

CHINA'S PROGRESS IN DEVELOPING MODERN BUSINESS PRACTICES

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I start this analysis of China's business practices by citing my own experiences. Sometime in the early 1970s, I stood at the edge of the New Territories in Hong Kong and gazed into the vastness of undeveloped rural China in the distance. Several decades later, I returned to the same spot and saw in the background the tall buildings of Shenzhen. Since then, I have spent some time as a factory inspector in Quangdong province, working in behalf of a large U.S. company manufacturing products in China.

Thus my view of China is that of a country undergoing an historic transformation. Its economy has been growing more rapidly during the past quarter of a century than any other

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nation of significant size, at least during modern times. My attitude is informed, surely by reading and listening to others, but also by what I have personally observed.

In this light, I sympathize both with the criticisms on the part of Western companies doing business in China and with the reports by Chinese authorities of progress in business-government relations. I am also chastened by some knowledge of the obstacles facing foreign companies who want to do business in the United States.

This presentation covers five interrelated topics: (1) factors influencing the adoption of modern Western business concepts, (2) obstacles facing Western companies doing business in China, (3) progress in adopting Western concepts, (4) lessons for Western business, and (5) an upbeat outlook for the future.

Factors Influencing Adoption of Modern Business Concepts

Many analysts have observed that the influx of Western companies into China has been accompanied by changes in business practices. U.S. headquartered firms in particular have brought a tradition of strict internal rules and procedures to their China operations. This trend has been accelerated by the return of young Chinese business students who have been educated abroad.

Prodded by nongovernmental organizations and by domestic activist groups, some large U.S. corporations have set up codes of conduct for their factories in China and other developing nations. These higher standards cover workplace operations as well as environmental responsibilities.¹

A related factor is the sharp decline in the importance of the large state-owned enterprises (SOEs) and thus the fading away of the traditional “iron rice bowl” (lifetime employment regardless of performance). In 1981, the SOEs accounted for 75 percent of China’s industrial production. By 2004, their share was down to 20 percent. Increasingly, the SOEs have entered into joint ventures with foreign-based companies. To attract international investors, many SOEs have adopted international accounting standards.²

A more generalized but important factor in encouraging China-based companies to adopt Western business modes of operation is China joining the World Trade Organization with the accompanying responsibilities of membership. Along these lines, one Chinese executive was recently quoted as saying that, several years ago, a \$20,000 business gift would be given without creating problems, but that such action is “unthinkable today.” He noted that now the gift giver likely would be fired.³

Obstacles to Adopting Modern Business Practices

As a powerful and self-contained civilization for four millennia, China has developed responses to the problems of human activity that often are different from those prevailing in the West. The Confucian approach is complex and varied in its application. Much attention is given to the importance of mutual trust among the interacting parties. The contrast is vivid with the popular Chinese view of Western business thinking as dominated by arm's length decisionmaking, short-term profit taking, and frequent change of employment.⁴

The traditional Chinese practice of Guanxi (loosely translated as “relationships”) is considered to be a key factor in doing business. It may take months or even a year or more to establish a long-term relationship. This typically involves developing a personal relationship based on friendship and trust. That process may include hosting people for meals, doing them favors, giving them gifts, and showing attention to their private concerns.

Although the term Guanxi is foreign to Western business representatives, the particular practices are not that arcane. Many U.S. marketing executives have generous company-financed entertainment allowances and expressing interest in the health of the other person's family is not unusual. Perhaps the basic differences are in terms of the speed that American

companies are accustomed to and the greater pervasiveness of relationships in China.

Nevertheless, the differences, albeit at times subtle, can be important. For example, a greater Chinese tendency to avoid conflict is explained by the expectations that direct conflict will hurt the basic relationship with the other party.

Progress in Adopting Western Concepts

Substantial changes have occurred in recent years, both in China's policies toward business and in internal business decisionmaking. Foreign companies now enjoy much greater access to markets in China. Import licenses and quotas have virtually been eliminated and tariffs have been reduced by nearly 40 percent. Tariffs on information technology products have been eliminated altogether. Ownership restrictions on foreign businesses have been relaxed and those companies now participate in many more sectors of the economy.⁵

In the four years since China entered the WTO, U.S. exports to that country have more than doubled. Yet American and other foreign companies are still in the early stages of realizing many of the phased-in market openings. A reasonable overall evaluation of the progress that has been made in recent years has been provided by the very knowledgeable U.S.-China Business Council: "China has

adopted policies resulting in a far more open, predictable, and profitable business environment for U.S. companies.”⁶

The U.S. Chamber of Commerce has provided some specifics along these lines. These include the relatively smooth acquisition of trading rights by foreign companies in China, approval of U.S. companies to conduct automobile financing, liberalization of financial services, and steady improvement in China’s agriculture import regime.⁷

Some cynical observers, however, describe the overall process as opening one door and then closing another. For example, China has abided by its WTO entry agreement to allow foreign-owned companies to directly import and export goods without dealing through designated Chinese trading companies. However, the ability to actually market these imported goods faces serious barriers in obtaining distribution licenses. China reportedly adopted recently more restrictive policies in construction and engineering services and in express delivery services.⁸

I can cite a personal example of adopting the letter and not the spirit of Western capitalist practices. In the course of inspecting a factory in China, I asked the plant manager about labor unions. He was pleased to report that a large portion of the work force was unionized. However, I was taken aback by his response to my next question, “Who is the head of your

local labor union?” It turns out that it was the company’s director of human resources!

Although China may not yet be considered to be a nation characterized by the rule of law, it has been rapidly expanding the resources devoted to establishing legal institutions. There are now an estimated 120,000 certified lawyers and more than 300 law schools. This is a substantial expansion from fewer than 2,000 lawyers and only two functioning law schools in 1979. A team of American analysts recently concluded that China has moved a long way toward a legal system that seeks to restrain the exercise of arbitrary state and private power.⁹

A measure of progress occurred in early 2006. A Shanghai court awarded the U.S. coffee chain Starbucks \$62,000 (RMB 500,000) in compensation and also ordered Shanghai Xingbake to stop using the Starbucks name and to issue an apology in a local newspaper.¹⁰ The case is noteworthy because of the favorable results to the plaintiffs.

Examples of improved internal business practices in China range from the use of Western-style performance appraisals and performance-based pay structures to results-oriented reporting systems and the implementation of new technologies, notably the Internet. Similarly, auditing standards have been revised to bring them closer to Western norms (in part this is a return to the pre-Mao situation prior to

1949). As might be expected, in practice these management techniques are being adapted to the specific circumstances of Chinese business. China's accounting standards are now largely based on International Financial Reporting standards but in practice they are being applied very selectively and adapted for the various local markets.¹¹

Although the restraints of traditional Confucian traditions may be substantial, some observers note that the Confucian ideal of enhanced learning and embracing education may explain the Chinese interest in learning from the West. Terms such as "entrepreneur," "venture business," and "globalization" have become quite popular.¹²

On the surface Western business practices are being adopted in China but they seem to be going through a series of filters not unlike the experience of American executives who are sent to an executive MBA program. The company expects to benefit from some of the new ideas the manager has acquired, but does not intend to automatically put all the new concepts into practice. This interaction is consistent with the conclusion of one Western observer that, if Confucius were alive today, he would put his Analects on a web page and send emails to supporters and opponents alike.¹³

On the negative side, the inadequacy of enforcement of intellectual property rights in China is a recurrent theme on

the part of Western companies. China's National Copyright Administration reported with considerable enthusiasm that it raided 52 video shops in 2003 to crack down on illegal products. However, the fines imposed amounted to a paltry total of \$6,900 — or an average of \$132 for each offender.¹⁴ Striking evidence of the overall situation is provided by the report that 70 percent of counterfeit and pirated goods seized at U.S. borders during the first six months of 2005 originated from China and Hong Kong. The total value of those seizures increased by 8 percent over the same period in 2004.¹⁵

On the positive side, in April 2004 the People's Republic of China issued rules to enhance distribution rights to foreign-owned companies by allowing them to expand their business licenses. However, for a substantial period of time, the Ministry of Commerce apparently did not accept applications to revise those business licenses. More recently, the Ministry has begun to issue approvals of revised business licenses, but with some confusion as to the tax consequences.

Transparency problems abound. Long, complex, and unclear product registration processes apparently impede the delivery of U.S. goods to the China markets. For example, in the case of pharmaceutical products, registering a drug and obtaining production and sales permits involve numerous central, provincial, and local government bodies. Many of

these government units reportedly are uncertain about the scope of their authority or have differing interpretations of official procedures.¹⁶

A somewhat more upbeat conclusion, surely one that points to progress in business-government relations in a shorter period of time, is Andrew Mertha's carefully researched analysis of the important role of sustained pressure for change from inside China. Mertha points to the role of foreign trademark owners and the private investigative agencies they employ in providing a prod to the official intellectual property enforcement agencies in China.¹⁷

Lessons for American Business

There is an aspect of the interaction between China and Western business concepts that Americans tend to ignore: the lessons for American business executives. For example, some Western executives say that their experiences in China have made them better managers. They are more apt to listen, to communicate more effectively, and to be more flexible in their decisionmaking. Chinese managers often emphasize their experience and empirical evidence rather than the more formal conceptual models that Western managers are trained to follow. Some analysts note that, in China, standard operating

procedures sent down from headquarters have rarely served Western companies well.¹⁸

We can also note an interesting claim that paper money was invented by Chinese bureaucrats in the ninth century B.C., about 2-1/2 millennia before the first issuance in the West.¹⁹

The Outlook for the Future

Business firms in China are currently developing at such great speed that much of our knowledge about them may be out of date. It is heartening to note the frequency with which the younger generation is leaving the security of factory jobs to become entrepreneurs, borrowing capital and moving into new fields. Some observers refer to a new generation of well-educated cosmopolitan Chinese business executives with Western brains but Chinese bones.²⁰ (This is a neat phrase, but my experiences caution me not to underestimate Chinese brainpower.)

Despite the seriousness of IPR concerns in China, it is useful to note that some studies show that the level of intellectual property protection increases with a country's real gross domestic product per capita. Growing levels of income increase the demand for higher quality and differentiated products. This in turn leads to great interest in protecting

intellectual property, such as patents, copyrights, and trademarks.²¹ Along these lines, in February 2006, a Chinese company based in Shenzhen took a New Jersey technology firm to court in Texas claiming that the U.S. company had infringed on its patent.²²

As an indication of future developments, in 2005 China attained for the first time one of the top ten rankings among nations filing patents with the World Intellectual Property Organization. Moreover, 90 percent of the cases filed in China's IPR courts involve Chinese parties suing other Chinese companies for patent infringement or other IPR violations.²³ Apparently, China is experiencing the advantages as well as the disadvantages of adopting Western management techniques.

Notes

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³ Michael H. Pedersen, “Business Integrity in China,” *China Business Review*, January-February 2006, p. 33.

⁴ Carolyn Blackman, *China Business: The Rules of the Game* (St. Leonards NSW, Australia: Allen & Unwin, 2000), p. XV; Frank-Jürgen Richter, *Redesigning Asian Business* (Westport, Conn.: Quorum Books, 2000), pp. 3-4.

⁵ U.S.-China Business Council, *China’s WTO Implementation*, September 14, 2005, p. 3. See also Murray Hiebert, “China Gets a Passing Grade From Foreign Firms,” *Wall Street Journal*, November 28, 2005, p. A11.

⁶ *Ibid.*, p. 14.

⁷ U.S. Chamber of Commerce, *China’s WTO Implementation and Other Issues of Importance to American Business in the U.S.-China Commercial Relationship* (Washington, D.C.: The Chamber, September 2005), p. 4.

⁸ *Ibid.*, p. 6.

⁹ C. Fred Bergsten, et al, *China: The Balance Sheet* (New York: Public Affairs, 2006), pp. 8, 66.

¹⁰ Mure Dickie, “Starbucks Wins Case Against Chinese Copycat,” *Financial Times*, January 3, 2006, p. 1.

¹¹ Elizabeth Fry, “China Syndrome,” *CFO*, August 1, 2005, pp. 8-10; Deloitte, *Comparison Between PRC GAAP and IFRS* (unpublished, April 1, 2005).

¹² Richter, pp. 106-133; Chiu and Luk, p. 416; Ronald Davidson and Stanley Chang, “The Importance of Auditing Topics to Chinese Auditors,” *International Journal of Auditing*, Vol. 5 (2001), p. 127.

¹³ Ray Friedman, Shu-Cheng Chi, and Leigh Anne Liu, “An Expectancy Model of China-American Differences in Conflict-Avoiding,” *Journal of International Business Studies*, January 2006, pp. 76-91.

¹⁴ Ted. C. Fishman, “Manufaketure,” *New York Times Magazine*, January 9, 2005, p. 43.

¹⁵ U.S. Chamber of Commerce, p. 17.

¹⁶ U.S.-China Business Council, p. 7.

¹⁷ Andrew C. Mertha, *The Politics of Piracy: Intellectual Property in Contemporary China* (Ithaca: Cornell University Press, 2005).

¹⁸ Usha Haley and George Haley, “The Logic of Chinese Business Strategy,” *Journal of Business Strategy*, Vol. 27, No. 1, 2006, p. 36.

¹⁹ Richter, p. 142.

²⁰ *Ibid.*, p. 97.

²¹ *Economic Report of the President, February 2006*
(Washington, D.C.: U.S. Government Printing Office, 2006, p.
225.

²² “The Boot Is On the Other Foot,” *The Economist*, April 1,
2006, p. 55.

²³ Bergsten, p. 91.