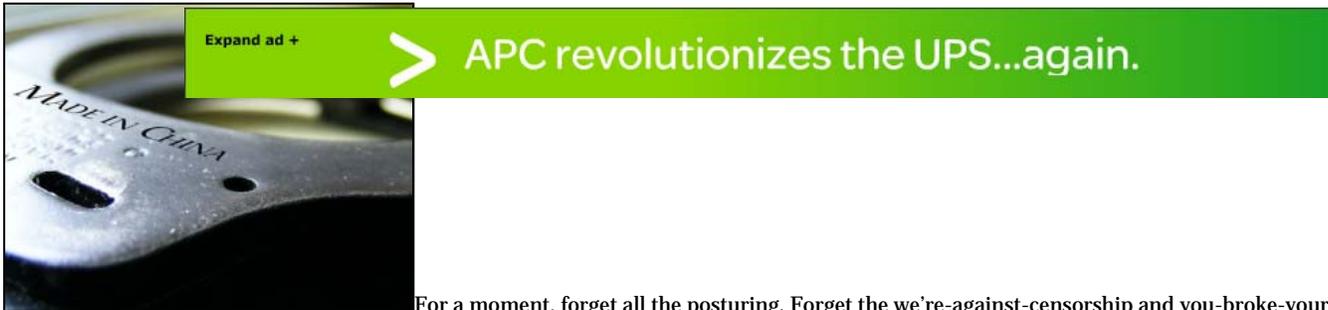


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Google's Radical Realization: Who Needs China?

By Erik Sherman | Mar 24, 2010



For a moment, forget all the posturing. Forget the we're-against-censorship and you-broke-your-word arguments of **Google** (GOOG) and China. Instead, look at the enormous business lesson we can learn from Google's decision to pull back from China: Western technology companies don't need China and might be better off without them.

Over the last couple of decades, the smart people said that companies must move headlong into Asia, and particularly China. There was too much economic growth — too many potential customers — to ignore. And, it's true, the country's economic might is impressive. Nevertheless, that still hasn't translated into a proportionately large pay-off for most companies.

Estimates I've seen suggest that Google gets only 1 to 2 percent of its revenue from China. **HP** (HPQ) notes 40 percent year-over-year revenue growth in China during the company's fiscal year 2009 fourth quarter, but still China — with Brazil, Russia, and India — is only part of an emerging market that is becoming an "increasing portion" of the company's business. Translating the corporate-speak, it's still relatively small potatoes. For **IBM's** (IBM) fiscal year 2009, the entire Asia Pacific region represented 21.6 percent of total revenue, but that includes Japan, Taiwan, Korea, India, and Hong Kong. Again, China saw great revenue growth of 10 percent, but it still probably represents only a few percent of total revenue. **Oracle** (ORCL) saw 14.5 percent of its total 2009 revenue from the entire Asia Pacific region; similarly, China would be at most a few percent of its revenue.

To put it differently, for one large company after another, revenue from China is barely above the level of rounding error. To gain this relatively trifling amount, here's what companies risk:

- China wants to acquire western technology, and so intellectual property is at great risk. As George Haley, director for the Center for International Industry Competitiveness at University of New Haven and an expert on doing business in China, has noted, "If a technology is crucial to a company's future success and competitive advantage they should never risk it in China."
- Although western companies go to China assuming that they build facilities for 30 to 50 percent cheaper than in the US or Europe, a recent analysis notes that plants are just 10 to 30 percent cheaper "when they are designed to meet Western quality, operability, and safety standards and are resourced to protect the owner company's intellectual property."
- According to the same study, almost half of the projects that western companies undertake in China "could be considered failures" because of "high costs and cost growth, long execution schedules and schedule slip, and major operability issues."
- China has oriented its economy on export growth, not imports. The country favors native- instead of foreign-produced goods in domestic consumption. The deck is stacked in favor of local competitors.
- Government procurement in China now favors Chinese companies and "indigenous innovation."
- Many accuse China of using currency manipulation to essentially subsidize exports.

You can only expect China's inclinations to intensify as the country expects its first monthly trade deficit in six years.

Promised high growth opportunity in China has not been realized for western companies, which operate in the country at a planned and controlled disadvantage to local firms. Chances of failure are great. At the same time, risk to intellectual property — the real value of technology companies — is high.

Some years back, I spoke with a supply chain management expert who talked of companies that made choices based on preconceived notions and without regard for the complexity of reality. He pointed to U.S. businesses that outsourced manufacturing to China. In his

estimation, all the financial benefit the companies accrued in lower unit costs they gave up because they now held an additional two months of inventory sitting in the ships that brought the products back.

Even now, executives look to China, entranced by perceived low costs of operations and labor. However, China is an opportunity that highly uncertain and demands a stiff price. It's time for companies to block their ears to the siren call of growth, undertake rational evaluation, and decide, between China's way or the highway, whether a long road trip might not be preferable.

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Tags: Revenue, China, Google Inc., Operational Accounting, Intellectual Property, Finance, Research & Development, Business Operations, Erik Sherman

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