

Multinational Companies And The Prism Of Chinese Development

PART ONE



In March this year, China's National People's Congress approved the termination of a significant form of preferential tax treatment for foreign companies, rolling back an arrangement of more than two decades that had allowed them to pay around 40% less income tax in China than domestic enterprises, as an incentive to invest. Chinese authorities made it abundantly clear that as part of a strategy to increase the overall "quality" of foreign investment - and to steer it with more specificity in certain directions - they will still offer tax breaks for foreign investment and participation in projects in key focus areas such as environmental protection, agriculture, water conservation, work safety, high-technology and public welfare, as well as in China's poorer central and western regions. But the blanket tax breaks for all foreign investment are gone. The move was applauded by domestic stakeholders who have agitated for years to remove perks for foreign investors, even as government spokespeople reassured foreign firms that China favors them still, if not quite so much. Meanwhile, in April a global investment giant was declined permission to invest in a growing urban commercial bank reportedly because it was not perceived to be "adding value". In the same month, a major foreign bank saw the domestic bank it had invested in reclassified as a "significant state-owned bank" or an "integral state asset that cannot be controlled by foreign interests". Then in May, China's National Development and Reform Commission released a 5-Year Plan to accelerate "domestic high-tech development" and "autonomous innovation" in part by favoring purchases of "local technology" over technology developed by "foreign" companies.

What prompted all this? Why now? And what does it mean going forward?

Instruments and Impediments – The Double Edged Sword of Foreign Investment

Consider this: Many Chinese stakeholders still view multinational companies (MNCs) principally as instruments of China's development. At the same time – and from myriad aspects - Chinese stakeholders increasingly see MNCs as impediments to China's development in its current phase.

This issue of **CHINA PERSPECTIVE** looks at the role of foreign multinational companies in China's development and the need for a sophisticated understanding to drive business success.

Part One

Instruments and Impediments
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The Next Installment - Part Two

Part Two of this article will look in more detail at the "Market Access for Money, Technology and Expertise Bargain" struck with foreign capital at the beginning of the Opening and Reform and how it is still fundamentally important today.

In China business, as in life, it's important how you look at things. And it's crucial for MNCs refining their China strategy to understand the competing, often seemingly contradictory and conflicting, views of MNCs among Chinese stakeholders, and the ways those views can shape decisions that affect the business environment.

One way to understand what's going on is to realize that Chinese leaders have, in recent years, been putting foreign investors under a microscope, carefully reevaluating and scrutinizing the role of foreign direct investment (FDI) and MNCs as part of an overall reevaluation and recalibration of China's approach to development. This detailed reevaluation has been prompted by macro-level concerns related to China's uneven success - such as growing gaps between rich and poor, rural and urban, economic and environmental goals, as well as by concerns about continuing foreign dominance in certain sectors. It was and also continues to be prompted by China's progress in certain aspects of development - such as in developing its own MNCs and the country's move up the industrial value chain. Indeed, with increased self-reliance and burgeoning domestic capital reserves, in some ways China values foreign investment less. Simply put, Chinese are looking at foreign investment differently now. Things are more complicated. In fact, as China's needs and expectations grow more complex, Chinese stakeholders are looking at MNCs increasingly through the lenses of a range of complex new requirements, adding up to more fractured and fragmented images of MNCs.

From one perspective MNCs are seen to have played a key role in China's export-driven growth since the beginning of the Opening and Reform policy. From another, they are seen by some to have benefited disproportionately from China's growth, and to have not lived up to their end of the "market for money and technology" bargain China struck back in the 1970s, granting MNCs the right to operate in the world's most populous country and its potentially largest market in exchange for capital, technology, and expertise. By contrast, and despite a host of preferential measures favoring MNC technology transfer, many Chinese see MNCs as treating China primarily as a base for sales and a source of cheap labor and raw materials. Others criticize MNCs for allegedly transferring and exporting pollution from developed countries to China. From one perspective, the spate of foreign R&D centers announced in recent years are seen to be good for China's innovation strategy, from another they are seen to perpetuate the dominance of foreign companies and to result in an "internal brain-drain". And so on, and so on.

To some extent, the point is not whether these are fair assessments or claims. At least that is not the point of this article (there are indeed many well-known counter claims and arguments that can be leveled in the other direction). The reality is that this is how many Chinese see things. And those perceptions shape the evolving environment for MNCs, whether you like it or not. The key is to understand why. We know this because we are constantly researching, analyzing and advising on these issues, and because 90% of our team in China is Chinese.

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Exacerbating concerns is the intense focus on parity between MNC and Chinese firms brought by China's World Trade Organization (WTO) accession, under the rubric of "national treatment." As WTO accession has led to lower tariffs and compulsory roll-back of restrictions on FDI and protection for Chinese firms, Chinese voices have increasingly - and ultimately successfully - called for a parallel roll-back of preferential treatment for MNCs. In this light, the ending of preferential MNC tax policies can be viewed together with the proposed anti-monopoly law (intended to curb allegedly monopolistic practices by certain MNCs), and with government procurement policies favoring local companies, new restrictions on foreign acquisition of Chinese assets, and government support for "home-grown" technology standards and innovation. All are part of a "balancing act" seeking to ensure that "parity" under WTO national treatment rules is at least as fair to Chinese firms as to MNCs - if not more so.

Increasingly mixed and complicated images of MNCs have also played a part in the seemingly unprecedented number of major crises for MNCs in recent years. Rising scrutiny of and ambivalence towards MNCs has been a key factor in issues ranging from labor rights to official corruption, environmental degradation and product safety - all of which have collectively, in turn, further fueled ambivalence toward MNCs.

The overarching allegation is often that MNCs themselves apply “double-standards” in China. This has contributed to what has been heralded as a crisis of trust in MNCs. Some would argue vehemently that the ‘double standards’ apply both ways, with Chinese stakeholders targeting leading MNCs for singular criticism, while local companies are seen to benefit from various forms of veiled protectionism. This stance too depends on your perspective, and is similarly subject to distortion and exaggeration.

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Increasingly complicated and sometimes contradictory, these images and concerns undoubtedly influence:

- Chinese public policy and regulation affecting foreign business
- Purchases of foreign goods and services, foreign business, technology and investment approvals and decisions to partner or collaborate with foreign companies
- Corporate reputation for foreign companies in China
- Evolving Chinese stakeholder expectations of MNC corporate responsibility that go much deeper than simple corporate philanthropy, codes of conduct and alike

The lenses through which Chinese stakeholders view MNCs, therefore, have enormous implications for MNC success or failure in what many view as the world’s key growth market. Companies seen as instruments of or supportive of China’s development efforts and goals stand to gain, while those viewed as impediments will suffer the consequences. Yet for MNCs in China today, achieving a win-win strategy viewed as positive for both China and the MNC – in other words, assuaging local concerns - is perhaps more challenging than ever before. China has raised the bar, with much more emphasis on the intangible “quality” of foreign investment. With two trillion dollars in foreign exchange reserves expected by 2008 (accumulated via those decades of rapid growth), a drive to continue moving up the industrial value chain (from “made in China” to “created in China”), and an agenda to address the ills of over-rapid development, China is choosier about FDI than ever before. How can MNC leaders thrive and adapt in this situation? How should they look at things?

The Developmental Prism - A Sophisticated Understanding of China Business Imperatives

Now more than ever, anyone who wants to play a leading role at an MNC in and in relation to China must have a sophisticated understanding of China’s ever-more complex business and public policy landscape.

And when we say leader, we don’t just mean CEOs and Presidents, we mean anyone who has a position of leadership in and in relation to China - whether it be a functional role or operational, whether in China or at other levels. Indeed, companies cannot afford to rely on top leadership only to have this sensitivity and sophistication (as in our experience many top country, regional and global MNC leaders do). Indeed, major problems often arise because the levels further below do not possess the same understanding, and/or because there are operational silos that contribute to decisions with unforeseen consequences.

This then requires a leader who can both identify risks and opportunities for the company in being perceived as impediments to or instruments of China’s development, and then ensure those insights are reflected in company strategy and decision-making.

Maintaining and gaining that sort of sophistication requires moving beyond too often simplistic and outdated images of China’s needs and goals. MNC leaders cannot afford to view China, and their company’s opportunities in China, through the singular, simplistic development lens of the past, in which contribution to China’s GDP and export growth rate was considered sufficient by many (we recognize that some enlightened companies have moved beyond this or indeed came into China with more sophisticated thinking in the first place). So, how can corporate leaders gain and maintain a more nuanced and strategic understanding?

First, MNC leaders must remember that development is always a multifaceted and evolving process, involving a spectrum of factors and phases. As development guru Jeffrey Sachs puts it, each country's approach to development must be continuously calibrated based on evolving national and global socio-economic, geo-political, environmental, technological and other dynamics. China's capacity to innovate, access and utilize resources and energy, manage health and education systems for a huge population, balance growth in exports and infrastructure, tax systems and capital markets, savings and consumption rates, and many other factors are all facets of the classic struggle to move from a developing to a developed country. And the role of MNCs in China can – and should – be understood in light of all these various factors.

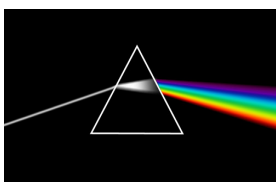
Second, MNC leaders must understand China's development struggle as unique to her own culture at this specific historical moment. Thus for instance the current administration's stress on "harmonious" development and society invokes traditional Chinese concepts of balance and order between people and nature, commerce and intellect, to highlight China's need to develop human, knowledge, institutional, natural/environmental and infrastructure capital, as well as financial success. Similarly, the heritage of Chinese Marxist ideas on science echoes in current themes of a scientific approach to development, broadening and refining the gradualism, pragmatism experimentation of the initial "Opening and Reform" era (even if many Chinese view the "scientific approach" as a means to incorporate the experiences of capitalist developed countries). In fact, in some ways today's emphasis on "balancing" GDP growth with human needs represents mainly a shift in priorities, a sequencing of reforms. China's development strategy was always to grow first economically, then develop in other areas. Based on various factors and major pressures, today's leaders have simply decided that the time to broaden the agenda is now.

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Third, MNC leaders need insight into the spectrum of geographic, demographic, and macro-economic challenges still facing China, many of them exacerbated by uneven growth. By 2020, China aims for major progress in health care, public health, education, infrastructure, the environment, and greater energy/resource efficiencies and security, as well as developing more China-based MNCs and global brands, consolidating certain industries, and doubling the average annual income of its citizens – yet even then China does not expect to attain developed country status by 2020. China's situation, then, is not Brazil's or India's, let alone that of Japan, Korea or the United States (even at earlier phases of their development). And MNC leaders need to seek to see and analyze the complex spectrum of development factors in China in their own light.

In sum, MNC leaders need to avoid oversimplifying their China focus. They need to see and understand the spectrum of complex challenges that China faces, in order to find their own place, to be part of the solution. In other words, differentiated corporate leadership in China today requires jettisoning the simple lenses that may have been used in the past in favor of a sophisticated prism of Chinese development, refracting and illuminating the full spectrum of China's growth, all the potential areas of alignment for the company, and the various instruments and impediments the company may pose - at a given point in time, and with an eye to the future.

Metaphorically speaking, the development prism illuminates the company and its actions in terms of social, technological, environmental, or economic dynamics, its actual or potential role in infrastructure, education, rural and regional development, local industry enablement, and resource/energy security - in light of evolving local priorities and expectations.



A prism in optics is a piece of translucent glass or crystal that forms a spectrum of light separated according to colors - like in a rainbow - from a projection of a single beam of white light. A development prism delineates all the various aspects and components of development so as to better understand the risks/opportunities for MNC alignment.

Take just a single example: a corporate decision as to whether or not to pursue an IPR lawsuit against a Chinese company believed to have copied the MNC's products or intellectual property. The simple answer in a developed country would be to sue, sue, sue. And indeed, after review via the developmental prism, a company may well still decide to proceed with a lawsuit, perhaps supported by a phased, knowledge-driven public affairs strategy to help allay stakeholder concerns and legitimize the case in the court of Chinese public opinion (remembering that Chinese traditionally view lawsuits differently than westerners). Scrutinizing the decision in light of impacts on China's industry growth, brands and innovation strategies, and the rest of China's spectrum of developmental goals will help the MNC understand all possible ramifications of the lawsuit (due to perceived conflicts with Chinese stakeholders and aspirations), and calibrate its approach accordingly. In the final analysis even MNCs with legitimate grievances might choose "collaborative" or "less adversarial" approaches to IPR issues, given the trade-offs of potential damage to local reputation/relationships in a nation where "generous gestures" and "understanding of challenges" can help allay fears of "monopolistic practices" and "inordinate market power". Like it or not, these perceptions form part of the reality facing MNCs, and this "developing country perspective" is ignored at the MNC's peril.

Again: a company looking to build a new facility in China may after review via the developmental prism decide that it make sense to do so in the north-east, in support of China's efforts to revitalize that part of the country. It may well be that higher training costs and infrastructure challenges will be overbalanced by the "good-will" credit earned from this effort, supporting the firm's China-wide business growth, to say nothing of the preferential government policies from which it will benefit. These are just two among an endless spectrum of examples.

And let's be clear before we move on - we are not suggesting that companies either roll over to every Chinese demand, or sacrifice principle to pragmatism via Machiavellian pretenses of support for China's goals. Rather, we believe that principled leadership demands careful balancing between the needs of the MNC and the needs of China. Achieving that balance requires precisely the sort of sophistication we are advocating. It also supports sustainable success, enhancing the competitive context for the company.

Developmental Prism and China's National Mission

At a certain level, one way of understanding what is happening in China today is to understand that her leaders, too, view and understand China through a complex developmental prism. Indeed, development has been China's number one goal from the start of the Opening and Reform period. After three decades of the world's fastest continuous GDP growth, China's leaders as much as ever consider development - and eventually attaining developed country status - to be the national mission. For many Chinese, sharing a strong sense of historical mission and intense national pride, all other considerations remain secondary. That is widely understood to have been Deng Xiaoping's view when launching China's Opening and Reform policy in 1978, and again on his "Southern Tour" of 1992, galvanizing continued reforms following the collapse of the Soviet Union. Deng and his policies favored an intense, singular focus on economic development and China's GDP explosion was the result.

Deng Xiaoping's policies opened the door to foreign investment and manifested a "development first" approach. His slogans such as "it does not matter whether the cat is black or white as long as it catches mice", and "to cross the river by feeling the stones" still resonate strongly today as China adjusts and calibrates its approach to development, based on pragmatism, gradualism and experimentation.

The difference today lies not in any devaluation of development as China's #1 goal. Rather, today's leaders have broadened the spectrum of issues seen as crucial to balanced national growth and development. In other words, they now prioritize more holistic development - because the country has attained a certain level of economic success, and because of the negative by-products of rapid economic growth (environmental impacts, social tensions over disparities, resource shortages etc). "Quality of life" factors count more than in the past in relation to GDP, because the leadership feels they can afford to, and because in some ways, given shifting political dynamics in China, they have little choice.

It needs to be understood that being perceived as opposing or being “misaligned” with key aspects of China’s developmental goals can greatly limit MNC opportunities for business success with local customers, employees, partners, distributors, governments, and other stakeholders, as many have learned the hard way in recent years.

This selection of facts gives just a hint of the massive challenges and issues China still faces on the road to development and of the new challenges brought about by its uneven success. Indeed, the challenges facing China as it develops are in many ways unprecedented.

Did you know?	
That:	Yet, even so...
Since 1978, China has had the world’s most successful economy, with 9% + average annual GDP growth (last year it was around 11%).	60% of Chinese cities face water shortages, 70% of its rivers are polluted, acid rain causes major health and economic impacts and is so bad in some places that rainwater has the same PH as vinegar, while thousands of protests occur each year related to pollution and environmental issues.
Since 1978, China’s average life expectancy has risen by 7 years to around 71 today (average life expectancy was just 41 years in 1949 when the Communist Party took power).	Gaps between urban and rural health are growing. In 1981, rural areas had 1.7x the infant mortality of urban areas. By 2000 that figure was 2.8x. Today in China, relative rural life expectancies are declining.
China’s largest cities now boast world-class health care facilities, with walking MRIs, scanning electron microscopes, and all the other accoutrements of modern medicine, as well as top doctors, many with training abroad as well as in China.	Quality health care is unaffordable to many Chinese (especially in rural areas). In part for this reason, Chinese save huge proportions of their income out of concern for the future, keeping China reliant on exports and FDI to fuel and sustain growth
Since 1978, China has lifted more people from absolute poverty, faster, than any other nation in history; with estimates of China’s “middle class” ranging from 25 million to hundreds of millions (depending on the criteria used), and some predicting 80% of urban Chinese will be “middle class” by 2015, to the delight of major international brands among others	Income for China’s 800 million farmers averages just US\$468/year. In 1981, workers in China’s 5 poorest provinces earned on average Y3,719RMB/year less than people in the 5 richest provinces; by 2004 that gap was Y20,188. Migrant workers often work 14-16 hour days in coastal factories despite legal limits, while thousands die each year in coal mining accidents in China’s 15,000 + small and unsafe coal mines.
China’s top cities face growing shortages of skilled talent with wages rising rapidly – stunning some MNCs that see China as a source of “cheap human resources”	Unemployment among less-skilled workers is huge & growing; estimates show 10M vacancies for 25M white collar applicants in 2007, & the “floating population” of unskilled migrant workers tops 160M.
Since 1978 China has developed home-grown multinational companies which are on the rise in many industries, from energy to semiconductors.	Chinese MNCs feel “blocked” by global MNCs in areas ranging from oil rights to intellectual property (some 80% of the value-added in China’s computer exports, goes to global MNC licensing fees), and seek help from Beijing to create “space to grow.”
China took 15 years to move from a cumulative total of 400K patent applications to a total of 1 million; 4 years to move from 1M to 2M; and just 3 years to go from 2M to 3M. In 2002 China ranked 13th in the world in new patents applied for that year; by 2005 China ranked 4th in the world.	To date China’s share of world patents remains small, and many China-issued patents remain beholden to foreign JV investors (one survey ranked just a single wholly Chinese-owned firm (Huawei) among China’s top 10 patent issuers). IP protection and tech standards remain top hot-button issues.

Source: The above statistics are from a variety of sources including the Chinese Government, the World Bank, the Asian Development Bank and related development literature.

The Developmental Prism: A Corporate Leadership Challenge

For MNCs, the challenge is to make understanding across the developmental spectrum – review via the developmental prism – integral to China leadership (leadership in and in relation to China at various levels of the company). Despite a boom in development-related topics at global forums from Davos to the Boao Forum for Asia and continuing globalization of business, too many MNCs still rely heavily on executives at various levels of leadership whose understanding of the developing world is relatively limited. Greater corporate focus is needed to break through the insular viewpoints that can form in the stable developed world, to understand the dynamism and range of factors that development, especially in China, involves. In other words, while most MNCs need no reminding that China's continuing growth is key to their own, they must also remember that contributing to China's development is now as much as or more than ever part of the price of admission, the license to operate. And as we said, the bar has been raised.

Today, MNCs that require differentiated leadership and business strategies in China – which means all MNCs that mean to succeed in China – need:

- Win-win approaches that align with China's evolving development agenda
- Knowledge-driven issues management when there is a real or perceived misalignment
- Understanding of the state of play in development economics and theory, of the substantive differences between developed and developing countries, and between China and other developing countries
- Continuously updated understanding of where China is and wants to be on the road to development both in relation to specific aspects of development and overall
- Stakeholder mapping and public policy analysis on specific development issues, policy frameworks and regulations
- Analysis and tracking of evolving Chinese and international stakeholder expectations of foreign companies, in development terms
- Articulation of the company's value proposition and relevance to the evolving Chinese development agenda, in both qualitative and quantitative terms
- Dialogue, engagement and collaboration with the development community and related government stakeholders in order to build understanding and trust, and to improve organizational intelligence and decision making

And to answer the concerns that some may have after reading this, that they have a business to run, not a development agency: we say that if you want the right to operate and profit in this market over the long-term, and you want to beat and differentiate from your competition – then you have no option but to view China and your business using the prism of Chinese development. This by no means implies you should forsake business imperatives – indeed, this is one.

– Douglas Dew, Practice Leader, Public Affairs Practice, Burson-Marsteller China
with Rebecca Weiner, Senior Consultant

About CHINA PERSPECTIVE

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