be different from them. Instead of trying to change China, they should look for positive steps that take their differences into account.

Accordingly, Burstein and de Keijzer recommend that the United States take a highly cooperative, almost nonconditional approach in dealing with Beijing. They advise Washington to support China's membership in the World Trade Organization (WTO), to ease up on human rights issues, and to expand exchange programs for students and legislators. The book's tone reminds readers of Chancellor Helmut Kohl's remarks on the eve of German unification when, against nearly all his advisers, he agreed to a one-to-one exchange of East German marks for

West German marks. Kohl made a fundamental political judgment, setting his sights well over the immediate horizon. And although Germany is still paying a huge financial and social price because of his decision, most now say that the alternative would have been worse.

Burstein and de Keijzer are arguing for similar boldness in overcoming what they see as the inertia, inconsistency, and dangerous drift in U.S. policy toward China. Like Kohl, they acknowledge the perils of the measures they advocate, but they think the current course is far more dangerous in the long run. China's emergence, they say, is "one of the great epochal *positive* events in world history," and Americans should wish to support it and benefit from it.

Greg Mastel's *Rise of the Chinese Economy* urges a more conditional, if still positive, approach. Mastel, vice president of the Economic Strategy Institute in Washington, begins with a broad look at China's economy but soon rolls up his sleeves and concentrates on the trade issues that the United States faces in dealing with China. He goes beyond the usual litany of rising trade deficits, tariffs, and licensing arrangements to describe an economy with layers of barriers and government controls. Economic planning, discredited almost everywhere else, has been on the rise in China, as Beijing tries to develop "pillar industries" and big industrial conglomerates like those in Japan and Korea. Permission to import or export is only part of that regime. Foreign companies face many requirements to transfer technology or to export a certain percentage of their products made in China. Controls on foreign exchange keep them from moving funds freely out of the country.

The book clearly reveals the enormous structural differences between China's economic system and true capitalism. *Big Dragon* acknowledges many of these same gaps but urges the U.S. government not to denounce China for them. The United

States, Burstein and de Keijzer say, should deal with China as it is—banking on the hope that the more it engages the country commercially, the more it will change over time. Mastel, by contrast, worries that China cannot be effectively integrated into the global economy as long as government directs so much of the nation's economy. He believes China will have to do much more than shift its economic policy. Only a restructuring of the country's totalitarian political system will suffice, he says, because a free-market economy depends on a free marketplace of ideas. If China wants to be fully accepted as a trading nation, it must be prepared to vastly limit the government's ability to meddle in the affairs of companies and individuals—and it must do so within the next decade or two.

These are fundamental changes, and *Big Dragon* predicts there will be at least two more generations of Chinese leadership before they take place. But Mastel, worried about the short term, thinks the West now has effective levers for pushing China forward: admittance into the WTO with its trading privileges and dispute-settlement procedures, not to mention the status that goes with full membership in the "club." He believes that China has too much at stake in trade to lose the permanent

Given its size and rate of growth, an unreformed China may greatly distort the free-market trading system.

trading privileges that membership would bring. Exports and foreign investment have been strong engines of the country's growth—and not just exports of textiles and other low-cost goods but sophisticated electronic components as well. Imports are critical, too, especially those that add to China's technological base, and there is a good chance that China will rely increasingly on global markets for energy and food. Moreover, if China were a member

of the WTO, other nations, including the United States, would have a much harder time withholding their exports, because the WTO places great constraints on such behavior.

Although Mastel acknowledges the importance of good relations with China and seeks greater en-

As China aggressively pursues its development goals, world capital markets could be squeezed.

agement overall, he insists that allowing China into the WTO without first requiring it to make fundamental changes would have dangerous repercussions. He is convinced that China's mercantilist industrial policies will spawn a new generation of protected, aggressive corporate competitors. Already, these policies are causing rising trade surpluses with the West, and given its size and rate of growth, an unreformed China may greatly distort the free-market trading system. Moreover, allowing China an easy entry into the WTO would set a poor precedent for other countries applying for membership, such as Russia and Vietnam, not to mention countries that are already members but are still struggling with reforms. The result, he says, could be a worldwide trade war that undermines the current and highly beneficial consensus around the world for freer trade. That fate can be avoided, Mastel believes. He points approvingly to Poland and Romania in the 1960s, which the WTO's predecessor subjected to a variety of requirements, including, most dramatically, specific targets to import increasing amounts of foreign goods.

China's Clout

Although Burstein and de Keijzer surely have the right perspective on China-U.S. relations over the long term, they waive off too many of the short-term problems involved with letting China reform on its own. Their book seems to suggest that if the long-term goal is right, the

United States should be relaxed about the interim steps. But Mastel is correct to insist that the devil is in the details. The WTO has had a great deal of difficulty changing the behavior of big countries once they are granted membership – even today, for example, Japan is seen as an outlier in adhering to WTO rules. The United States would benefit enormously from bringing China into a broad-based, sophisticated trading regime, but not if China maintains restrictive policies that make WTO enforcement impossible. Some U.S. pressure is desirable, even if it is less than fully effective.

China's impact on the world economy also goes beyond the trade issues that Mastel focuses on. Whatever Washington does, and no matter how well U.S. companies succeed in China, the country's emergence on the global economic stage is going to create enormous disruptions. The tension between China's demand for access to a large share of global markets and its restrictions on its own economy is just the starting point for recognizing what's in store. China's size and its ambitious plans for growth mean that we will probably see a replay of some of the massive problems that arose when Germany and Japan sought their place in the sun in the first half of the century.

As China aggressively pursues its development goals, world capital markets could be squeezed. China already receives by far the most direct foreign investment and foreign aid of any developing country. With so many companies now eager to establish a presence there, China is likely to attract more than its proportionate share of investment – just think of what will happen when its gigantic infrastructure projects take hold in the interior. Smaller countries will attract less investment, even though individual projects in those countries might offer higher returns than they would in China. Similarly, the world's commodity markets, particularly for grain and oil, may well face greater volatility

as China's enormous needs rise and fall episodically.

Another area of concern is exchange rates, as demonstrated by the current financial troubles in Asia. One match that lit the Asian fire was China's devaluation of the yuan in 1994. That move undermined the competitiveness of many exporting industries elsewhere in Southeast Asia, thereby slowing growth in the region and beginning the buildup of excess capacity. Now that most of the currencies of the East Asian countries have been devalued by half or more, creating renewed competition for China, Beijing will be under pressure to devalue again – possibly undercutting any financial stability achieved by the IMF plans to restructure those ailing economies. And even without changing the value of its currency, China is likely to gain market share as it develops industries to tap into its enormous low-paid labor supply in the interior.

Even if China is working diligently toward full WTO membership, it threatens to distort the global trading system in dangerous ways. The WTO may simply be unable to handle the commercial realpolitik arising both from China's single-minded focus on its own development and from foreign companies' desperate efforts to win a foothold in the country. And in the next few years, slower economic growth all over Asia, combined with the big currency devaluations, will cause heightened trade friction between Asia and the United States. The United States' trade deficit will soar, and even greater attention will be paid to the fastest rising component – imports from China. Mastel's tough but reasoned approach will seem moderate compared with the screaming from Congress to punish a protectionist China for taking advantage of open U.S. markets.

Managing the Risks

Indeed, no one should underestimate Washington's difficulties in fashioning a consistent commercial diplomacy with the support of U.S. companies. As the lone superpower with global security interests, and as a culture founded on deep respect for

the rights of individuals, the United States will inevitably have interests that supersede commercial goals. In addition, there is a strong congressional drift toward economic nationalism in both political parties, as well as an increasing skepticism of the benefits of international trade. Nevertheless, the United States' global interests are increasingly commercial in nature, and it will relate to other societies mainly through trade and financial links, not through diplomacy or military missions. Even if China goes far on the path to reform, it will be a long time before its government does not dominate the country's commercial and legal framework; before it stops merging its own foreign and commercial policies; and before Tokyo, Berlin, Paris, and other governments stop helping their companies gain contracts.

Both *Big Dragon* and *The Rise of the Chinese Economy* contain elements of a reenergized commercial diplomacy. Burstein and de Keijzer are right that the United States needs a long-term vision for China, one that will accommodate the inevitable problems between two proud and powerful countries. They are right in proposing a broad scope of cooperative endeavors and a U.S. diplomacy that accords China much more respect for the enormous change it is trying to make—arguably the greatest peaceful economic and political transformation in history. Mastel's realism is also on target, especially his dispassionate technical analysis of government's control over the Chinese economy and the dangers of allowing China into the WTO. At first blush, his approach seems incompatible with that of Burstein and de Keijzer. But it could amount to a toughening up of certain elements of the relationship—without jettisoning the spirit of working on all fronts to bring China into the global economy on terms that everyone can live with.

These thoughtful prescriptions need only heightened awareness of the enormous disruptions that will arise because of China's size and structure. China's emergence will have repercussions on a range of for-

eign policy and global economic issues. Washington should therefore make China a priority in its ties with Europe and Japan, as well as in its negotiations on global trading issues.

As for companies entering China, they need to brace themselves for a rough ride. On top of all the difficult issues of doing business there—corruption, the shortage of trained personnel, the absence of clear regulations—managers can expect sudden shifts in markets and institutions as waves of problems cascade over one another. What this means for individual organizations varies enormously according to their size and industry, but companies can take some steps to reduce the risks.

It will pay to take a serious second look at plans for investment, making sure to allow for less stability in the future. Managers need to set realistic projections for earnings. Elsewhere in East Asia before the financial crisis, many multinational companies assumed that economic growth rates would remain robust and the region would somehow overcome the excess capacity emerging in several industries. They expected that poorly regulated financial systems would somehow muddle through. They knew of, but waved off, the political interference in Indonesia and other countries, where cronyism and corruption were the order of the day. They never factored in the possibility of large changes in exchange rates. In China, these problems still exist in spades. Worrisome signs are already appearing in the aftermath of the crisis—in the country's slowing growth rates, in the dramatic decline of incoming investment, and in the precipitous drop in the share prices of Chinese companies registered in Hong Kong. Companies should also anticipate serious trade conflicts between Beijing and Washington.

It will pay to diversify strategy within China, maintaining a wide portfolio of investments. For example, Morgan Stanley set up its own investment group in the country, but it also purchased a 35% stake in a new joint venture, the China International Capital Corporation. The remaining stake is held by the Peo-

ple's Construction Bank of China, the China National Investment and Guarantee Corporation, the Government of Singapore Investment Corporation, and the Hong Kong-based Mingly Corporation. Morgan Stanley did not give up its ability to operate as one company; it merely hedged its bets by having two ventures. In a much different business, Praxaire, a large industrial gas company, established two wholly owned companies, six joint ventures, and several strategic alliances in China. It has diversified its stakes and relationships among different sectors of the economy and different levels of the Chinese government.

It will pay for companies to appoint a sophisticated government-relations manager who reports not just to the head of operations in China but also to the chief executive of the company. For decades to come, the structure of China's government will be far less important to businesses than the officials who are in charge. More than any other large country, it will be a system not of laws and institutions but of people and relationships. Seeing how the political winds blow, building personal ties, and adjusting corporate strategy accordingly—particularly in an era of turbulence and sudden shifts—will be invaluable. Procter & Gamble, which has already been highly successful in China, recently conducted a search for such a manager. Acknowledging the importance of the position, the company's chairman spearheaded the effort, using his vast network to scour the company and the globe for someone with great business acumen and sensitivity to governmental affairs.

It will pay for companies to invest heavily in local communities and in projects of broad interest to the country in order to build deep roots that can withstand changes in the winds. Motorola, for example, established in China its first manufacturing research laboratory outside the United States. It also set up two branches of its worldwide training "university" to educate customers, suppliers, and government officials, as well as its own employees. It sponsored a symposium on environmen-

tal protection, provided scholarships to students, built labs at universities, and donated money to primary schools in rural areas. Bristol-Myers Squibb provided research grants to universities and contributed to the ministry of health in order to train Chinese pharmacists.

As for operations in the United States, companies may need to rethink their political, legislative, and educational strategies. When it comes to helping Washington develop a consistent, long-term commercial diplomacy toward China, U.S. companies have traditionally taken a short-term approach, ramping up their lobbying whenever there is a crisis or a legislative showdown over a sanction, but otherwise retreating into their commercial shell. Yet Congress and the U.S. public sorely need more information about China—where it's going, what U.S. interests are, and what sensible policy choices exist—and U.S. companies could do a far better job of

facilitating that information flow.

Coming directly from companies, such information will lack objectivity. Companies should therefore work with nonprofit institutions, akin to the many existing Japanese-American societies, in order to create a web of Chinese-American ties—not only to provide economic and political information but also to create a cultural interchange. The United States' and China's understanding of each other's societies is not only primitive but also badly distorted by stereotypes and the media's penchant for promoting crises and scandals. Only a major and sustained effort can facilitate the change and understanding that is essential to stable commercial relationships between the two countries. And only the business community—working through more objective intermediaries—has the resources to move the countries in the right direction.

Politicians often deride commercial diplomacy, preferring to focus on national security, while corporate executives are fond of saying that government is part of the problem and should just get out of the way of business. But in the case of China, government and business interests cannot be disentangled and should be coalescing for everyone's benefit. Now is not the time for political grandstanding or illusory free-market dreams. A reinvigorated commercial diplomacy, based both on dialogue between the administration and executives and on a joint effort by the two to educate Congress, is needed for the giant emerging in Asia. As Lee Kuan Yu, senior minister of Singapore, recently said with only a bit of hyperbole, "It is not possible to pretend that China is just another big player. This is the biggest player in the history of man." 

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