

# DOING BUSINESS IN CHINA

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## BUSINESS IN CHINA

China's recent entry into the World Trade Organization (WTO) opened many viable, unsaturated markets for foreign investment. In fact, World Bank predicts that Mainland China will be the world's second largest trading entity within twenty years. In 2002, Financial Secretary Antony Leung noted that China is a robust country with consistent economic growth of 7-8% per year, stable currency, a well-performing manufacturing base and a growing domestic market (Government of Hong Kong, 2002). While considering entry into China, it will be important to explore the history of the country; the political, social and business climate; and the economy. Such exploration will provide sound information to determine the feasibility of opening a business in China; will help to identify barriers to entry; and will help in the development of a sound strategy for building a flourishing business in China.

## History of the Country

The history of China is a complex topic that could not possibly be fully covered in a report of this nature; so the following is a condensed overview of significant historical events in the development of modern China as we know it. There are three phases in modern history that have shaped the country. First was the founding of the Qing Dynasty that occurred after the Manchus took over China in 1644. During the era of the Qing Dynasty, from 1644 to 1911, the arts and culture flourished significantly, but the country was plagued with corruption. Foreign policy was oppositional, to say the least, and the country was plagued by the Opium Wars. In the mid-1800s, rebellion arose and there was a steady decentralization of power and unequal treaties existed along with government regulations that greatly restricted international trade. In 1911, the dynasty collapsed and chaos began (Frankenstein, 2004).

The country became a bit more cooperative with the world during World War I; however, the Treaty of Versailles of 1919 ended the war, but a provision of the peace treaty handed China to Japan rather than restoring its sovereignty. This prompted a massive cultural movement known as the "May Fourth Movement" (Wikipedia, 2004). The movement prompted the spread of Marxism through China which built the foundation of the Communist Party of China and marked the beginning of the New Democratic Revolution. As a result, China became somewhat divided with fascism and Leninism (Wikipedia, 2004). In the early 1920s, there was an effort to reunite China, but when the leader of the effort died, conflict between Communists and Nationalists continued (Frankenstein, 2004). Japan invaded China prior to the start of World War II. After the war, the conflict between the Communists and Nationalists started up full force again. In 1949, the People's Republic of China was created and by 1962, China had begun to establish itself as a superpower, but that progression was somewhat halted by the emergence of the Great Proletarian Cultural Revolution which was Mao Zedong's attempt to alleviate his political rivals (Frankenstein, 2004). Economic stagnation was a result and education was negatively impacted as well (Wikipedia, 2004). After Mao's death, Deng Xiaoping emerged as a leader and launched an economic reform program. As a result of his negotiations with Britain, Hong Kong was handed back over to China. Economic reforms continued as did the attempts at political reform which led to the Tiananmen Square protests (Frankenstein, 2004). These protests were centered on disagreements between the Chinese Democracy Movement and the Communist Party of China. As a result, a great number of unarmed protestors were slain by military troops. As a result, Ziyang, the then leader, was placed under house arrest (Wikipedia, 2004). Jiang Zemin replaced Ziyang and the 1990s were an era of recovery for the country and between 1990 and 2000, the economy grew at an average of 9.7% per year. Mainland China was comparatively unaffected by the Asian Financial Crisis. Although global trade was somewhat stagnated, China's trade grew by 18% in 2002 with foreign direct investment



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(FDI) growing by 22.6%. The political climate began to stabilize some as well and economic reforms and structural changes continue today (Wikipedia, 2004).

## The Political Structure and Climate

The government of the People's Republic of China is a one-party rule by the Chinese Communist Party (CCP) consisting of a state council approved by the National People's Congress (NPC). The country has many long standing political parties (China in Brief, 2003).

Historically, Chinese politics have been plagued by corruption. This seems to be somewhat under control now; however, in my visit to China, I observed that in regard to business, connections are very important - predominantly connections with government officials. Wining and dining government officials is a common public relations tactic in China and companies that I visited specifically pointed out the importance of having relationships with those on the "inside" - especially to facilitate expedited processing of paperwork and applications.

The importance of networking with government officials is paramount for foreign firms entering the marketplace because bureaucrats and government officials have immense influence in regard to economic development and close ties to them have proven to gain tax breaks and access to well-educated personnel. Failure to network with government officials and bureaucrats can cause barriers, including legal barriers, as well as delays (Kanellos, 2002).

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## The Social Climate

Social issues in China are somewhat profound including major concerns for religious freedom, AIDS, drugs, organized crime, infanticide, family planning, censorship and prisons (CNN, 2001). Through observation during my visit, I learned about the some social issues including societal differences and language barriers.

In 2000, Chinese authorities implemented some rules that govern the religious activities of foreigners and forbid them from "expounding the Scriptures" at unofficial churches (Christianity Today, 2000). This could be of concern to some foreign firms and entrepreneurs setting up shop in China. China's constitution calls for religious freedom - meaning the freedom to believe or not believe - but the government attempts to regulate religious practices restricting them to government sanctioned organizations and registered places of worship. These restrictions are thought to be for the purpose of controlling the growth and scope of religious activities (US Department of State, 2002).



In 2001, the government of China emerged from denial and suppression and recognized that country faces a serious AIDS crisis. Since most infections have been linked to intravenous drug use and transfusions safety practices have been implemented. Additionally, the government has begun to encourage the media to provide accurate information on the epidemic and to educate the public (Avert, 2004). Public policy has been implemented targeting marginalized groups such as

prostitutes, IV drug users and homosexuals; however, broad education efforts seem to be curbed by economic and social limitations (Seidman, 2001).

Drugs and organized crime are nothing new to China. It's even been referred to as a "narcotic culture" and is well known for its fight against Britain's influx of opium into the country during the Opium Wars (Dikotter, 2004). The country managed to curb the opium problem in the 50s when the People's Republic was established; however, they were unable to escape the escalation of world wide drug abuse and was quite overcome by the problem in the 80s. Extreme drug trafficking led to a rapid growth of drug addicts forcing the government to take action. The National Narcotics Control Commission moved to set up research and treatment centers and to provide guidelines

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for drug control. The Ministry of Public Health started working toward the development of detoxification drugs for use in clinics and health education campaigns are part of the crackdown on trafficking and drug use. The country is also active in international drug control and is a member of the Commission on Narcotic Drugs of the Economic and Social Council of the United Nations as well as participating in the International Narcotic Control board (N.A., 2004).

Drug trafficking, gun-running, smuggling, illegal gambling, extortion, prostitution, illegal immigration, piracy and fraud are among the choice activities of organized crime rings in China. Secret societies in China, referred to as "Triads" have flourished since the social culture of China changed in the late 70s. Relaxation of government controls, economic booms and official corruption are some factors the problem is attributed to (CNN, 2004).

The practice of infanticide in China is well known as being attributed to the traditional preference of male children by the Chinese and the government's one-child policy that was part of their population control initiatives which led to vast infanticide of female babies. After the Communist Party seized control in 1949, the practice was eradicated due to strict punishments, but in the census in the 80s showed that thousands of baby girls were missing each year. This has led to concern of an unbalanced male/female ratio in China which is certainly a threat to the population as men are having difficulty finding wives (CNN, 2004).

In September 2002, a family planning law took effect in China. The family planning policy steers away from the one-child policy in some respects, but actually rewards families who stick to the one-child policy. In urban areas where boys are needed in a family, the family can apply for permission to have a second child if their first child is a girl. Birth policies are also set by provinces and can vary from one province to the next depending on local conditions (China Internet Information Center, 2002).



Censorship of the media in China is of concern and is believed in some cases to be covering or contributing to human rights violations (Pruitt, 2004). In recent years, there has been emerging concern about abuse in Chinese prisons and labor camps. At least 1,100 prison camps existed and were used primarily to repress, control and eliminate those whose religious and political views differed from that of the Communist Party. The harvesting of organs from those put to death in such prisons was a common form of profit for the government for many years (Wu, 2001). Prison overcrowding was also a problem in China which prompted the construction of bigger and more modern prisons throughout the country (Hui, 2004).

In my visit to China, I found that Beijing is somewhat of an old money culture characterized by vast multinationals that have been there for several years. Shanghai, on the other hand, is new money. It is marked with a lot of start-ups and investment banks. The city has grown remarkably over the last eight years, but at a cost. Many families have been forced to leave their homes without compensation in order to allow for urban development.

## The Business Climate and Economic Outlook

The business climate and economic outlook for China is good. Although there were setbacks in the 60s and 70s, economic growth has been tremendous since the economic reforms began in 1978. These continue today and are changing the centrally planned form of state capitalism to a socialist market economy making China a country that is emerging as a significant economic power with booming business (Sinomania, 2001).

While the general consensus is that China's entry into the World Trade Organization (WTO) creates an improved business climate for foreign investors and entrepreneurship, my observations do not necessarily support this concept. What I observed is that reforms have taken place at high levels of the government, but are not visible in the streets. The reforms are occurring at a very high-level and they need to filter down to local governments before they will truly be effective.

Supposedly, China has adopted English as its business language and has adopted international accounting standards which is a good sign of sustainability in the global markets. However, experts predict it may be eight to ten years before the accounting

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standards become the norm in China based upon Russia's experience - it has taken Russia fifteen to twenty years to implement standards and they still are not fully implemented (Eng, 2003).

Even though English may have been adopted as the business language in China, by personal observation I can attest that language barriers definitely exist for newcomers to business in China. In Beijing and Shanghai, English is not widely spoken, so it is difficult to communicate. The government of China has recognized the need for its citizens to become fluent in the English language due to the country's entry into the World Trade Organization. They are taking steps to provide English language education to citizens with intentions of having 400,000 fluent by 2008; English is now taught beginning in the first grade. Though these efforts are admirable and will produce results in the long-run, for the short-term, firms entering the marketplace need to consider the time and costs of training staff to speak the English language (Aiyar, 2004).



Additionally, I observed that the Chinese come from a high-context culture and the unspoken word says a lot more than the spoken word. Traditional customs are held in high regard, so understanding the culture and cultural perceptions is critical for foreign investors and those establishing businesses in China.

Because connections are so important in China, foreign investors often develop strategic alliances with Chinese natives when entering the business

place in China. This is a cooperative tactic that can certainly lead to success as demonstrated through Audi's record sales in the Chinese marketplace. The growth of the company in terms of image and positioning has made China one of its most important export markets. The success is contributed to cooperation that was set forth through its joint venture with the Chinese First Automobile Works (FAW) in 1989 (Automotive Intelligence News, 2001).

China's economy is strong, in fact, it's the world's second largest economy in terms of purchasing power parity and since its entry into the WTO, the country runs a trade surplus with the United States and is developing a high-tech industry as well as improving the vitality of state banks and in 2003, there was more than \$57 billion in foreign investment (Economist, 2004).

## Conclusion

Despite the social concerns in China, the economic outlook is very good in terms of entrepreneurial opportunities although political unrest is something that can be expected from time to time. Entry into the World Trade Organization is a positive move for the economic future of China in terms of foreign investment, trade, growth and stability; however, it may take some time before the benefits are realized as there are still barriers at the lower levels of government that must be overcome. The "good ole' boy" network and relative customs certainly warrant full attention to facilitate positive relations in the Chinese business climate. Networking with government officials and bureaucrats is vital and developing strategic alliances through joint ventures is a business approach that is recognized to foster cooperation and generate success in the marketplace.

Prior to setting up shop in China, it is recommended that a full market analysis be conducted in order to formulate a sound strategy and business plan that will guide an entrepreneur in exploiting opportunities, minimizing weaknesses, and overcoming threats.

Two primary causes of failure of foreign investing firms in China had been identified. They are poor strategic assessment and weak execution of strategy. Other barriers that pose significant risk include ignorance of regional differences which leads to overestimation of markets, misunderstanding of consumer dynamics which can result in an unsuccessful marketing mix and lack of preparation (CalTrade, 2003).

Language barriers are something that foreign firms entering the Chinese marketplace need to be prepared to address. Likely English training of staff will be required, so the time and costs involved in that training must be considered.

With an effective strategic plan and sound business relationships coupled with efficient execution of the plan and attention to details and potential threats, China is a good place to consider for entrepreneurial activity. It is a country that is on the move with a



flourishing economy that can be expected to continue to grow for years to come.



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