

# **China Business: Experiential Viewpoints and Approaches**

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Working Paper, April 2004

Abstract added and Introduction revised in June 2005

## **Abstract**

Asian business has undergone substantial changes with the emergence of China. This paper aims at describing general trends in China business strategies being sought and followed by the Japanese multinationals in the electronics industry based on the author's practical business experiences with Hitachi, Ltd. in the region.

## **1. Introduction**

China's economic and social developments have been driven by the policy of "Reform and Opening-up", and enormous amount of foreign direct investment has been made. In spite of the spread of SARS, which occurred in the spring of 2003, business in China has continued to attract the enthusiastic attention, and the growing trend for world industry players to shift their operations to the Chinese mainland has even been intensified.

This paper\*1 is written from a general perspective: it tries to assess some of the important trends in China business and business strategies being followed by Japanese companies. Firstly, company structure to cope with Asian business will be examined, and based on this analysis strategic tasks of Japanese firms will be discussed. One of the objectives of the paper is to document the author's experiential viewpoints and approaches\*2.

## **2. Issues of Region in Asian Business**

### **(1) Changing Roles of Regional Headquarters**

There are many arguments on how regional headquarters is organized in Asia. Regional headquarters in Asia is now literally beginning to swing with many companies performing organizational changes. This does need some background explanations. One of the most significant factors is a new creation of specific business groups through "Spin-offs" and "Mergers". "Spin-offs", a Japanese terminology "*Bunshaka*", refer to the creation of a subsidiary within a company group, or rather, the creation of an individual company for each major product group, and such a company is detached from the parent

company and become a member of the group company. The new creation of business group through “Mergers” refers to the case, for example, where the semiconductor group of Mitsubishi Electric Corporation merged with the semiconductor business group of Hitachi, Ltd. Both companies created Renesas Technology on a joint venture basis. In this case, the newly created company is carved out of both Mitsubishi Electric Corporation and Hitachi, Ltd. and also becomes detached from the supervisory coverage of the overseas regional headquarters.

We have perceived a historical scene in Japan where "International Business Division" increased its status within a company and a regional headquarters incorporated business groups into its umbrella one after another. What we see now is the opposite situation where “business” comes before “region” and therefore a regional headquarters is losing its power, and this is creating a new major current of today’s business. The duties of the President of a regional headquarters have so far entailed those of an "apartment superintendent", and this trend is even accelerated now. If a big business group leaves from a regional headquarters due to either “Spin-offs” or “Mergers”, the activities of the regional headquarters will significantly be affected.

## (2) "Bigger Regions" and "Smaller Regions" in Asia

Major changes are also occurring to the concept of region itself. Concerning this issue, the following three points will be mentioned:

### 1) Limitations of the "Single head office " approach

A regional organization, headquartered in Singapore for example, controls the whole of Asia. In the case of a European company, those who have a headquarters in London control all of Europe. Today, however, this "single head office approach” has started losing some competitiveness, since we need to respond quickly to changes in a "smaller region" or a "country" in an appropriate manner.

### 2) New Competition

Those working in networks and development-related operations in particular may well be aware of the existence of "Born Global Companies". In Southeast Asia, there is also a group of upstart ventures designed for the world market immediately after incorporation. Such companies take speedy actions in regions and countries having large markets, thus affecting the traditional multinational companies.

### 3) Rise of China and Changes in Business Trends

Speaking of Taiwan, the USA used to be its top economic partner and importer. Taiwan companies, who receive orders for OEM products from USA-based PC companies, produce PCs and supply them to the American PC companies. The USA was therefore long been the top destination for Taiwan exports, which means that Taiwan had

established itself as the number one PC producer in the world. In the mid-2002, however, the circumstances changed since Taiwanese companies relocated their production bases to the Chinese Mainland in order to maintain or improve their competitiveness in OEM PC production. Thus, China became a number one export destination. The same applies to South Korea, who, while remaining still much dependent on the USA, sees its exports to China growing rapidly. Business trends in Southeast Asia are changing rapidly, with the focus on China.

(3) The subject at issue here is the way the regions are classified in the present day business in Asia and the trends in the regional headquarters.

1) "Bigger Regions": Greater China and South Asia

Hitachi Asia Ltd. was an Asian business headquarters at Hitachi, Ltd. until the end of March 2003. The company, headquartered in Singapore, had a subsidiary location in India, Thailand, Malaysia, Hong Kong, Taiwan and various other countries in Asia. Hitachi Asia (Hong Kong) Ltd was the second biggest base, next to the Singapore headquarters, in the pan-Asian organization. The company was responsible for Hong Kong, China and South Korea business but the Singapore headquarters handled Taiwan business through its branch in Taipei.

Hitachi, Ltd. established a new organization named Hitachi China Ltd. as of April 1, 2003, headquartered in Hong Kong and the new company is responsible for sales, marketing and services of electrical and electronics equipment as well as international procurement in Greater China Region\*3 (Taiwan, Hong Kong, and China). This was to counteract to major changes in the Asian business; the continued rise of China.

Historically Hitachi, Ltd. had an umbrella company named "Hitachi (China) Ltd." It was renamed "Hitachi (China) Investment Ltd." and remains in existence following major downsizing. We should note the fact that the newly created "Hitachi China Ltd." covers Greater China. This is in a sense a new organizational approach. The remaining portion is therefore "South Asia" region. The classification of region is changing and I believe that such changes will lead to new trends.

2) "Smaller Regions": Pearl River Delta and Yangtze River Delta

The regional economy known as Southern China economic zone, which is centered around Guangdong Province, has been formed and many business activities have been developed with this in mind. These days, the center of the region is known as the "Pearl River Delta" and many have offered an insight into the relations between the Pearl River Delta and Hong Kong. Hong Kong, who is now one of the international China cities after it was handed over to the mother country, still faces with many challenges, and the SAR (Hong Kong Special Administrative Region) Government is devoting its

energy to the "Pearl River Delta" project to revive Hong Kong\*4. The other region lies on the Yangtze basin, more precisely the Yangtze River Delta that encompasses 15 cities including Shanghai City and other cities in Jiangsu and Chejiang Provinces. With the factories in Suzhou, Kunshan and other cities in Jiangsu Province in the background, Shanghai-based companies have started to develop business. Even when we talk about China, seemingly a market of considerable size, the significant regions are not many. Taking Southern China, we have the Pearl River Delta and Eastern China, for example, has the Yangtze River Delta. The central city of each region is Hong Kong and Shanghai respectively. A business framework is slowly emerging, where the Hong Kong- and Shanghai-based companies play an important role in these regions.

### **3. Greater China region as the Starting Point for Business in China**

The term "Greater China" emerged as a business concept when U.S.-based multinationals such as IBM, Hewlett Packard and other companies have developed China business based on the regional organization called "Greater China Group or Division". Japanese companies, however, did not share such a concept. In consequence, many of the latter set up local subsidiaries in Hong Kong, Taiwan and China independently deploying facilities, which means that the regional company locations were independently built up. In that sense and as aforementioned, Hitachi's reorganization for the Asian business and intention to focus on the Greater China region concerning China business somewhat represents a new organizational concept.

Why do we develop business based on the Greater China concept? The intention is to take the advantage of the respective economies and business environment and make optimum use of the human resources available in this region. Particularly the initial stages of building up businesses in the Chinese Mainland become smoother if we use the strength of Taiwanese in production and that of Hong Kong people in marketing as well as other advantages. In addition to the human resources available both in Taiwan and in Hong Kong, there are overseas Chinese who had left China from various reasons and settled down in other countries. What are the greatest differences between Japanese and U.S. companies in terms of building up business in China? When American companies move to China, it looks like that they utilize a company wide database of Chinese personnel. Firstly, the U.S. multinationals attract those people who once moved to the USA but started thinking about returning to China and they recruit such Overseas Chinese and appoint them to a managerial position, which can make an initial phase of China business development a bit smoother. Secondly, they established a business approach where personnel from other Asian region, Singapore and Hong Kong

for example, are temporarily relocated to China.

When you operate in China, there are inevitably many uncertainties and difficulties. However, as we have just touched, the whole business process can become relatively easier if we relocate experienced people from Hong Kong, Taiwan, or other Asian countries. We should note that Taiwanese find the environment in China relatively similar to that of in Taiwan. Even under the challenging situation, building a project team on the Mainland around Taiwanese personnel would often be a factor to greatly increase a degree of success. As for engineers, those operating semiconductor product businesses for example find selling their technology difficult, particularly when they make an approach to some of the China local customers. Incorporating microprocessors or micro-controllers into the heart of IT products will require a full year effort. Even if you hire Chinese engineers to develop such a design-in activity, they are apt to quit from the company suddenly within a short period of time, six months for instance. Based in Hong Kong, we repeatedly came across with similar failures in Shanghai. To resolve matters, we made every effort to find out outstanding and bachelor engineers in Hong Kong-based organizations and dispatched them to Shanghai for about two years, and this approach tented to result in initiating a strong technical department on the Mainland. When you do business in China, you cannot broaden your management capability if you limit your view scope just within China. If your eyesight is broader enough to handle human and business factors from a wider scope in terms of the Greater China, you will find success more easily, since smoother starts are possible.

#### **4. New trends in China Business: From Factory to Market Place**

The term "*Kojo*" (Factory) is a Japanese term coined in the Meiji era while "*Shangchang*" (Market place) is a Chinese word. In April 2002, Nikkei BP published a Japanese book entitled "China has become a 'Factory of the World' before you notice it" ("*Kigatukeba Chugoku ga 'Sekai no Kojo'*"). In the autumn of the same year, Nihon Keizai Shinbun issued a Japanese book entitled "China - From the 'Factory' to the 'Market' of the World". ("*Chugoku – Sekai no 'kojo' kara 'shijo' he'*").

The word "Shangchang" in this paper has a couple of meanings according to a Chinese dictionary. One is "market". Another is "department store or shopping center". In addition, the third is "business trends" or, in abstract terms, "business in general". The strength of Japanese companies lies in their strength in manufacturing. When it comes to China business, however, it is critically important to have viewpoints such as "reinstatement of sales and marketing".

(1) Changes in the Way Companies invest in China: From "Joint Ownership" business to

### “Full Ownership” business

More than 80 members of Hitachi Group companies moved to China by April 2003. If we look at those subsidiary companies in the Mainland China on a regional basis, the region attracting the largest cluster of companies is the City of Shanghai. The second is Jiangsu Province (particularly Suzhou City) while the third is Guangdong Province. Such trends reflect almost the norm in Japanese multinationals. In December 2001, China joined the WTO. Foreign companies' means of investment in the Mainland China underwent substantial changes according to before and after of this historical event. Before China joined the WTO, most of the companies entering China chose to establish a joint ownership company and the China government have historically seemed to encourage joint ventures in certain industrial segments. Even if it was possible for companies to make an investment in China with a full ownership, they often faced administrative guidance that requires a certain level of an export ratio, 80 percent for instance. Another reason why the joint venture type of investment was chosen is that the level of environmental uncertainty was quite high in China. Companies operating with a full ownership encounter many unexpected obstacles that they do not understand and they sometimes fail to counteract. Hence, companies moving to China wished to establish joint ventures with China companies.

Recently, particularly after China's access to the WTO, the wholly foreign-owned investment has increased at an overwhelming rate. One of the reasons why many companies have chosen a 100 percent ownership is simply because they wish to do business in their manner of choice. As for Western multinationals, not a few companies have bought the equity share in their joint venture with China partners to increase their capital ratio or make their companies independent.

#### (2) Major tasks of a full ownership company

However, in the case of businesses with a full ownership, companies have no local Chinese partner and yet need to establish a subsidiary in China. This must involve obtaining advanced information and consultants' assistance on the business in China such as the details of local governments' formalities and how to organize sales activities. This represents some of the important management tasks. For those companies coping with such "uncertainties," prior surveys and consultation obviously become ever more important. Without effective surveys and consultation, the portion that was somewhat clear with the assistance of a Chinese partner in a joint venture becomes very challenging. Another important issue is the means by which you develop sales activities. Most joint ventures have tended to leave almost 100 percent of the sales work to the China side, which often resulted in missing the details of customer activity and

therefore making sales business a black box. Those who want to enter sales activity area may find this very difficult, since the issue of sales has been a tough obstacle to overcome for Japanese companies aiming to enter China markets.

### (3) Understanding China as a Market Place

To understand China as a market is to recognize the size of its domestic market and this does not only mean to use China as a "factory (*kojo*)" but also to regard it as a "market place (*Shangchang*)". It is not a bad idea to use China as a place to manufacture. The strategy of producing things at extremely low cost in China, such as Uniqlo's case in Japan, is a great China strategy. Producing PCs in China and selling them throughout the world is another great strategy.

China market is growing in terms of the overall global market, meaning China is beginning to exercise great impact as a market. Whether China is used as a "factory" or a "Market Place" depends on the nature of individual companies and their business strategies. It is also true that, of all global companies entering China, the top-ranking companies are considerably "Market-oriented".

### (4) Successful companies in China are strongly "Market-oriented"

Since the concept of China as a market or a trading place is seen as overly severe for Japanese companies, they generally appear to have avoided the topic. While working in Hong Kong, we once advocated the concept of "Volume Zone" and attempted to motivate the head office divisions to pay attention to the Asian market. The Volume Zone represents a mass market, one of low-end products from a technical point of view. While the Chinese and Asian markets are part of the Volume Zone, Japanese companies tend to have a long history of escaping to the higher value-added products instead of facing with the low-end markets.

ST Microelectronics (a joint venture established by the semiconductor division of Italian SGS and that of French Thompson in 1987) is said to rank fourth in the world semiconductor sales in 2002\*5. In 2001, when most semiconductor companies were in the red ink, ST Microelectronics remained profitable. A close look at ST Microelectronics and Phillips for example indicates that they are facing with the Volume Zone and taking the mass market for granted to establish their business. The same is true for Samsung of South Korea, who recently posted a record sales and profits in its history. The company is engaged in low-end products, DRAM's and TFT LCD Displays, which are hard to handle, but they are producing very fine results.

Let us now turn to the China local industries. Among the China companies expanding strongly, we can pick up Legend Group Ltd. in the field of PCs for example. They are virtually headquartered in Beijing (Their legal head office is in Hong Kong, Legend

Group Ltd. is listed on the Hong Kong Stock Exchange.) The sales share of Legend Group in China's PC market once reached a 28-29 percent level in the past (in 2000), thus being unrivaled. An American president of IBM's PC company in Shenzhen said that they could not beat Legend. How Legend Group managed to achieve a 28-29 percent market share in China? The reasons include their market-oriented business or sales oriented approach. We can simply admire Legend's management approach on market segmentation. American companies tend to concentrate on single product concept (notebook PCs and/or desktop PCs), while Legend PC's have a great variety from model to model, depending on whether the targeted consumers are high-school students, housewives, or businessmen. Legend handles products very well considering such market segmentation. Another factor that greatly boosts the company's sales is the creation of their own sales network. They made tremendous efforts there. Legend Group launched its own new sales system in addition to the distributor sales network in August 1998. Since then, they started selling through their direct sales channels. We can find out a similar case at Dell Computer who has built Internet based sales in China during the past several years. It is interesting to note that Legend Group, Dell Computer and other companies with direct sales have seen the market share increase. After-sales service is also extremely important: Selling is not the be-all and end-all. In that aspect, too, Legend Group is outstanding.

## **5. Important Factors in Establishing Business in China**

### **(1) Basic Orientation**

The first essential key word in terms of orientation will be "Just do it" or "Begin with what you can do now." Secondly, conduct your business in line with the motto "Earlier" and "Cheaper." "Earlier" does not mean "faster" in speed terms, it means "early" in the sense of getting a head start on rivals. Business in China is often conducted upon the basis that early starters win, or in other word, the early bird catches the worm. It is therefore important to do things earlier than other people do. The concept of "cheaper" does not merit explanation in my opinion. When doing business in China, you will surprisingly see prices over a relatively wide range of business domains descend pretty close to the minimum global levels.

### **(2) Shifting "Pivotal Foot" into the Chinese Mainland**

These days, a majority of companies target Shanghai or some other big cities in China when commencing business with China, while historically, the world's known multinationals and Taiwanese companies, if we take an Asian example started their China business in the earliest stages from Hong Kong as the basic window. Before

physically moving to China, they first trained themselves in their skills in Hong Kong. Pursuing business in that manner proved to reduce the level of uncertainties that they might otherwise have encountered when doing business in China. One practical method to eliminate or reduce such difficulties and uncertainties in China business is to take the “Copy and Paste” approach. The business models that were developed in Hong Kong can be copied and used in the Mainland China. After initially launching the business models in Hong Kong, the basic techniques can be transplanted to the Chinese Mainland on an as-is basis. For sales in particular, I have often seen such methods rather successful.

It is time to describe what type of activity we should be developing in sales business in China. When thinking in terms of the sales field of semiconductors and other electronics parts, more than 90 percent of the export transactions were still settled in Hong Kong with a relatively low remainder settled directly in China at the company the author worked. Hong Kong therefore plays the role of sales headquarters or control tower while the Mainland China is the front line for technical sales, field sales, after-sales service and sales agency work.

Another aspect regarding areas to be handled in China is to develop those activities that are almost impossible for Hong Kong companies. These include operations such as carrying local inventories within China so that we can provide China customers with meticulous support and materializing business payments in RMB currency, knowing that the latter case still involves China trading firms between end customers in China and trading companies in Wai Gao Qiao Free Trade Zone for instance.

Anyhow, it is good to develop such business in the Mainland as is not possible at Hong Kong companies. China government is committed to open up sales rights fully within around three years after China’s access to the WTO membership. At this stage, those currently wishing to pursue direct sales in China, however, must build a factory in China first. Company activities designed just around sales are not, as a rule, allowed except for companies set up in certain free trade zones. By 2005 or thereabouts, people will be free to establish sales companies in China. You should not, however, wait but put wheels in motion by setting up a company in Wai Gao Qiao Free Trade Zone, Zhang Jiang High-Tech Park or somewhere similar. Certain limitations clearly exist now but you do not have to wait until the rights are opened in the service business. The quickest way would be to take a full advantage of current possibilities.

### (3) Attitude towards Facing the Market, Customers, and Sales

As mentioned before, it is getting more important to conduct market surveys when moving to China. Historically, Japanese companies in China have learnt much from their China partners. It would be a good advice to find out a qualified consultant who is

likely to give appropriate advices, since the number of fully foreign-owned companies is growing now. It is true that hard work is important when building up a sales organization in China, but it is also a critical task for you to cultivate sales partnership in any case.

#### (4) Regional Headquarters

The concept of region is becoming relatively thin in overseas business. When doing business in China, it is still important to establish the functions of the regional headquarters. Those functions include regional representation, brand and public relations management, legal affairs and intellectual property management, personnel training and human resources, finance and tax affairs, IT support, project development and research and development. The function of the regional headquarters is more important in China than in any other regions. Among these functions, human resources development, IT support and project business development are some of the most important tasks. Japanese companies in general have so far been engaged in selling rather standard and mass production products and been strongly oriented toward commodity business. Recently solution business has caught a keen attention in Japanese companies, and from now on, the overseas regional headquarters will have to enhance their project business development capabilities.

#### (5) Roles of IT

Finally, yet importantly, some issues concerning IT support and services activity in China will be discussed. People use three "no's" when describing the status of IT activity in China. The first "no" refers to "no people", the second "no" relates to "no money" and the third "no" comes from "no time". These are all true.

Firstly, "no money" refers to the difficulty of making IT investment. In the case of joint ventures, in particular, this field receives very little priority. In the manufacturing industry, it is quite natural for factory management members to devote themselves in setting up factories in the initial stages, and then they move to the production equipment area to rationalize problem areas to improve manufacturing efficiency. Regarding investments for production ramp up, China partner also gives the green light comparatively easily. When it comes to somewhat invisible activities such as attempts to increase office work efficiency, however, the same factory management tends to attach a little priority or sometimes neglect the issue. Companies in China can employ human-wave tactics and IT investment proposals quite often be rejected in board directors' meetings and other management sessions. We tend to suspect that China companies do not even spend money on such items.

It is a well-known phenomenon that to secure IT people in China is hard and to keep

them in the organization is even harder due to their low stability. Colleges and universities in China have been eager to train IT engineers. If you stay on site, however, you will find it hard to hire qualified staff, and even if you secure some people, they tend to quit soon. One of the solutions to the IT personnel shortage and their high turnover is to purchase package software products, and the companies involved in ERP (Enterprise Resource Planning) packages have become active now. In China, only a very limited number of companies can make an investment that exceeds several millions of US dollars a year for IT purposes. Therefore, these cheaper package software products attract customers. The Chinese version of Business One by the German company SAP was released in September 2003. SAP will then use this version to enter into the small and medium enterprise market in China and afterwards they will bring those IT users, as they grow with the years, to the usual upgrade path. In China the heated competition to attract customers for cheaper package has just been started.

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- \*1. This manuscript is based on the transcription from tape-recording of the speech delivered by the author in Japanese at the seminar organized by Seed Planning Inc., Tokyo in March 2003. The author edited the transcription and rewrote the manuscript in English.
  - \*2. The author worked as Managing Director of Hitachi's sales company that is headquartered in Hong Kong and responsible for Hong Kong, China and South Korea for about six and a half years from November 1995 through March 2002.
  - \*3. The term Greater China often appeared in the American journal in the early 1990's.
  - \*4. See research reports issued by the Trade Development Council in Hong Kong.
  - \*5. Gartner Dataquest publications were referred.