

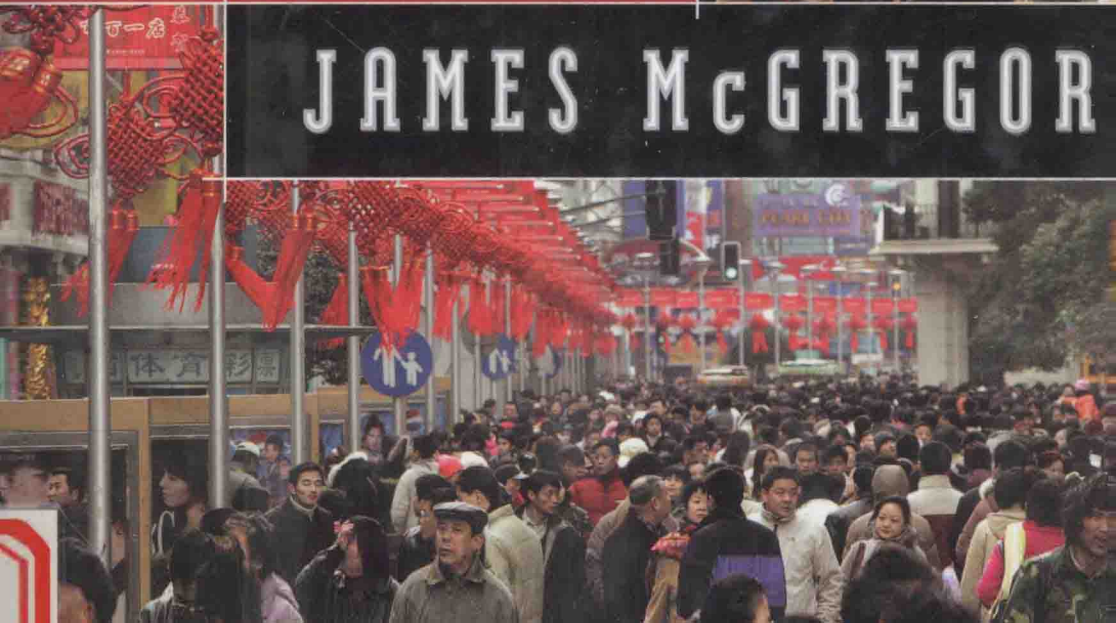


ONE BILLION CUSTOMERS

LESSONS FROM THE
FRONT LINES OF DOING
BUSINESS IN CHINA



JAMES MCGREGOR



One Billion Customers

**Lessons from the Front Lines
of Doing Business in China**

James McGregor

A Wall Street Journal Book

Published by Free Press

New York London Toronto Sydney





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To my family

Cathy, Sally, and Grady

John, Sally, Armando, Bruce, Laura, Donald,

Douglas, Lisa, John, and Mary

Cast of Characters

Chinese Government Officials

Deng Xiaoping The leader of China from 1978 to 1989 who established market-oriented reforms and sparked the ongoing economic boom.

Ding Guangen China's "propaganda czar," director of the Communist party Propaganda Department who controlled the Chinese media throughout the 1990s.

Gao Xiqing A key founder of China's stock markets and longtime senior securities regulator who most recently was vice-chairman of the National Council for Social Security.

Hu Jintao President of China and Communist party boss starting in 2002.

Jiang Zemin President of China and Communist party boss who carried out Deng's reforms from 1989 to 2003.

Li Peng Premier of China from 1987 to 1998 who became the belligerent face of the government during the Tiananmen demonstrations. Despite his reputation as a conservative hardliner, he pushed government acceptance of a 1992 U.S.–China market access agreement that led to China's first significant commercial regulatory reforms.

Long Yongtu Senior Chinese trade official who handled China's negotiations for the country's 2001 entry into the World Trade Organization.

Mao Zedong Chinese Communist revolutionary leader who defeated Chiang Kai-shek in 1949 and led the People's Republic of China from triumph into tragedy. His rule ended with his death in 1976 after the country's economy and social system were destroyed by the Great Leap Forward and the Cultural Revolution.

Shi Guangsheng Minister of trade from 1998 to 2003.

C. H. Tung A shipping company executive who was Hong Kong chief executive after the handover of Hong Kong to China from Britain in 1997. He resigned in 2005 due to deep unpopularity in China and Hong Kong.

Wang Qishan Most recently the mayor of Beijing and formerly president of China Construction Bank from 1994 to 1998. He oversaw the Morgan Stanley joint-venture investment bank, China International Capital Corporation (CICC). The son-in-law of Yao Yilin, who was vice-premier in charge of finance and economics from 1979 to 1993, Wang is also the godfather of China's stock markets.

Wu Jichuan As the minister of the Ministry of Information Industry (and its predecessor, the Ministry of Posts and Telecommunications) from 1993 to 2003, he was known as China's "telecom czar" and architect of the world's largest telephone system.

Wu Yi Most recently vice-premier and health minister who served as trade minister from 1993 to 1997.

Zhao Weichen The first chairman of China Unicom and creator of the "Chinese-Chinese-Foreign" investment structure that gathered more than \$1 billion in investment from international telecom companies without giving away any equity in China's telephone operating system.

Zhao Ziyang The premier of China who was ousted after the Tiananmen Massacre and held under house arrest until he died in 2005. He was the architect of Deng's first wave of reforms and mentor to a generation of Chinese reformers.

Zhou Enlai Mao's right-hand man and longtime premier of China who is credited with working to curb many of Mao's excesses. He died in 1976.

Zhou Xiaochuan Most recently governor of China's central bank, the People's Bank of China, he earlier served as China's top securities regulator and chairman of China Construction Bank.

Zhu Rongji Premier of China from 1998 to 2003 who is credited with designing and implementing the country's most significant financial and economic reforms.

Zou Jiahua The vice-premier of China in the 1990s who served as the key patron of Unicom and advocate for breaking the China Telecom monopoly of China's telephone system.

U.S. and British Government Officials

Charlene Barshefsky The U.S. trade representative from 1997 to 2001 who engineered the U.S.-China agreement that led to China's entry into the WTO.

George H. W. Bush The forty-first president of the United States, from 1989 to 1993, who had served as Nixon's representative in China in 1974–75 and later personally ran China policy from the oval office as president.

George W. Bush The forty-third president of the United States, assuming office in 2001, who initially considered China a second-priority country for the United States in Asia because of its lack of democracy, but befriended China after the September 11, 2001, Al Qaeda attack on the World Trade Center towers and Pentagon.

Bob Cassidy The U.S. trade representative's chief negotiator for China's accession to the WTO.

Warren Christopher The U.S. secretary of state from 1993 to 1997 who was strongly criticized by the American business community while carrying out Clinton's policy of threatening to cancel China's MFN status on human rights grounds.

Bill Clinton The forty-second president of the United States, from 1993 to 2001, who initially threatened to cancel China's "most favored nation" trading status on human rights grounds but soon capitulated and oversaw successful U.S. efforts to bring China into the WTO.

Christopher Cox Republican congressman from California who headed the congressional committee that issued the hyperbolic "Cox report" on China's systematic stealing of American nuclear and military technology, thereby igniting a frenzy of racism against Chinese in America.

Henry Kissinger Nixon's national security adviser and secretary of state who negotiated and engineered Nixon's rapprochement

with China and later became a fixture in U.S.-China political and business relations.

Richard M. Nixon The thirty-seventh president of the United States, from 1969 to 1974, who led U.S.-China rapprochement by traveling to China in 1972.

Chris Patten A British Conservative party leader and the last British governor of Hong Kong who enraged China by pushing democratic reforms in the colony prior to the handover.

Robert Rubin The U.S. secretary of the treasury during the Clinton administration who advised Clinton to reject an agreement for U.S. approval of China's entry into the WTO brought to Washington by Chinese premier Zhu Rongji in April 1999.

Gene Sperling The national economic adviser to President Clinton and the head of the National Economic Council from 1996 to 2000 who also advised Clinton to reject Zhu's proposed WTO deal.

Chinese Businesspeople

Payson Cha Chairman of the Mingly Corporation Ltd. and one of the founders of China International Capital Corporation (CICC).

Fang Fenglei The vice-president of CICC from 1995 to 2000 who was the leader of the Chinese side of the joint venture and steered huge investment banking deals to Goldman Sachs because Morgan Stanley executives failed to take him seriously.

Pan Shiyi The chairman and co-CEO of SOHO China Ltd. who with his wife, Zhang Xin, established a new real-estate development model for China and struggled with blending Eastern and Western management systems in their company.

Tang Shisheng The powerful human resources director of CICC who rejected many of Morgan Stanley's proposed executives.

Wang Boming A founder of China's stock markets who turned to business and is now publisher of the investigative *Caijing* magazine that is setting new standards in Chinese journalism.

Wu Ying A founder of UTStarcom who successfully outmaneuvered China "telecom czar" Wu Jichuan to establish the "Little

Smart” mobile phone technology across China, despite Wu’s disapproval.

Zhang Xin The co-CEO of SOHO China Ltd. who struggled to impose Western management systems in the company, but eventually acceded to her husband’s Chinese management ways.

Levin Zhu The son of Zhu Rongji and most recently head of CICC who turned the enterprise into the equivalent of a well-run state enterprise once Morgan Stanley withdrew from management of the venture.

Zong Qinghou The founder and chairman of the Wahaha Group who built a beverage conglomerate that challenges Pepsi and Coke in China by combining astute politics, clever marketing, and strict Chinese management practices.

U.S. Businesspeople

John Bruns The McDonnell Douglas China hand and troubleshooter in China who handled the export licenses for the machine tools that later led to a federal indictment. He was not implicated in the charges.

Gareth Chang The president of McDonnell Douglas Asia/Pacific who put together the company’s aircraft assembly facility in Shanghai and later headed Hughes Electronics International and oversaw its satellite launches in China.

Bob Hitt McDonnell Douglas production boss who oversaw the assembly of airliners in Shanghai and was indicted by federal prosecutors when Chinese partners diverted machine tools to a military factory. The politically motivated charges were later dropped.

Austin Koenen The third CEO of CICC who was making progress in soothing the company’s culture clash when he died of a sudden heart attack in Beijing in 1998.

Elaine La Roche The fourth CEO of CICC and longtime deputy to Morgan Stanley CEO John Mack.

Edwin Lim The first CEO of CICC and former chief representative for the World Bank in China who produced the first foreign studies of the Chinese economy in the reform era.

Rupert Murdoch The head of News Corp. and media mogul who gained access to the China market and helped modernize China's propaganda machine only after convincing the Communist party that he was interested in making money, not trouble.

Jack Wadsworth The chairman of Morgan Stanley Asia in the 1990s and visionary creator of the joint-venture CICC investment bank with China Construction Bank.

Harrison Young The second CEO of CICC.

Chinese Media

Guo Chaoren The president of Xinhua when the state-controlled news agency attempted to take over the financial data business in China of Dow Jones and Reuters.

Hu Shuli Managing editor of *Caijing* magazine and crusading reporter who has set new standards for watchdog journalism in China.

Liu Changle Founder, chairman, and CEO of Phoenix Satellite Television and media entrepreneur who guided Rupert Murdoch into China.

Wang Wenlian The first director of Xinhua regulatory body, the Foreign Information Administration Center, that monitors foreign news and financial information coming into China.

Yun Yiqun Famous wartime reporter in China and founder and director of several journalism schools who as a political outcast taught Hu Shuli the importance of ethical and responsible journalism.

Historical Figures

Chiang Kai-shek (1887–1975) The Chinese Nationalist leader who fled to Taiwan in 1949 after losing the civil war to Mao Zedong.

Carl Crow (1883–1945) American journalist-turned-businessman and author of *400 Million Customers* published in 1937, who lived in Shanghai for twenty-six years and founded one of the first advertising agencies in China.

Charles George “Chinese” Gordon (1833–1885) A British mercenary and adventurer who led the “Ever Victorious Army” in crushing the Taiping Rebellion for the Qing dynasty.

Emperor Qianlong (1711–1799) The fourth emperor of the Qing dynasty who rebuffed British attempts to open China to foreign trade.

Empress Dowager (1835–1908) Also known as Cixi, a powerful and charismatic imperial concubine who was the de facto ruler of China at the end of the Qing dynasty in the late nineteenth and early twentieth century.

Hong Xiuquan (1814–1864) Leader of the Taiping Rebellion in 1851 who declared himself to be the “Younger Brother of Jesus Christ” and ruled much of southern China for a dozen years.

Li Hongzhang (1823–1901) Chinese official in the Qing dynasty who became the country’s first and foremost barbarian handler.

Lin Zexu (1785–1850) The Chinese commissioner in Canton who was ordered to put an end to the illegal opium trade.

Lord George Macartney (1737–1806) An envoy sent by King George III in 1793 to open China to British trade who was rebuffed by the emperor.

Scholars

Justin Lin Academic entrepreneur who founded the first independent economic research institute in China, the China Center for Economic Research, and Beijing International MBA (BiMBA), one of the first MBA schools in China.

Lucian Pye MIT Sinologist and political psychologist who wrote *Chinese Negotiating Style*.

John Yang A mainland native and Fordham University management professor who is the U.S. dean for the BiMBA school and leading theorist on blending the East and West to build new business management systems in China.

Lai Changxing Case

Lai Changbiao Lai Changxing's brother, accused of running the cigarette smuggling business. He ended up a paraplegic after a bar fight.

Lai Changtu Lai Changxing's brother, who ran the automobile smuggling operation and is serving fifteen years in jail.

Lai Changxing Peasant entrepreneur who built the \$6 billion Yuanhua smuggling empire in partnership with Chinese military and police organizations and went from respected tycoon to China's most-wanted criminal when Premier Zhu Rongji cracked down on smuggling by the Chinese military.

Lai Shuiqiang Lai Changxing's oldest brother who died in prison after convincing thirteen others involved in the case to return to China from overseas and face charges.

Lan Fu Vice-mayor of Xiamen and inveterate gambler who was sentenced to death for taking some \$600,000 in bribes from Lai. His death sentence was commuted to an indeterminate prison term after he assisted prosecutors.

Li Jizhou Close friend to Lai and vice-minister of China's Public Security Bureau who headed China's antismuggling efforts and was sentenced to death after he, his wife, and his daughter received more than \$600,000 from Lai. His death sentence was commuted to an indeterminate prison sentence after he assisted prosecutors.

Yang Qianxian Award-winning chief of Xiamen customs and Communist party secretary for the organization who was sentenced to death for taking \$170,000 in bribes from Lai. His death sentence was commuted to an indeterminate prison term after he assisted prosecutors.

Zhuang Rushun One of Lai's closest friends and deputy chief of the Fujian province police who was sentenced to death for taking bribes from Lai. His death sentence was commuted to an indeterminate prison term after he assisted prosecutors.

Zhu Niuniu Lai's business partner who wrote a seventy-four-page report to authorities, detailing Lai's smuggling operation after Lai refused to help him pay off gambling debts.

Preface

I T SHOULD HAVE BEEN a routine flight from Beijing to the coastal city of Fuzhou. The government-owned airline was new and the airplane was fresh from a foreign factory. But I began to get a sense that this ride wouldn't be entirely routine when I saw how cheerfully untrained our crew was. The flight attendants sat giggling in the front row, eagerly putting together take-home bags of the best food from the extra meals. The cockpit door was open throughout the flight. The flight engineer came back to snooze in the front row.

Finally we began our descent. The lush green countryside, populated by farm huts and pigpens, loomed closer and closer. As the aircraft swung around to line up on the rapidly approaching runway, two of the flight attendants stood behind the pilot and copilot as if surfing the plane onto the runway. Then, with barely fifty feet between us and the rubber-scarred runway, the pilot suddenly jammed the throttles forward. Engines screaming, we began an abrupt climb. Amazingly, neither of the flight attendants toppled over, but they did stumble back to their seats with a look of fright. Up and around we went, once again lining up on the runway. Then I heard the distinctive *eerrrrrrrr* of the landing gear being lowered and felt the shuddering as the wheels entered the airstream. I hadn't noticed any of that on our first approach. So that's why we did the sudden go-around!

I was thinking about how sensible it was to travel by train as I walked into the terminal. Then I saw a propaganda poster on the wall that has since remained firmly in my mind as the perfect description of the transformation China is undergoing: STRIVE TO FLY NORMAL. That is the essence of what China is trying to do: become a normal country, one that is integrated into the world econ-

omy, a place where citizens can concentrate on their prosperity and happiness instead of suffering from political power struggles. Like our novice flight crew, China has spent that past twenty-five years alternately stumbling and soaring through a massive trial-and-error reform process, and so far most of the landings have been smooth.

It is difficult for anyone in the West to overestimate China's growing role in the global economy. With 1.3 billion mouths to feed, its consumer market has the potential to be larger than North America and Western Europe combined. Measured by purchasing power parity, China's current per-capita GDP is \$5,000 and rising steadily each year. It has surpassed Britain as the world's fourth-largest economy. China consumes 25 percent of global steel, 30 percent of cement, and is the world's largest market for electrical appliances. Foreign companies are flocking here, both to sell and to buy. Contracted foreign investment in China now averages \$420 million a day.

Since 1978, when Premier Deng Xiaoping launched a set of economic reforms that included using foreign companies and their capital, technology, and management skills, China has become a manufacturing powerhouse, combining technologically sophisticated factories with energetic, intelligent, and low-cost labor. But China has allowed foreigners in only on its own terms, and those terms are often opaque, contradictory, and bewildering. All too often, laws are only the law when they benefit China. Negotiations can take forever and the resulting agreements can be promptly ignored. Corruption is frequently the lubricant that greases the wheels of commerce. Business in China has always been conducted behind multiple curtains and amid much subterfuge, and that hasn't changed. Foreign companies rightly fear that Chinese partners, customers, or suppliers will steal their technology or trade secrets or simply pick their pockets. Testy relations between China's Communist leaders and the United States and other democracies requires that politics be an integral part of business plans. China's entry into the World Trade Organization in 2001 and the country's desire to transform local companies into global leaders is bringing

more international practices into China by the day. But I still see foreign executives confidently breeze into China only to be run over by their Chinese competitors, the Chinese government, or their Chinese partners—or sink themselves through various combinations of unrealistic expectations, impatience, and lack of common sense. The more business in China changes, the more it stays the same. As a journalist, I have traveled the entire country and enjoyed a front-row seat for this historic drama. As a businessman, I've been involved in the power plays, the complex negotiations, and the political intrigues that are a routine part of doing business in the country.

This book is intended to show rather than tell what it is like to do business in China. There are no simple formulas or magic solutions. Only by showing the sometimes complex details of how certain deals came together or fell apart, how the people involved viewed and treated each other, how politics and prejudices tainted expectations and outcomes, will I be able to convey to you the nuances that have made China such a frustrating yet rewarding place for so many foreign businesses. Each chapter begins with a simple introduction of the characters and situation. Next, in an overview section, I put the characters and situation in their proper context. The story then unfolds as a straightforward narrative. At the end, in a section entitled “What This Means for You,” I explain how what happened in this chapter can affect how you do business in China. Finally, I summarize—pithily, I hope—many of my own observations in a takeoff on Mao's Little Red Book.

Demographers may quibble with the title: China's current population is 1.3 billion. But it is the round “billion” that matters, that threshold number that symbolizes the vast and untapped continental-size market, the teeming Chinese masses waiting to be turned into customers, the dream of staggering profits for those who get here first, the hype and hope that has mesmerized foreign merchants and traders for centuries. The title is my tribute to another American journalist-turned-businessman, Carl Crow, who lived in Shanghai for twenty-six years and in 1937 wrote *400 Million Customers*,

a rich trove of anecdotes and insights about the Chinese people and doing business in China, much of which still holds true today. I share Crow's deep respect and admiration for, as he put it, "the interesting, exasperating, puzzling, and, almost always, lovable Chinese people." My goal for this book is to also share Crow's ability to convey timeless insights and commonsense lessons about Chinese business practices, and the deeply ingrained thinking and behavior patterns of Chinese people, through a combination of scholarship, grassroots experience, lively narrative, and good humor that transports the reader deep into the China business world.

Please enjoy the journey.

James McGregor
Beijing, 2005

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