Doing Business in and with China: The Challenges are Great, but so are the Opportunities

By Mohammad Sharfuddin Rashed & Ashraf Un Nesha
University of Chittagong, Bangladesh

Abstract- Doing business in and with China has become much easier than it was decades ago. But doing business does not guarantee that everyone will make money. China has embarked an unprecedented economic growth since its economic reforms (1978) three decades ago, rising to become the world’s second largest economy today and will become largest by 2020. A new path under the 12th Five-Year plan (2011-2015) towards sustainable and balanced development, alongside a focus on boosting domestic consumption is opening new opportunities in china for continued industrial innovation and business expansion. China still holds a number of challenging areas for foreign investors. Beside the cultural and language challenge, business men might be faced foreign exchange restrictions, anti-trust laws, intellectual property rights and diversified people in all over china.

Keywords: economic growth, economic reforms, innovation and business expansion, challenges, opportunities.

GJMBR - B Classification : JEL Code : M10

Strictly as per the compliance and regulations of:

© 2016. Mohammad Sharfuddin Rashed & Ashraf Un Nesha. This is a research/review paper, distributed under the terms of the Creative Commons Attribution-Noncommercial 3.0 Unported License http://creativecommons.org/licenses/by-nc/3.0/), permitting all non-commercial use, distribution, and reproduction in any medium, provided the original work is properly cited.
Doing Business in and with China: The Challenges are Great, but so are the Opportunities

Mohammad Sharfuddin Rashed & Ashraf Un Nesha

Abstract- Doing business in and with China has become much easier than it was decades ago. But doing business does not guarantee that everyone will make money. China has embarked on an unprecedented economic growth since its economic reforms (1978) three decades ago, rising to become the world’s second largest economy today and will become largest by 2020. A new path under the 12th Five-Year plan (2011-2015) towards sustainable and balanced development, alongside a focus on boosting domestic consumption is opening new opportunities in China for continued industrial innovation and business expansion. China still holds a number of challenging areas for foreign investors. Beside the cultural and language challenge, business men might be faced foreign exchange restrictions, anti-trust laws, intellectual property rights and diversified people in all over China. In order to overcome many challenges, there are different forms of business might be opened by foreign investors in China like equity joint ventures, cooperative joint venture, wholly foreign owned enterprises, joint stock companies, foreign enterprises, branches of foreign enterprises and so on.

Keywords: economic growth, economic reforms, innovation and business expansion, challenges, opportunities.

I. ABOUT CHINA

China (Zhonghua Renmin Gongheguo), a country in the East Asia, is the third world largest country with an area of 9.6 million square kilometers (-after Russia and Canada) and the largest by population (almost 140 billion). The People’s Republic of China is bounded on the north by the Republic of Mongolia and Russia; on the north east by Russia and North Korea; on the east by the Yellow Sea and the East China Sea; on the South by China Sea, Vietnam, Laos, Myanmar (formerly known as Burma), India, Bhutan, and Nepal; on the West by Pakistan, Afghanistan, and Tajikistan and on the Northwest by Kyrgyzstan and Kazakhstan (“Nation of China”, 2010). This country is divided into three geographic regions: the mountains to the west, the various deserts and basins in the northeast and the low lying valleys and plains in the east. Most of China, however, consists of mountains and plateaus such as the Tibetan Plateau which leads into the Himalayan Mountains and the Mount Everest.

China is a country of diversified people that mixture of 56 ethnic groups. About 91.6% are of Han Chinese (“China”, 2012). Zhonghuo, the Chinese name for the country, means “central land”. Most of the people in China believe that their country is the geographical center of the earth and carries the only true civilization (McFarlan, 2012). This history reflects several important aspects of China:

The role of the state: China has a long tradition of strong central government; with military power being critical. China was held/built by the gun (McFarlan, 2012). It is impossible to underestimate the role of the state in all activities. The role of the state has led to tremendous bureaucracy.

A sense of superiority: China doesn’t see itself as a newcomer to the global stage. It sees itself as the center of the world and superior to other countries.

Relationships: China is a relationship society, far more than a law society (McFarlan, 2012). In particular, due to the prominent role of government, long-term relationships with government are critical.

II. BUSINESS CULTURE IN CHINA

Chinese society is heavily influenced by the traditional values associated with Confucianism which promotes a strict system of norms and propriety. These values determine how a person should act within a community, with hierarchy a central theme. In addition, there is little separation between business and private life in China (Irwin, 2012). The concepts of ‘guanxi’ and ‘mianzi’ are central to Chinese society and, thus, heavily influence business life. Guanxi is a deeply system of relationships, personal connections, contacts and networks. Mianzi refers to the concept of ‘face’-broadly defined as pride or self respect, and preservation of the self respects of others. Mianzi is related to prestige and one’s position in a hierarchy. Practices such as gift giving, token cash gifts (e.g. red envelopes) at special occasions (e.g. the Spring Festival or the birth of a child) and invitations to family events are prevalent in today's business environment and serve the important function of ‘giving face’ or honoring a potential business partner. In China, meetings start with the shaking of hands and a slight nod of the head. Be sure not to be overly vigorous when shaking hands as the Chinese will interpret this as aggressive. The Chinese are not keen on physical contact especially when doing business. The only

Author a: University of Chittagong. e-mail: rashed_mgt@yahoo.com
circumstance in which it may take place is when a host is guiding a guest. Body language and movement are both areas you should be conscious of when doing business in China. Business cards are exchanged on an initial meeting. Make sure one side of the card has been translated and try and print the Chinese letters using gold ink as this is an auspicious color. Relationships in China are very formal. This is not because the Chinese are humorless but rather jokes may be lost in translation and hence be redundant. Meetings must be made in advance. Punctuality is vital when doing business in China. The Chinese are renowned for being tough negotiators. One must be willing to show compromise and ensure their negotiators feel they have gained major concessions. Above all, patient and there will be no way to show anger or frustration with Chinese counterparts ("Doing Business in China", 2015).

One of the most important cultural symbols to understand, there is a great deal of mystery about ‘Yin’ and ‘Yang’ and how the two of them work together. Even people who speak the same language often misunderstand each other ("Chinese Business Culture", 2015).

The concept of ‘yin-yang’ (often called “the yin and the yang”) is a Chinese philosophical idea used to explain how opposite forces are interconnected and interdependent upon each other. In other words, black could not exist without white, dark without light, cold without heat, etc. The connection between yin yang and Taoism, however, is undeniable. Tao deals with the flow of the universe, or the force behind natural order that keeps all things balanced and in order. It is considered to be a source of existence and "non-existence (Zacharias, 2002).

III. DIFFERENCE IN BUSINESS CULTURE BETWEEN CHINA AND WEST

Hofstede (1980) identified four dimensions of culture based value system: power distance, individualism/collectivism, masculinity/femininity, and uncertainty avoidance. In another research, Bond and Hofstede (1989) identified a fifth dimension called long-term/short-term orientation. The five dimensions of Hofstede framework which explain the cultural differences in shown below (Hofstede, 1993):

<table>
<thead>
<tr>
<th>Cultural Dimension</th>
<th>China</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power Distance</td>
<td>High</td>
<td>The extent to which the less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally.</td>
</tr>
<tr>
<td>Individualism</td>
<td>Low</td>
<td>Focuses on the degree to which the society reinforces individual or collective, achievement and interpersonal relationships.</td>
</tr>
<tr>
<td>Masculinity</td>
<td>High</td>
<td>The degree to which society reinforces or does not reinforce the traditional masculine work role model of male achievement, control, and power.</td>
</tr>
<tr>
<td>Uncertainty Avoidance</td>
<td>Low</td>
<td>The level of tolerance for uncertainty and ambiguity within the society.</td>
</tr>
<tr>
<td>Long term orientation</td>
<td>High</td>
<td>Focuses on the degree to which society embraces persistence, has a sense of shame, orders relationships by status and observe this order.</td>
</tr>
</tbody>
</table>

In Chinese business culture, the collectivist way of thinking still prevails, even in sectors experimenting with free enterprise. This is in contrast to the individualistic culture that predominates in the West. An understanding of accepted Chinese customary behavior and etiquette will ease business negotiations and the furthering of collaborative business ventures between Chinese and non-Chinese business partners. Although most cultural groups have their own communication styles, the differences of communication styles between the Asian and the Western worlds are most distinct. Chinese have strong task orientation that prevents them...
from understanding the importance of developing rapport and earning trust from others. It is most common to get poor listening skills lead to misunderstandings that blows the deal or escalates conflict. They are clueless on the important customs and courtesies that mean lot of individuals can’t make a positive first impression or engage in small talk (Guo, 2013).

It’s important to realize that one of the more subtle aspects of culture and business etiquette has to do the way one thinks about how the world. The following table presents some of the differences between how the Chinese and the Western individuals think about culture and values (“Chinese Business Culture”, 2015).

<table>
<thead>
<tr>
<th>Cultural Value</th>
<th>West (America and most European Countries)</th>
<th>East (China and Asian Countries)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of Logic</td>
<td>Linear (More causal relationships and direct associations between A and B)</td>
<td>Spiral (more roundabout and subtle)</td>
</tr>
<tr>
<td>Expression of Agreement and Disagreement</td>
<td>More argumentative, willing to express disagreement verbally</td>
<td>More difficult to say no even if one means no, disagreement expressed nonverbally</td>
</tr>
<tr>
<td>Communication of Information</td>
<td>More meaning is in the explicit, verbal message. Use of direct language</td>
<td>Meaning is often implied or must be inferred. Use of indirect language patterns</td>
</tr>
<tr>
<td>Expression of Honesty</td>
<td>More overt, one is more likely to ask the person to “speak their mind” or “get it out on the table”</td>
<td>Subtle, nonverbal</td>
</tr>
<tr>
<td>Expression of Self</td>
<td>“I”-oriented Sender-oriented</td>
<td>“We”-oriented Receiver-sensitive</td>
</tr>
<tr>
<td>Thinking Orientation</td>
<td>More rule based or based on application of abstract principles such as regulations or laws</td>
<td>Tends to take context and the specific situation into account in rule interpretation</td>
</tr>
<tr>
<td>The Individual</td>
<td>Has to have rights and greater need for autonomy and individual achievement</td>
<td>Group duty preservation of harmony</td>
</tr>
<tr>
<td>Nature of the Business Relation</td>
<td>Less important, tend to substitute relationship for written agreement, superficial, easy to form, not long lasting</td>
<td>Most important business cannot occur until relationship if sound, written agreement secondary to quasi, hard to form, long lasting</td>
</tr>
<tr>
<td>Conflict Resolution</td>
<td>Trial or confrontation, use of lawyers and courts</td>
<td>More mediation though trusted third parties</td>
</tr>
<tr>
<td>Time Sense During Meetings</td>
<td>Be on time and end on time.</td>
<td>Appointments less driven by exact start and end times</td>
</tr>
<tr>
<td>Conflict results</td>
<td>Perception of two states: win or lose</td>
<td>Win-Win</td>
</tr>
<tr>
<td></td>
<td>To lose is to win</td>
<td>To lose in order to win</td>
</tr>
</tbody>
</table>

IV. Business Opportunities in China

Economic reforms (1978) in China have led to an unprecedented change in the nature of the business environment and the opportunities available for foreign investors and privately owned companies. China officially joined the World trade Organization (WTO) in November 2001, and foreign investment and trade has further grown rapidly as a result. China, a $10 trillion economy growing at 7% annually (Tsoi and Zheng 2012), is a never before seen force reshaping the global economy and rising to become the World’s second largest economy after United States. Some even predict that it will transcend the United States as the World’s largest economy by 2020 (Tsoi and Zheng 2012). A new path under the 12th Five-Year plan (2011-2015) towards sustainable and balanced development, alongside a focus on boosting domestic consumption is opening new opportunities in China for continued industrial innovation and business expansion (Lam, 2012).

China is a center of business hub. A large and capable workforce are available because almost China having 20% of the world’s population (McFarlan, 2012). Among the factors contributing to China’s growth depends not only on population is large, but also the literacy rate (the literacy rate is 93% compared to 61% in India) and hard working attitudes. China has excellent universities which are producing a large pool of competent graduates. Despite the history of state-owned enterprises, the Chinese people have a long history of entrepreneurship (McFarlan, 2012).
V. INCENTIVES FOR FOREIGN INVESTORS

In order to attract foreign investment, Chinese government has introduced a number of benefits and incentives towards foreign investors in particular industries of which we set out a brief list as follows (Lam, 2012):

Qualified small and low profit enterprises and qualified high/new-tech enterprises are subject to reduced income tax rates.

Technology Advanced Service Enterprises (TASE) which include information technology outsourcing (ITO), business process outsourcing (BPO) and knowledge process outsourcing (KPO) are subjects to income tax benefits; entitled to a preferential Corporate Income Tax (CIT) rate of 15% and a higher education expense deduction cap of 8%.

Enterprises or projects with a focus on technological development, environmental protection, energy and/or water conservation, production safety, for example, may be entitled to various types of income tax incentives.

Tax incentives for foreign investment enterprises of a productive nature and most of the “geography based incentives have been removed.

Technology transfer, technology development and related services are exempt from business tax (BT).

Apart from incentives, China’s investment attraction strategy is the customized liberalization of trade with some of its key partners, in the form of a Free Trade Agreement (FTA) (Tsoi and Zheng 2012).

VI. SCOPE OF DOING BUSINESS IN CHINA

Many of the industries with the highest growth potential in China over the next decade will be in the services sector, but not all. For example, energy and agriculture will have segments with very rapid growth. It is expecting to grow more than 6% for the next five years (Dwight, 2014). Below is a very brief description of where foreigners have business opportunities:

a) E-tailing

The online share of retail in China, at 8 percent in 2014 (Orr, 2014), is higher than it is in the United States and is not close to reaching saturation. Increasingly, this is conducted through mobile devices. The payments system is in place, logistics are improving, and online providers are trusted. Many retailers will adapt, often with far fewer physical locations. Malls will have to become destinations for services beyond retail.

b) Logistics

Modernization of supply chains is a key enabler of increasing productivity in many sectors in China today. Until recently, most goods were carried by individual truck owner-operators. As express parcels become a $100 billion industry on the back of e-tailing, e-commerce companies themselves are investing billions in modern warehouses and trucks (Orr, 2014). Alibaba alone is committed to spending billions of dollars on its own logistics. Third-party carriers such as SF Express are rapidly becoming regional leaders on the back of growth in China. Even in agriculture, massive investment is under way in cold storage and cold carriage to reduce waste and provide higher-quality food products to China’s middle class.

c) Education

Education is a top government priority and critical to China’s economic development. Alongside companies opening private universities for their employees, annual government investment in education of about US$250 billion should help expand access to education, and boost the quality of the education system and its ability to support China’s transition toward a more services-based economy.

Nearby two-thirds of registered kindergartens in China are privately owned (Sun, 2015). Private universities are expanding, namely Shanghai New York University, Duke Kunshan University, John Hopkins University in Nanjing, etc. Traditional and online vocational learning schools are publicly listed multibillion-dollar businesses. Niche businesses, such as preparing children to apply to the US, the UK, and the Australian high schools and universities, are also flourishing. The Chinese are also willing to spend on tutoring and support for their children is almost unlimited. As the middle class becomes wealthier, the increased ability to spend will drive market growth (Sun, 2015).

d) Healthcare

China has 13,440 hospitals that are government-owned as of October 2013, providing more than 90% of all health services (Orr, 2014). More than 1,500 new private hospitals opened in China in 2013, a number of which are 100 percent foreign owned (Orr, 2014). The shortcomings of the mainstream public healthcare system in China are not likely to be overcome quickly. Patients are looking for solutions where both cost and quality are more certain, and private and foreign companies are being encouraged to deliver. There is a related boom in supplying equipment to these new facilities.

China’s healthcare market is expected to boom over the next decade, driven by the country’s giant economic expansion and its burgeoning senior population. The consulting firm McKinsey & Company estimates that health care spending in China will grow to $1 trillion by 2020 equivalent to nearly 7% of GDP, up from just over $350 billion in 2011 (Sun, 2015).

e) Tourism

Available hotel rooms in China have tripled over the last decade. Four million mainland Chinese visited
South Korea in 2013; four million visited Thailand (Orr, 2014). China’s middle class expects to take three to four weeks of vacation each year and no longer accepts visiting the overcrowded, overexploited traditional domestic destinations. Disneyland’s opening in Shanghai in 2016 could trigger a new wave of investment to create higher-caliber resorts.

f) Wealth management

China represents more than 50 percent of Asia ex-Japan growth, with high-net-worth assets expected to reach $16 trillion by 2016 (Orr, 2014). The more than one million high-net-worth individuals in China remain generally unsophisticated as investors, seeking advice on how to broaden their investment portfolio both onshore and offshore.

g) Entertainment

China is the second-largest movie box office market in the world. Chinese box office ($4.8 billion) increased 34% in 2014, becoming the first international market to exceed $4 billion in box office (“Theatrical Statistics Summary”, 2014), although tickets cost upward of $10 and DVDs are still available for $1 (Orr, 2014). In 2013, more than 1,000 new theaters opened, yet admissions per capita are less than one-fifth of South Korea’s.

h) IT Services

Finding the chief information officer (CIO) in a Chinese company is often hard, especially in a state-owned enterprise. Historically regarded as simply a support role for the business, CIOs were pushed three to four levels down in the organization and attracted little talent (which instead went to Internet start-ups). A typical Chinese company spends only 2 percent of revenue on IT versus international benchmarks of around 4 percent (Orr, 2014). As these companies struggle to bring technology into the core of their operations, they need massive amounts of help to do so. The cost of good IT talent is already soaring. Most Chinese companies will be unable to solve their technology challenges for themselves.

i) Clean energy

China already produces 60 percent of solar panels and wind turbines. Increasingly, it is consuming this output domestically (Gandolphe, 2014). For example, 11 gigawatts were installed in large-scale solar farms in 2013, and this will grow an additional 30 percent in 2014. China is also investing heavily to exploit its shale-gas assets and develop cleaner coal technologies (Orr, 2014).

j) Agriculture

China does not feed itself today—certainly not with the kind of quality and value-added products that the middle class seeks—but it will be challenged to do so in the future. Continual food-safety crises illustrate the challenge. For many successful technology investors, such as Legend Holdings, agriculture is the new Internet. Chinese companies are investing in agriculture outside of China at scale, from Chile to the Ukraine, for China (Orr, 2014). They also invest in China, especially in value-added products—such as fruit and the production of frozen ready meals.

VII. Challenges of Doing Business in China

China still holds a number of challenging areas for foreign investors and businessmen. It is obvious to face cultural and communication challenges in China when someone is going to business with China. In particular, while investing in China; careful attention needs to be paid to intellectual property rights (Lam, 2012). Even though the Chinese government has somewhat recently made its agenda, foreign companies or investors still need to be aware of issues related to copyright. In addition to this, China is not a homogeneous market; Chinese consumer behavior can change from one province or city to another (Cisse, 2013). Moreover, there are some other challenges may have to face in China at the time of doing business found by Lam (2012) and McFarlan (2012).

a) Foreign exchange restrictions

This is the first restriction faced by foreigners to make the payment. Foreign investment enterprises are required by the State Administration of Foreign Exchange (SAFE) to separate their foreign currency bank accounts into capital accounts and current accounts (Lam, 2012). The Chinese government is clamping down on the amount of cash its citizens can withdraw from ATMs overseas, its latest attempt to stop money flooding out of the country. From January 2016, an annual limit of 100,000 Yuan ($15,737) is applied. China already limits the amount of money an individual can move out of the country to $50,000 per year (Riley, 2015).

b) Anti-Trust Law impacts foreign investment

Merger and acquisition transactions in China involving foreign parties will be subject to review and can be halted due to anti-trust law which came on effects on 1st August, 2008 (Lam, 2012). On 19 January 2015, the Ministry of Commerce of the PRC (“MOFCOM”) published a new Foreign Investment Law on its official website. Under the current foreign investment regulatory regime, a foreign-invested enterprise, regardless of its scale, investment amount and industry, will require governmental approval from cradle to crave, including its incorporation, liquidation, increase or decrease of capital or share transfer. The regulatory red-tape increases regulatory costs for foreign investors and, to some extent, impedes free competition and liquidity flow (King & Wood, 2015).
c) Lack of infrastructure

By all measures, China’s infrastructure is far behind that of the United States. The lack of infrastructure could actually hinder growth. In the 12th five year plan, infrastructure development remains a top priority for China’s government, which has long recognized that a modern economy runs on reliable roads and rails, electricity, and telecommunications (Chen et al. 2013).

d) Lack of raw materials

China has an extraordinary need for raw materials and energy resources. To address this need, China has developed and continues to develop international relationships. For example, Australia has become “China’s quarry” and China has made investments in Africa to procure raw materials. The Chinese Minister of Land and Natural Resources announced that by 2020 it will encounter serious shortages in 25 different raw materials. Currently China is experiencing shortages in 11 metals that are critical for the development of the Chinese economy. China is the world’s largest user of iron, copper, lead and zinc (“Chinese demand for raw materials will accelerate”, 2015).

e) Environmental issues

Environmental issues in China are plentiful that severely affecting the country’s biophysical environment and human health. Rapid industrialization and lax environmental oversight are main contributors to these problems. According to eco-city designer Thomas V. Harwood III, 16 of the world’s 20 most polluted cities are in China (“Environmental issues in China”, 2016). Pollution mainly related with air and water pollution. Manufacturing industries and 5 million-plus cars in Beijing all contribute to the city’s crippling air pollution, but most experts primarily blame the coal-burning electrical plants that power China’s breakneck economic growth (Marc Lallanilla, 2013). These problems are not unique to China. Other developing economies faced similar situations, including the United States (McFarlan, 2012).

f) Corruption

China is very much a relationship society, where long-term, carefully nurtured relationships are tremendously important but the importance of relationships can result in corruption. The companies are likely to experience bribery, political interference or facilitation payments when acquiring public services and dealing with the judicial system. The common practice of ‘Guanxi’ is a custom for building connections and relationships based on gifts, banqueting, or small favours (“Business Corruption in China”, 2015).

g) Income inequality

A widening gap between China’s rich and poor makes it “one of the most unequal countries in the world” where the rich are gleaning most of the fruits of the transition from a system of centrally-planned socialism to a market-oriented economy (Cevik and Correa-Caro, 2015). “China’s widening income inequality is largely a reflection of faster income growth among the rich, rather than stagnant living standards among the poor”.

h) Social stability

New wealth is developing quickly but deep inequalities have emerged. There are major imbalances between the eastern and western regions of the country, as well as between the rural and urban areas. Although national peace has existed since 1948 under the philosophy of “harmonious development,” incidents of civil unrest have grown 400%.

VIII. Conclusion

Businessmen must recognize, respect, and reconcile cultural differences if they hope to contact successfully in the Chinese environment. Bridging these cultural differences adds value to business transactions and minimizes the risk of failure (Eric, 2014). While there remains a strong emphasis on hierarchy in Chinese business culture, this is changing. The two main elements specifically driving these changes in China are the Internet and unique structural demographics driven by the family planning policy (Dumont, 2012). China is by far the biggest global market and has the world’s largest and most vibrant online community and, as much as anything, it is these sheer numbers that is driving this rush to embrace global business practices and management systems. China’s family planning policy, with a consequent focus on educational performance, which is at the heart of Chinese culture, has produced a generation of highly educated, highly motivated and extremely competitive professionals. Grosse and Ling (2015) identified three important themes in their paper titled “Competing in China: Local Firms, Multinationals, and Alliances”. First in order to compete with china’s changing situation, managers need to work on different aspects to enhance and retain their firm’s flexibility and innovativeness. Second the institutional environment in China, from government regulation to the style of doing business, presents some important differences from that in the west; and foreign firms operating in China need to understand these differences. Third, the cultural differences in particular are the key barriers or opportunities for foreign companies to understand and leverage so that they can operate most successfully in China. The principal forms of business open to foreign investors in China are equity joint ventures, cooperative joint venture, wholly foreign owned enterprises, joint stock companies, foreign enterprises, branches of foreign enterprises and so on (Lam, 2012).
References Références Referencias

Doing Business in and with China: The Challenges are Great, but so are the Opportunities

This page is intentionally left blank