

Doing business in **CHINA**

THE REALITIES OF

Thinking of outsourcing to China? Then think carefully. It's a land of opportunity, alright, but go in with your eyes wide open, says China Consulting analyst Udani Eriyagolla

Are the perceived benefits of lower labour costs, highly skilled and numerous workers enough to tempt you to grow your business in China?

India used to be the home of outsourcing for western companies looking to keep costs down and profits high, but increasingly it's being sidelined. So are you ready for the land of the Dragon?

MOVING MANUFACTURING

Until very recently, outsourcing was only relevant for large companies where economies of scale made manufacturing in China realistic. Now, however, with an increased understanding of the situation and better communication, even smaller companies can move parts of their production.

Many manufacturers specialise in OEM (original equipment manufacture), where the retailer's logo or brand can be added to a homogenous product. Even for retailer-specific products, it is becoming easy

for manufacturers to make high-quality goods in smaller runs at a cheaper cost than expected.

Undoubtedly, low labour costs and a huge supply of workers is a key pull factor to moving eastward. The cost of low-level labour is between 10% to 15% lower in China than India. However, Sudip Banerjee, of Indian IT company Wipro, told CNET news that management-level Chinese people are actually up to 25% more expensive than their Indian counterparts.

Another factor to consider is the cost of shipping to the desired market destination from China. This should be viewed in actual monetary terms, and also from a time perspective. Take, for example, clothing manufacturing, an industry subject to fickle and ever-changing fashion trends. By the time the product has been made and shipped, the trend may have passed and the product will lie wasted in warehouses. What's more, at key times of the year for retailers - Christmas, for example - it may

be impossible to find shipping space to get your goods to the market in time.

It's also crucial to find the right Chinese partner when moving production there. The marketplace is fragmented in terms of geography and operating companies. Smaller companies are plentiful, and while they may be cheaper, they bring along greater risk. The size of the project needs to fit with the capabilities of the Chinese partner.

When choosing a service provider, a company with an import and export licence must be selected, and these tend to be larger companies. However, it is also possible to find a smaller firm that may be able to manufacture at a lower cost, and then find a company with an import/export licence to act solely for this purpose.

OUTSOURCING OTHER SERVICES

There are a number of factors to consider when deciding whether to outsource other (non-manufacturing) services to China.

Improving English skills is a high priority for the Chinese Government. Children start to learn from the age of seven, but current English standards are considerably varied. It is generally perceived that standards have improved dramatically at management level, but essential tasks such as the translation of brochures or instructions on products is still left to amateurs. Even on a higher level, those making key decisions may not have good English. It is worth ensuring that translators are employed and it is essential that all contracts are in English and Chinese.

There are millions of Chinese students graduating each year, and the competition to employ the best is fierce. They are highly skilled, hard-working and intelligent. However, because the growth of the market economy is relatively new in global terms, particularly in sectors such as IT outsourcing, there is a certain lack of experience that must be overcome.

Although the Chinese workforce will adapt to needs of the job market quickly, the westerner looking to outsource must still be aware that there may be a premium to pay for certain skills, and that skilled graduates are not available all over China.

Moving manufacturing to the interior of Guangdong province, on China's south coast, may be the cheapest option for production, but you may be unable to find competent English-speaking managers outside Beijing and Shanghai.

Other issues that need a great deal of thought and preparation include staff training, retention and cultural differences. China is at a turbulent stage in its growth, not only economically, but also culturally and developmentally. Skilled graduates are unsure whether to back national Chinese-owned companies for a smaller wage, or earn more at a western enterprise. These are not issues you can control, but you need to be aware of them.

THE CHINESE IN YOUR SUPPLY CHAIN

It is very important when dealing with the Chinese that strong relationships are made. *Guanxi*, loosely translated as connections, are a central part of Chinese business cul-



ture. The relationships will be formed over lavish banquets, often involving a lot of drinking. Once *guanxi* are made, they do not go out of date. However, be aware of the favours you accept as you will be expected to repay them at some stage.

In the backdrop to all decisions of outsourcing is the legal environment in China, particularly protection of intellectual property rights (IPR). China has enacted a number of statutes covering trademark, copyright and patent laws, but the reality of intellectual property is somewhat different. First, the idea of intellectual property as something to protect is not something that sits naturally in the Chinese mindset. This can be seen by the vast array of counterfeit goods on sale on China's streets and in its markets. Beijing has seen recent crackdowns on fake DVDs, but there is still a problem.


Second, although in recent years there have been advancements towards upholding the law in the same way as we do in the west, the influence of local officials and their interests in the judicial process commonly results in skewed judgments. The best thing is, therefore, to ensure that there is some kind of IPR infringement protection prior to moving to China.

Furthermore, once in China you need to ensure that offshore employees are clear of the consequences of such an

infringement. Employing a number of factories in the assembly of a product will ensure that no one facility can know the make-up of the whole item and therefore lessen the ability of the Chinese partner to infringe any IPR.

Interaction with China undoubtedly offers great rewards for western businesses, but processes should not be hurried. It is essential to choose the right partner for manufacturing, sourcing or other services.

Frequent visits in the lead up to the deal are important, and a strong understanding of the culture is also recommended. One solution is to consider hiring a western intermediary to handle interactions with the Chinese counterpart. This can result in many advantages for the parent company, such as lower costs, greater reliability and increased protection against copyright infringement.

China is undoubtedly a challenge, but it is one that the ambitious and insightful entrepreneur should embrace rather than ignore. 

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