



Close
Window

JANUARY 6, 2006

Doing Business in China

By Michelle Dammon Loyalka

The Art of Chinese Relationships

Westerners entering the market had best learn the basics of *guanxi* if they want their ventures to thrive

As a Scottish citizen, Rod MacGregor, who founded the U.S.-based NanoMuscle in 1998 with venture capital from Germany, Switzerland, Italy, and France, knows a thing or two about international business. But when he started moving production and R&D of the company's miniature motors to China, MacGregor quickly realized that while it's nearly impossible to make a fatal mistake in other Western countries, doing business in China is an entirely different story.

Here's an example: Once when MacGregor went to visit a powerful factory owner in the south of China, an American business associate he was traveling with handed over his business card with a nonchalant, one-handed grasp rather than the more respectful and deliberate two-handed technique typically used in China. The factory owner accepted the card but didn't offer one of his own. Later, his people called MacGregor and told him to never bring that man back again.

The key to avoiding such deal-killers is understanding the etiquette of business in China. How to present your card is important. But even more crucial is understanding the web of relationships that defines business in China. That's why, after recently launching China Corp., a company that specializes in helping Western companies enter the Chinese market, one of MacGregor's first moves was to compile a guidebook to doing business in China that devotes plenty of attention to *guanxi* (pronounced GUAN-SHEE), or the art of relationship development.

ELUSIVE PROFITS. "Often when we engage a new customer at first, they say 'Yeah, yeah, we don't care about that cultural stuff. We just want to find out how to buy parts there,'" says MacGregor. "It takes some time to convince them that in actual fact, that's the most important thing."

Important, especially, to securing those elusive profits in China. In her most recent research, Usha C.V. Haley -- a University of New Haven international business professor and the author of *Asian Post-Crisis Management: Corporate & Governmental Strategies for Sustainable Competitive Advantage* -- found that only about one-third of multinational corporations have ever made a profit in China.

A host of issues -- from rampant piracy to a plethora of cumbersome bureaucratic entanglements -- contribute to such woes. But for many

experts, that dismal performance underscores the fact that, while it's imperative to do due diligence before taking the China challenge, establishing good relationships on the mainland with everyone from your partner to your smallest suppliers and distributors is equally essential.

THE BIGGEST MISTAKE. "I think that's what a lot of companies had trouble with in earlier years. Getting things done was so difficult, and they couldn't figure out why," says Kenneth Wong, managing partner at SmithWong Associates, a Trevese (Pa.)-based consulting firm that specializes in helping businesses implement their China strategies. "The nuances may seem tiny, but they certainly do make a big difference in the long run." That's especially true for small companies, which tend to have much less time and money to spend on mastering the subtleties of the Chinese business environment.

In researching their book *The Chinese Tao of Business*, Usha Haley, George Haley, and Chin Tiong Tan spent five years looking at the psychology and philosophy underlying the Chinese business model. In the course of their research, they found that one of the biggest mistakes Western companies make is to bank only on China's low costs of doing business, while underestimating the high transaction costs that come with a business climate based on relationships and reputation.

"You have to spend a lot of time there building your relationships," says George Haley. "So that first contract is very expensive to make." While the standard American approach is to get straight down to business, in China the focus is first on forging a more personal relationship. "It's a very different style of doing business," says MacGregor. "Probably your first meeting you wouldn't mention business at all."

LAW AS LAST RESORT. That doesn't mean spending long hours swapping stories over tea will win you a contract, nor does it mean you have to use the back door to get things done. At a deeper level, real *guanxi* is about creating and realizing opportunities for win-win situations. "In the business world, the relationship must be mutually beneficial," says Chelsea Qi Huai, a Stanford MBA who recently returned to China to launch her own business. "I don't think [just] a simple, good personal relationship can make things happen."

Forging mutually beneficial relationships is especially important considering that, while China is working to bring its legal system up to speed, for now at least it's rare to even try to enforce a contract through legal channels unless a substantial sum is at stake. While drawing up a clear contract that spells out the terms of an agreement is still a necessity and serves as an important reference point, making sure that both you and your Chinese associates profit from the cooperation is one of the surest ways to guarantee your success.

Take the case of David Chou. The president of Hong Kong-based Pacific-China Aero Technology, which sells and leases aircraft to airlines around the world, Chou likes to joke that PRC doesn't stand for the People's Republic of China: It really stands for Patience, Relationship, Contract. In China, it's impossible to get to the contract stage, he says, without first having the requisite patience and relationships.

MAKING CONNECTIONS. When Chou, who grew up in Hong Kong and later emigrated to Canada, signed a contract to help set up the first Chinese domestic regional air carrier in the early '80s, he delivered the aircraft as scheduled, but it was later returned, unpaid. Though the aircraft manufacturer urged him to file a lawsuit, he knew that would effectively shut him out of the country's aviation industry.

Instead, Chou swallowed his losses and patiently continued to seek out opportunities and cultivate relationships within the industry. From that incident, he says, China's aviation leaders gradually grew to respect and trust him, and in the end those connections enabled him to introduce big-name companies like Raytheon and Gulfstream to the Chinese market.

Chou and his clients are also learning that dealing with one company in China inevitably connects you to other companies in the same *guanxi* networks. Chou recently helped Xavier Hervé, president of Montreal-based flight-simulator manufacturer Mechtronix, ink a \$9 million deal with the Civil Aviation Flight University of China (CAFUC).

KEEP IT QUIET. Shortly after the contract was signed, a senior executive at a big Chinese airline unexpectedly invited Hervé to his office for tea -- and then let him know that the people at CAFUC were his long-time friends and that Hervé wouldn't make it far in China's aviation industry if he didn't make sure the CAFUC folks were happy. "Even if you're going to meet the VP of a big, modern airline, he comes from a world where people have been loyal to each other for a very long time," Hervé says.

Though cultivating good relationships can be daunting and frustrating for even the most experienced Westerner, Hervé says in the end doing business in China is based on same principle it is everywhere: respect. The challenge is simply in learning when and how to show it in a culture that's quite different from your own. Unlike the West, where straight-talking is a business virtue, for example, Chinese communication is typically indirect and nonconfrontational, and getting loud or aggressive is a sure way to lose face and jeopardize your relationship.

So, before you head to China, MacGregor strongly suggests brushing up on the basics of Chinese business etiquette -- through books, other small-business owners who have succeeded on the mainland, or competent consultants who have a proven track record in China. And remember, when you find yourself in a situation where you're not sure how to act, the best line of action is usually to keep quiet and defer to your Chinese counterparts. In building good *guanxi*, it can never hurt to be too humble or too respectful.

Loyalka, a BusinessWeek Online intern during the summer of 2005, is a graduate student at the University of Missouri School of Journalism.

[Advertising](#) | [Special Sections](#) | [MarketPlace](#) | [Knowledge Centers](#)

[Terms of Use](#) | [Privacy Notice](#) | [Ethics Code](#) | [Contact Us](#)

The McGraw-Hill Companies

Copyright 2000- 2006 by The McGraw-Hill Companies Inc.

All rights reserved.