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LOVE IS BLIND, GREED IS INSATIABLE

The Classic Case of a China Business Venture

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Description

An MBA graduate, originally from China, joined a multi-billion pound sterling British multinational in the late 1990s to assist its senior executives to make multi-million dollar investments in China. He had been involved in the whole decision-making process, consisting of assessing business opportunities and potential partners in China through to establishing and operating a US$ 25 million pharmaceutical joint venture business.

With vivid accounts of what he had experienced, he reveals that it is human intuition - including the pain and the joy as well as the misery and the hope - that makes up the very fabric of business. In the end, it is a story that shows why business conducted on the basis of partner attraction and for the sole purpose of making money is self-defeating, and why successful business is done not only through people but also for people.

Learning Objectives

The principal objective is to help students understand the nature of business, in particular with reference to doing business in China. The other objective is to help them develop an appreciation of how business school-taught concepts and tools might be applied to the messy reality of business.

Subjects Covered

Networking, market research, business alliance, negotiation, business case, management, leadership, business strategy and worldview

Setting

Late 1990s; China, the UK, and the starch industry

Teaching Notes

The case can be used in two ways. One is for classroom discussion, aimed at developing an understanding of the key issues involved in doing business in China. First, students are given time to read the case on their own. Then, they are asked to talk about the issues they have identified. Finally, the teacher summarises the key issues for the class.

The other is to use the case as part of an individual/group project. First, students are asked to read the case and identify the issues involved. Second, they are recommended the book *The China Executive*, from which they are required to put the identified issues into context and develop more effective actions were they in the MBA graduate's position. Finally, they are required to write a project report and/or make a presentation.

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About BC

Being an MBA graduate, originally from China, William joined a British company (BC) in January 1995 when BC was seeking a bilingual business development executive to participate in its investing activities in China.

From the induction programme William learnt that BC was part of a European conglomerate (EC), which was one of the largest food companies in Europe with an annual turnover of over £4 billion and 55,000 employees. It had businesses spread across Europe, Australia and North America. Although publicly traded, over 60% of EC was owned by a billionaire family, from which came "the Boss", i.e. chairman and CEO of EC for twenty-five years by then. Recognising the growth potential in Asia, EC had long been conscious of saving cash to prepare for investments in the region. By 1994 when "the Boss" gave the spearheading mandate to the CEO of BC, which contributed half of EC's profits, and also set the grand vision of "building another EC in Asia within ten years", EC had more than £500 million of cash. In late 1994, BC's CEO appointed Tony Smith, BC's former director of research and development, as general manager of business development (Asia) to be based in the posh Lippo Centre in Hong Kong. BC also hired an international investment bank as its financial advisor, and an international law firm as its legal advisor.

But the driver behind BC's overseas activities was a unit called the "nerve centre" of BC. Heading the unit was not one person but two, i.e. Jack Hunt – director of business planning and development, and John Strain – director of overseas operations. Along with the CEO, the three directors were called the "big three", making the crucial decisions in BC. On his first day in BC, the CEO personally came down to the "nerve centre", introduced himself and welcomed William by shaking his hand. He also asked William what he used to do, how he was doing his commuting and what his work plan was for the near future. William felt very warm. But soon, he found that what characterised the organisational behaviour of the "nerve centre" was, in the word of one of his colleagues, "dynamics".

For a start, indeed, Jack and John and other directors seemed to be in debate with each other about everything, sometimes even with unkind words flying around. Yet, they still worked together. More importantly, it was in these hot debates that quality decisions were made, and one of them was a determined direction that China should be the main target in EC's Asian initiative. After a couple of first visits to the Chinese government arranged by the Shanghai office of BC's financial advisor, the "big three" realised that there were huge difficulties in establishing new businesses in an entirely new environment by BC itself. The CEO commented: "As soon as you walk out of Beijing Airport, you do not know where to go without the help of a local guide, and this applies to our business development too." BC's Board then unanimously decided that the entry approach was to find local partners and establish joint venture (JV) businesses.

At the core of the dynamics was interpersonal networking, though. Aside from Jack who appointed William, the other main mentor of his was David Williams, business development director (starch). David used to be managing director of a wheat starch and glucose business, which was owned by EC and struggling in a competitive environment dominated by a small number of very large international players. After acquiring BC for £880 million in 1991, "the Boss" made it a subsidiary of BC and relied on BC's management to make it profitable. BC's board then decided that the way forward was to develop it in the Chinese context. But in China, starch had to be processed from maize because there was insufficient wheat to satisfy human consumption needs. William learnt from David that BC wanted to be in the business of producing starch from maize first and then establish down-stream businesses to produce added value starch products. David told him that there were three critical success factors for a starch business: "maize, maize, and maize". In other words, their potential starch JV partners must be located in a maize growing region. He also learnt from David that starch could be used as either a feed stock or an ingredient in a wide spectrum of industries, including food, pharmaceutical, and papermaking.

Of course, William also needed to network with other members of staff in the unit, including the sales and marketing director, corporate affairs director, finance director, several middle managers, other junior staff and, last but not least, the secretary. Indeed, it was the secretary who kept the unit's networks alive. There were some thirty people in the unit who were at any time spread around many parts of the world, but the secretary made sure that they could communicate to each other.

When John asked William to join him on one of his trips to China, the secretary had to organise travellers' cheques, executive limousine from home to airport, business class air travel and overnight stay at the posh Marriott Hotel in Hong Kong. When they stayed at a hotel in a remote part of China, she made sure that the first thing they did after checking in at the hotel was to ring her to give her all the necessary communication numbers.

The dynamics was also characterised by a challenging culture. From day one, Jack challenged William like "throwing bricks at you", as one of William's colleagues put it. But Jack also plainly told William that while he "kicked" William, William could also kick him. Indeed, William soon noticed that it was a norm for junior staff to challenge senior staff - even the secretary challenged the directors when the former had a piece of truth in hand. To co-ordinate international personnel policies, "the Boss" assigned a personnel manager from EC's headquarters to the "nerve centre", but three months later he was kicked out of BC because the "big three" found what he had to say to them "illogical".

William therefore learnt that what drove BC's corporate dynamics was "logic", which also squeezed any slack in its organisational activities and ensured everyone's efficiency to the bone. But would logic be the driver in the China business environment?

Initial Search

Shortly after William completed his three-month familiarisation period, Jack charged him with the task of organising a three-week programme for David to visit Chinese companies and relevant governmental bodies to establish a comprehensive understanding of the China starch industry and to look for suitable JV partners.

At that time, they did not have any information as to whom and where the Chinese starch or starch-related companies were. William therefore rang up a friend of his in Beijing, whom he had met when they were studying at a university in the UK, who was by then working at the China Science and Technology Information Centre. She conducted a database search at China's largest information centre but found little useful information for him. After mobilising her contacts in Beijing, she gathered some contact details of a few large food and papermaking companies. However, these companies indicated that unless they had the intention of doing a JV with them, which William knew they could not promise to have, they were not interested in receiving them. She then suggested that she would ask the Information Bureau of the State Science Commission, which supervised her information centre, to issue a notice instructing these companies to receive them. William did not ask her on what ground they deserved such a notice, but she managed to get it and send it to the target companies, which then all agreed to meet them.

William also got to the library of a China-Britain trade organisation in London. In a dated Chinese Company Directory, he noticed that a Chinese company (CC) specialised in making a flavour ingredient (FI) was one of the largest companies in the Chinese food industry. As the production of FI uses a lot of starch, he thought this company was definitely worth seeing. He also found another large FI producer and one of the largest Chinese papermaking companies in the Northeast. He rang up these companies but none of the telephone numbers was correct. He therefore had to ring up the "114" telephone directory enquiry number in each city and found the latest numbers first. From these companies' telephone operators, he got hold of their fax numbers. He then sent each company's top man a fax, in Chinese of course, expressing BC's intention to visit it. One replied to him by fax two weeks later. Another did not reply but expressed its willingness to meet them when he followed up with a phone call. The most impressive response though was a fax from Mr Chen Huanting, chairman of CC, only two days later. In his fax, Mr Chen said that his company had long looked for a Western partner to do a JV business in starch, and that he was looking forward to meeting them as soon as possible.

Given his experience, David had some high-level contacts in the European and American starch industries. He and William visited a manufacturer in Germany, which was selling starch equipment in China and knew quite a few Chinese starch companies that were looking for Western partners. Executives of this company promised to arrange a visit programme for David and William in the Northeast. William also contacted the Beijing Representative Office of an American starch equipment manufacturer, and found a willingness to make arrangements for them to visit a couple of local companies, to which this manufacturer had sold equipment.

But who could introduce David and William to Chinese government bodies related to the starch industry? William suddenly remembered a former diplomat at the Chinese embassy in London, with whom he became acquainted when he was Chairman of the Chinese Students and Scholars Association at a British university in the 1980s. This diplomat had by then returned to China and became director of the education bureau in the Ministry of Light Industry, which oversaw the Chinese starch industry. Although he and William had not contacted each other for years, he immediately offered to “help” William when William telephoned him. He gave William the number of a friend of his in the ministry who was to arrange for David and William to meet Chairman of the Fermentation Industry Association. He also introduced William through phone calls to Mrs Liu, a deputy director of the township enterprise bureau in the Ministry of Agriculture. He even promised to personally arrange for David and William to visit an “ideal” JV partner he had identified - a starch plant located between Beijing and Tianjin - because “the factory is located in the great Hebei Plain”, but William was not sure about the location’s business merits.

The last piece of the jigsaw was to arrange the travel and accommodation plan in China. As Thomas Cook could not issue tickets on domestic flights or make accommodation bookings at local Chinese hotels, William had to use a local travel agency in Beijing, whose head was introduced to him by a friend of his in the UK.

Having spent three weeks in the UK to arrange the programme, David and William began their visits in China on 22nd March 1995. In general, each visit was characterised by two-way information flow taking place in a face-to-face meeting, although they also benefited from site tour where available. After they made a presentation of EC and its aim and investment strategy in Asia and also gave their host a copy of the bilingual brochure they prepared, the host would make an introduction to themselves. And when they talked about certain issues in the context of the European starch industry, the host would talk about these issues in the context of the Chinese starch industry. But the quantity and quality of the information they collected varied greatly from visit to visit.

In their visit to the Ministry of Agriculture, six retired experts were invited by William’s contact Mrs Liu to the meeting. Due to time constraints, the experts actually began competing with each other in order to talk to them about what they knew towards the end of the meeting. William met the ex-diplomat in the Ministry of Light Industry who reminded him to prepare a gift for his friend who arranged their meeting with chairman of the Fermentation Industry Association. David was most satisfied with the meeting because the chairman gave him almost every bit of macro data about the local industry he wanted. In their visit to the Beijing Papermaking Corporation, they were delighted to see that two senior engineers had actually prepared in writing the answers to their questions that were sent to them beforehand. However, when they visited a food company in Beijing, although they were received by a good number of people, the latter were too cautious to give them any information. They also visited the small state-owned starch factory recommended by the ex-diplomat. Although the factory director gathered “all the employees” to welcome them, the factory was in such a dreadful condition that David called it a “nightmare”. An engineer from the Beijing Office of the American equipment manufacturer drove them to a factory in Shijiazhuang, which produced an integrated portfolio of starch and added value starchy products, including a starch derivative (SD) that was uniquely produced using imported European technology and equipment for the pharmaceutical industry. It gave William quite a good impression, but David considered it too small to be JV partner.

After their visits in Beijing, they were on their way to visit CC on 28 March 1995. They flew from Beijing to Zhengzhou in central China, and then were taken by a car. David thoroughly enjoyed the four-hour country journey. They saw endless flat farmland and commune after commune. The driver told them that as a major crop in the region, maize would be planted in autumn. By the time they got to CC, it was later in the afternoon. They were taken to a hotel that belonged to CC. In this very remote part of China, the design and hardware of the hotel impressed them. Mr Chen’s secretary and a girl from CC’s administration office were sent to accompany them at the dinner, but after the dinner, they politely declined their invitation to ballroom dance in the hotel.

The next morning, they met Mr Chen Huanting, the boss of CC, and Dr Tom Song, Senior Advisor to Mr Chen. Mr Chen looked a confident and relaxed man aged at around fifty-five and Dr Song a confident and energetic man aged at around forty-five. Mr Chen introduced CC’s history and future vision. CC was a state-owned enterprise with about 12,000 employees - which David found impressive. It certainly had an impressive development record with its FI production rising from 400 tonnes/year eight years ago to the then 120,000 tonnes/year. Apart from being the market leader in China, its FI was exported to a dozen countries in Southeast Asia. They were particularly impressed by Mr Chen’s visionary and forward-looking style because apart from seeking to grow its core FI business to become the world’s number one, CC was also diversifying into other industries, including mineral water and animal feed.

Commenting on the possibility for CC and BC to work together, Mr Chen pointed out that his company had one of the most advanced fermentation technologies for producing FI from glucose. But his company’s weaknesses were in the production of starch from maize and of glucose from starch - the respective yields were very low. He said that through working together, CC would benefit from learning BC's advanced starch and glucose production technologies while BC would benefit from CC's huge capability to off-take starch and/or glucose produced by the potential JV business. He also introduced that CC had just imported some key equipment items from a European supplier for a new starch plant, and that if BC were interested in a partnership with CC, CC could wait so as to build the plant together with BC.

During the meeting, William was interpreting for both David and Mr Chen. But towards the end of the meeting, Dr Song surprised David and William by starting to talk fluent English. They then learnt that Dr Song gained his Ph.D. in mathematics and had worked in the US before returning to China to work for CC. After the meeting, Mr Chen and Dr Song took them for a tour around CC's starch and glucose factories. Drawing on his many years of experience, David could immediately see the operational problems with these factories and therefore shared Mr Chen's earlier view of them. He told William that these problems could readily be solved through introducing better technology and more stringent operating procedures.

Over lunch, Dr Song told David and William that the market for FI in China was growing at an annual rate of 15-20%, and that the increase in the demand for FI would generate a huge demand for starch, making any investment in starch production in China a potentially prosperous business. They left CC that afternoon. On their way back to Zhengzhou, William could see that David was very delighted. He told William that there was a strong case for working with CC. William felt the same. That evening, they stayed at an international hotel newly opened by Holiday Inn, and toasted each other at the bar for the good progress they had made.

On the following day, i.e. 31 March 1995, they had a six-hour delay at the foggy Zhengzhou Airport and killed the time by writing their visit reports. By the time they got to Shenyang in Liaoning province it was completely dark. The next morning, they met director of Shenyang FI Factory and some of his managers. But despite excellent hospitality including paying for the use of the meeting room and the lunch at the hotel, David and William sensed that this factory was in trouble, which was confirmed during their tour in the factory that afternoon. The worst bit for David though was that they had to wait for about five hours in a cold office to give twelve people from the factory the chance to enjoy the state-funded banquet at "the best restaurant in the city". On April Fools' Day, David and William were told that the only flight between Shenyang and Jilin City had been cancelled - sadly, it was not a joke.

They therefore had to get on a train at 6:00 p.m. To this very day, David would refer to their fourteen hours on “a crawler stopping at every lamppost” overnight as one of the “most unforgettable” experiences in his life. The following afternoon, they had a meeting with the Chief Engineer and his staff of a paper mill who were only interested in seeking a solution to one of their technical problems. From 3 to 6 April 1995, the Vice President and a Technical Manager of the German manufacturer introduced David and William to two further starch projects in Jilin Province. One was a green-field site project proposed by a county government, and the other the expansion of an existing starch plant. But despite abundant maize supply, local government support and the Vice President’s proposition to have a 5% share in any potential JV of BC, they concluded that BC should forget about these projects because a French starch conglomerate was already active in the region.

On 7th April 1995, David and William left Changchun for Beijing, and got on a British Airway flight that afternoon to return home. Immediately on returning to BC, they produced a comprehensive report, in which they recommended that BC should consider negotiating with CC for a possible JV business. It could consist of initially a starch plant, based on CC’s recently imported equipment, producing starch for CC’s FI production plants, and if successful, a phase-two development made up of added value starch businesses as well as the expansion of the initial starch plant.

Conceiving the Business Proposition

After carefully reading the report of David and William and hotly debating aspects of their findings, BC’s directors thought that their recommendation was worth pursuing. Jack instructed William to inform CC that if they liked, they could wait for BC to build the new starch plant together but BC could not, at that stage, promise that it would definitely commit to the project. CC subsequently informed BC that it chose to delay its starch project and wait for BC.

Over the following eight months, BC sent a stream of technical specialists and business executives to visit CC and to hold discussions with CC’s staff. As William had to be involved in almost every visit or meeting, his initial freshness of travelling between Zhengzhou and CC was gradually replaced by a sense of adventure. On a very sunny day in July, a tyre on the car burst but the driver did not have a spare tyre. They had to wait under the burning sun for three hours before another car came to take them. On another occasion, as their flight from Beijing to Zhengzhou was delayed, they had to travel on the country road late in the night. While every passenger was half-asleep because of both exhaustion and bumpy roads, the car was suddenly brought to a stop. They then saw that a log was lying right in font of the car. When the driver got out of the car, several local people immediately surrounded him and asked him to pay them for removing the log. It was not until the driver shouted that he was taking some important foreigners that he was allowed to remove the log himself. One of William's colleagues later on described the journey as "the road to hell". Indeed, William soon discovered that scenes of traffic accidents on his trips between Zhengzhou Airport and CC were a norm. After he and Tony once saw two pedestrians lying in blood about fifteen meters apart on the road in a village area, they had a thorough discussion about the root cause of such regular traffic accidents. William managed to convince Tony that the reason for so many pedestrians being knocked down was their Chinese relational view towards the coming vehicles - they failed to realise that when they collided with the vehicles, they rather than the vehicles would lose life.

William's feel for the town where CC was based also became increasingly real. Pollution was the dominant feature. Each time he approached the town, he could see the huge columns of black smoke coming out of the big chimneys of the power and steam generation houses. As he entered the town, the smell of the air was so strong as if it had been fermented. When he walked in the streets, his shirt collar became black and his shoes were covered by dirt within ten minutes. Yet, the local people ate at tiny food stalls just beside busy streets as passing vehicles stirred up clouds of sheer ashes and rubbish. In the evening, they enjoyed dancing in the open-air ballroom, which had the effect of an air filter. Back in the CC Hotel, life was not as good as it initially looked. After a long-day of travel, having a shower was a sensible thing to do, but it was easy to miss it because hot water was only available for two hours in the evening. To make a long-distance call, William and his colleagues had to use the phone at the reception while being timed by the attendant and watched by anyone else in the hall. Despite the variety, food at the restaurant seemed to contain an excessive amount of FI, the stuff CC produced, making all the dishes taste similar.

David led BC's technical team. However, as he was based in the UK and was supposed to report to Tony who had had no experience in the starch industry, they were not in good harmony with each other. Leading CC's technical team was Mr Zhang, who was in his early thirties and had been an official of a town in the countryside of central China before Mr Chen transferred him to CC during CC's expansion in early 1990. He did his college degree in chemistry and worked in CC as a technical manager. The impression he created to people from BC during all the encounters was that he was bright, full of energy, and willing to co-operate. The technical visits and meetings helped BC's technical specialists understand CC's current technical capability in starch production and form a shared view with CC's technical staff on the technical parameters of the new starch plant, including open land area, local maize supply, utilities, process design, equipment scope and capital budget.

After Tony and David assured Jack of the technical soundness of the new starch plant, Jack visited CC. As an accountant, Jack was particularly keen to have a good grip of the financial capability of CC. In his first meeting with Mr Chen, he gave him a copy of EC's latest annual report. But when he asked for a copy of CC's annual report, Mr Chen smiled and said, "CC is a state-owned enterprise. We only prepare annual report for state authorities." He advised that Jack could develop an understanding of CC's financial capability by visiting its plants and facilities. They also exchanged views on the operating structure of the potential JV, covering shareholding, management structure, maize purchase method, starch selling price, and by-products' selling methods. On shareholding and management structure, Mr Chen said that CC and BC should each hold 50% and that the general manager should be from CC given the huge commitment needed to run a business. But Jack said that BC wanted a majority share and the right to appoint the general manager. Given the differences, Tony proposed a compromise to Jack that Mr Zhang could be sent for training at BC's headquarters for half a year and then appointed as general manager. But Jack remained unconvinced about the reliability of Mr Zhang and therefore suggested to Mr Chen that the differences should be resolved through further discussions at a later date, which Mr Chen happily accepted. On by-products, it was agreed that the JV would sell them to CC at prevailing market prices.

At a dinner held by Mr Chen for Jack, Jack asked about CC's secret of success. Mr Chen replied, "The oneness of politics and enterprise" (*zhengqi heyi*). Puzzled by what Mr Chen had said, Jack asked him to elaborate. He proudly gave an example where officers of the tax authority of the local government could work side by side with his accountants in one office. Jack also learnt from Dr Song that Mr Chen was a committee member of the prefecture government, which oversaw the town, of which CC was a part, and a representative of the National People's Congress. In fact, Mr

Chen's pictures taken together with several central government officials during their visit to CC featured highly in CC's introductory brochure. Mr Chen's political privilege was also vividly demonstrated in that he sent a car with a police flashing light and siren to escort Jack's car on the four-hour journey from CC to Zhengzhou!

In August 1995, BC extended an invitation to Mr Chen and Dr Song to visit BC in the UK, and helped them obtain the visa within three days through its contact in the British Embassy in Beijing. However, two days before the planned departure from Beijing, CC informed BC that the visit had to be delayed because, as a "model entrepreneur" for rural regions, Mr Chen had been asked to attend a meeting organised by the state council. William finally nailed Mr Chen and Dr Song down to a flight on 12 November, 1995 because any further delay would require BC to re-apply for visas for them. The programme BC organised for them was rich and colourful, which included formal meetings, informal chats at bars, dinners at restaurants of various styles, visits to BC's factories and R&D centre, and tours of London and Windsor Castle. Formal discussions were held mainly between Jack, David, Mr Chen, Dr Song and William, but the CEO also welcomed them and made an introduction to BC in his boardroom and hosted a dinner at a Chinese restaurant in his home village. During the week they stayed in the UK, a Chinese national flag was flown outside BC's headquarters. Upon hearing that Mr Chen and Dr Song flew to the UK in economy class seats, Jack asked William to make sure that BC provided them with business class tickets for their return journey.

According to an EC norm, an investment decision could only be justified if the financial model of the business case showed a return-on-investment (ROI) of over 20% in five years time. An accountant at BC had been asked to develop a financial model on the basis of local operating conditions, such as the costs of maize and utilities, but he had no way to verify the reliability of the data provided by CC staff who changed their minds several times. Nevertheless, he eventually produced a financial model that was worth presenting to "the Boss". As the total investment of the starch project was only about £7 million and less than £4 million was needed from EC and the technology involved was pretty basic, "the Boss" decided to meet Mr Chen and Dr Song after the CEO and Jack presented the business case to him.

On entering EC's headquarters, William immediately developed admiration for "the Boss". For a start, his headquarters was just a very small block in central London – he had set an example of efficiency for his many companies around the world. Being one of the richest in the UK, he dressed in a plain style. In his boardroom, William noticed two replacement chairs. This was in sharp contrast to the extravagant style of some Chinese millionaires he had met in China. When he later mentioned his observations to David who had known “the Boss” for a long time, David said that when “the Boss” walked in the streets, nobody would think he was a billionaire.

William acted as the interpreter for the meeting between “the Boss” and Mr Chen and Dr Song, which was also attended by the “big three” and David. “The Boss” asked Mr Chen about CC’s ownership and who would be running CC if the state made personnel changes. Mr Chen said that it was unlikely that the top job of CC would be taken away from him because the state wanted continuity and stability. “The Boss” then turned his attention to the proposed starch project. He said that in EC’s experience, the technology for starch production was very basic and that competition could easily develop leading to erosion of margin. Mr Chen commented that CC had achieved its success in China through a development strategy of “rolling a snowball”, i.e. one small but solid step at a time. “The Boss” did not directly respond to Mr Chen’s comment but asked David how the big players in the European starch industry made money. David said that in Europe, the leading players all made money through an integrated operation, i.e. producing starch and many other starchy derivatives. “The Boss” then suggested that it might be worth for both parties to explore whether, in addition to the starch project, there were any added value starch business they could do together so as to give the JV a stronger position in the China starch industry. Mr Chen happily accepted his suggestion.

On returning to BC’s headquarters, the CEO asked Jack to initiate another round of internal discussions. David thought that a hydrolysed, crystallised starch derivative (SD) for the pharmaceutical industry and the food industry, positioned in the middle of the starch product spectrum in terms of the sophistication of the required technology, might be the most appropriate entry point. We were all quite convinced by David’s “logical” arguments. At a formal meeting with Mr Chen and Dr Song, the idea of building an integrated starch and SD plant was then proposed to them. Mr Chen and Dr Song said that they did not know anything about SD. Dr Song then made some phone calls to China.

The news from China was that there was potential for a purer SD product for the pharmaceutical industry. In fact, there was only one factory in China that was profitably producing it using imported European technology. David and William immediately recalled that it was the starch and glucose factory in Shijiazhuang they visited in March 1995. David commented that it should not be difficult for CC and BC to build a SD plant with a capacity of 20,000 tonnes per year using imported technology, with CC's originally planned starch plant supplying the required 50,000 tonnes of starch per year. Dr Song said that no matter how large the SD plant would be CC would "guarantee" the sales of the product. Mr Chen agreed to the capacity of 20,000 tonnes per year and estimated that the SD plant would cost RMB 200 million to build. He also indicated that CC preferred a majority share holding but if this were not acceptable to BC, then he would accept a 50:50 structure. Jack replied that as BC was to invest in a place remote from its home base, a slight majority share holding would give it that little bit sense of security. Mr Chen finally accepted Jack's proposal of a 51:49 share structure.

On the last day of their visit to BC, Mr Chen signed a Letter of Intent (LOI) with the CEO of BC. It was stated that BC and CC would carry out a joint feasibility study, covering the maize raw material supply, the market for SD and the process design for the integrated starch and SD facility, the outcome of which would determine whether the project should go ahead.

Feasibility Study

In 1995, Western business media featured a dire prediction made by Lester Brown of the World-watch Institute that China's grain import needs would likely increase to as much as 300 million tonnes by 2030 – demand that would be far greater than all the global stocks then available for world-wide export. Clearly, if China were to have problems with feeding its growing population, then any BC investment in the Chinese starch industry might have problems with having a secure supply of maize raw material. "The Boss" even cut out a report on Lester Brown's prediction from the *Financial Times* and posted it to Jack, who charged William with the task of studying the maize supply issue.

Given the contacts William already had in China, there was no difficulty for him to plan and organise a three-week study programme. On 1 December 1995, he flew to Beijing to visit deputy director Mrs Liu in the Ministry of Agriculture. By then, he and Mrs Liu were quite acquainted with each other, and they called each other "old friend" (*lao pengyou*). He learnt, over dinners and *karaokes* with her, her husband (a military officer) and her assistant, that Mrs Liu was daughter of a former Hebei provincial governor, which explained why she had so many powerful contacts. For William's purpose of studying the maize issue in China, she arranged for him to meet two retired agricultural officials of the central government in Beijing, and then in Shandong, agricultural and grain bureau officials of the province and party secretary and other agricultural officials of Ningyang County. In Ningyang, William also walked into a maize field and talked with a farmer about the economics of his maize farming business. His ex-diplomat friend in the Ministry of Light Industry introduced him to a deputy director of Hebei light industry bureau who arranged for him to meet provincial officials in charge of agriculture and grain distribution. In the province where CC was based, William had a meeting with a provincial agricultural official arranged by a sales representative from CC's office in Zhengzhou. He also phoned up Zhengzhou Grain Exchange and managed to see the manager of the Grain Wholesale Market without anybody's prior introduction. The most detailed understanding of the logistics and economics of maize purchase from a starch factory' perspective was established through his meeting with the supply manager of CC, though.

Upon returning to the UK, William was asked by Jack to write a summary report for the CEO before completing the full report, which included detailed visit reports. In his summary report, on the basis of analysis of hard data from various perspectives (i.e. administrator, producer, distributor, user and consumer) and at different levels (i.e. national, provincial, local and factory) and his feel, he concluded that the potential starch JV with CC would have a secure maize supply. When he met the CEO in the corridor of the "nerve centre", the CEO told him that his report was "good". He felt motivated despite the fact that the long trip around China on his own was extremely exhausting.

BC's management then turned their attention to the market research for SD, which the CEO wanted to be done quickly. Tony's view was that BC should rely on CC to carry it out because CC already had connections in China. But Jack felt that it was premature to have total faith in CC at that stage and that BC should conduct its own independent market research. Nicholas Davies, a technical specialist who had SD technical service experience with his previous employer, and William were then charged with completing the task within two weeks. Given the time constraint, all they could do was make some preparations, travel to China, and visit some of the large customers in Shanghai, Beijing and Tianjin, and the State Pharmaceutical Bureau. They used the Shanghai office of BC's financial advisor to arrange some of the visits. During their study, they found that the market for SD consisted of two segments, i.e. SD for the pharmaceutical industry and SD for the food industry, each commanding a demand of 80,000 tonnes per year and already oversupplied by a large number of small domestic producers.

However, David's original proposition of 20,000 tonnes of SD per year, i.e. 10,000 tonnes of pharmaceutical-grade and 10,000 tonnes of food-grade, appeared plausible. First and foremost, there had been no foreign investment in the SD industry, and most domestic SD producers had a capacity ranging from 2,000 to 5,000 tonnes per year and produced SD of a very inconsistent quality. They were also in all sorts of troubles, such as cash shortage, backward technology, over manning, and poor management. Therefore, it would be possible for the JV to drive some of the small producers out of business through its strengths, such as financial muscle, advanced technology, economies of scale, and efficient management. Second, the purer SD for the pharmaceutical industry looked certain to be a product leader because while most SD producers were making losses, the one producer in Shijiazhuang was very profitable. This was supported by China's announcement in 1995 that from April 1996 the new edition of the Chinese Pharmacopoeia was to become effective, in which the purer SD product was for the first time specified for application in intravenous products. Third, according to Nicholas, if the purer SD for the pharmaceutical industry was successful, the process for food-grade SD could easily be upgraded to produce the former through addition of a few equipment pieces.

On the last two days of the two-week programme, Nicholas and William stayed in Hong Kong and produced their report, in which they made the above recommendation. They also identified two critical success factors, i.e. the building of a wide range of technical expertise and the building of a nation-wide distribution network.

When they returned to the UK, they heard that there had been a "split" among the "big three". As Jack "did not co-ordinate with the CEO", according to John, the CEO had deprived Jack of responsibility for overseas business development and given it to him. This meant that it was up to John to read their report. As John had never been involved in the starch project in any detail except being aware of its development, he relied on his sales and marketing director to digest the report. Without either prior experience in the sales of SD or on-the-ground feel of the China market for SD, he could only ask Nicholas and William a few questions of a logical nature on the basis of the information in the report.

The other aspect of the feasibility study was concerned with the design of the SD plant. Although it was straightforward for technical people from BC and CC to decide that they had to use an equipment supplier in Europe to design the process and supply the key equipment items, the decision on the scope of imported equipment was not. After several rounds of discussions at Beijing's Lido Holiday Inn, which was David's favourite meeting place because it required people from both parties to travel, David felt that the decisions were still sub-optimal because Mr Zhang and his staff could only make rough estimates on local purchases. On the other hand, William sensed at these meetings that David had the intention to import more equipment items in order to build the best SD plant in China. After being questioned about the high costs by Mr Zhang, David suggested that the JV could import some second-hand but refurbished equipment items from BC. CC's technical people regarded it a good idea. It was agreed that once the European supplier was selected, BC would undertake to sell these items to the supplier, which would then refurbish them and include them in its supply contract with the JV.

But the technical aspect of the feasibility study was driven much more by a change in government regulation. In late 1995, the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) suddenly announced that any imported equipment used by foreign-related investment projects approved in January 1996 and thereafter would no longer enjoy import duty exemption. MOFTEC later extended the dividing line to 1 April 1996 and required the import activity to be completed by the end of 1996. This meant that to import the required equipment free of duty, which was 25-30% of US$ 9 million, CC and BC had to not only form the JV before 1 April 1996 but also sign the supply contract with the European supplier well before they signed the JV Contract between themselves!

And that was exactly what happened. To make rapid progress, David suggested that BC should negotiate and select a European supplier on behalf of the potential JV and present the details to CC later on. CC agreed. David then negotiated with a German supplier and a Danish supplier. In the end, it was lower price that made him select the Danish equipment supplier (ES). After David finalised the contract with ES, Tony in Hong Kong took over the task of selling it to CC. He gave CC one week to read and sign the two-hundred-page English contract. As Dr Song was on holiday in the US, Mr Chen delegated the task to Mr Zhang, who rang Tony in Hong Kong through an interpreter and asked for more time, but Tony simply said "no". Mr Zhang also argued that, instead of the JV, ES should pay for after-sales services in the contract. In the end, Tony forced Mr Zhang to sign it by saying: “If you don’t sign it, you’ll have to take the responsibility for failing the whole project.”

As there was always the possibility that the JV might fail to establish, BC and CC agreed to share the contract cancellation charges at the stages of design, subcontracting, and manufacturing according to the 51:49 ratio by signing a special memorandum with ES.

In the meantime, the CEO still needed a financial model for the integrated starch and SD business showing an adequate rate of ROI before he could present the project to “the Boss”. Aside from the uncertainties associated with the capital expenditure budget and local operating conditions, the biggest uncertainty was with the sales forecast, to which the rate of ROI was most sensitive. The project team used current product prices as a reference point in the financial model, but as nobody had any SD sales experience they had very hot debates about the forecast of sales volumes. Eventually, they reached a compromise, but still it was just a big guess. William also contacted CC, and their view was that no matter how much the plant produced they would be able to sell it. After the first version of the financial model was completed, John presented it to the CEO, who was not happy with the rate of ROI.

John then examined the financial model and discovered that the transfer prices of by-products from the starch plant that Jack had preliminarily agreed with CC were “too friendly”. He asked Tony to travel to CC to negotiate with Mr Chen again on these prices. Tony explained to Mr Chen that as EC required the financial model showing a satisfactory rate of ROI to justify an investment decision, he needed better transfer prices to improve the model, but Mr Chen refused to change his position. Back in the UK, John saw that to break the negotiation deadlock while realising the vision of “the Boss” to target added-value starch business, the most “logical” thing to do was to take the starch plant out of the JV proposition of building and operating an integrated starch and SD facility. He consulted the CEO whose advice was that it was not until one left the negotiating table that one was able to find the bottom line of one’s opponent. John then instructed Tony to inform CC that BC now only wanted to work with CC on the SD business. He added: “This should hurt them.”

And it did, because it meant that after keeping its expensive, imported equipment unpacked for over eight months, CC finally had to build the starch plant on its own and would not be able to learn from BC to improve its starch operation.

William voiced these concerns to Tony but the latter told him that he should be clear about which company he was working for. John instructed Tony to tell Mr Chen that either CC accepted the new proposition or there would be no JV business. Mr Chen decided to choose the former.

As if this wasn't enough, the rate of ROI from the financial model for the SD plant was less than satisfactory. John then asked the project team to see if the rate of ROI could be "improved". David found that he could reduce the capital expenditure budget by scaling down the scope of imported equipment. Tony also revised the sales forecast by slightly increasing the sales volumes and prices, and rang William from Hong Kong asking whether William would support his revised forecast. William said that, to a large extent, sales revenue would be the result of the capability and effort of the marketing team that did not yet exist. But he also said that such a marketing team could be built. When John finally got a satisfactory financial model and was preparing to present it to the CEO, William told him that he felt that the biggest risk of this project was the fact that both CC and BC had never been in the SD business. But John simply said: "We'll crack it."

So the above change in government regulation drove everybody crazy. For everybody believed that, by capturing the last opportunity of preferential import policy, BC and CC could build the single best SD business in China. Yet, to do so, BC and CC still needed to complete another step.

Contract Negotiations and Project Approvals

According to Lee Walker at the Hong Kong office of BC's legal advisor, BC and CC had to negotiate and sign the *Joint Venture Contract*, the *Articles of Association*, and any ancillary contracts before an application could be made to the approval authorities for establishing the CC-BC joint venture. Although this sounded to be a mammoth task, it turned out to be the opposite.

For a start, most key issues regarding the establishment of the joint venture had already been discussed with consensus reached between the two parties by then. Although CC's negotiators argued for a bigger board of directors perhaps with the intention to generate more positions for them, Mr Chen eventually agreed to BC's proposal that two directors would be from CC and three from BC. At this point, BC's financial advisor gave BC perhaps the most important piece of advice that management control was more important than board control. As such, BC proposed to CC that chairman and deputy general manager would be from CC, while deputy chairman, general manager and financial controller would be from BC. CC accepted this proposal happily. On the issue of the fiscal year, although BC's norm was 1 April to 31 March, it accepted that the joint venture should follow the Chinese custom, i.e. 1 January to 31 December. On the duration of the venture, both parties easily agreed to fifty years, which would be long enough for most people not to worry about its ultimate fate.

In preparing the *Joint Venture Contract* and the *Articles of Association*, Lee advised Tony that other than containing some additional clauses for procedural matters, the *Articles of Association* would substantially mirror many of the provisions in the *Joint Venture Contract*. He also advised BC that MOFTEC had issued standard-form joint venture contract and articles of association, which did not protect the interests of the foreign party. Nevertheless, as the approving authorities were used to such standard-form contracts, he was to use them as an outline but to write the substance in such a way that would maximally protect BC's interests. Tony was delighted with his thoroughness and reliability. But when Lee provided Tony with a draft contract, which contained a provision requiring the joint venture to allocate no less than 5% of the yearly after-tax profits to the "Reserve Fund", the "Enterprise Expansion Fund", and the "Bonuses and Welfare Fund", he was unhappy. He told Lee that he had never heard of these three funds, which would reduce BC's ability to bring the joint venture's profits back to the UK. Lee then explained that this term was a requirement of Chinese law. However, he suggested that a term specifying a ceiling percentage, i.e. "no more than 10% of the after-tax profits would be allocated", could be added to the contract, which Tony happily accepted and to which CC subsequently showed no objection.

But the single biggest issue surrounding the *Joint Venture Contract* and *the Articles of Association* was concerned with the dilemma between government approval limit and the 1 April deadline. With capital expenditure budget of the project standing at US$ 18 million, i.e. exceeding the US$ 10 million limit for the provincial government, the potential joint venture would require MOFTEC approval, which could take several months. BC asked its financial advisor, who had powerful contacts in MOFTEC, for help but the advisor said that he could not get the approval before 1 April because many multinationals were trying to do the same. John then flew EC's legal affairs director to BC's Hong Kong office to discuss with Dr Song who held an Australian passport. Lee advised EC's director, John and Tony that there had been examples where a big project was divided into two to facilitate approvals. Dr Song confirmed Lee's assessment and also assured BC that so long as the application was made to the provincial government, CC could guarantee that approvals would be obtained before 1 April. They finally decided that they would divide the joint venture into two and apply to the provincial government for approval. Lee then produced two sets of contracts, one for the "glucose" company and the other for the "pharmaceutical" company. On 14 March 1996, BC and CC signed the *Joint Venture Contract*, the *Articles of Association* and the starch purchase contract and a couple of by-products sales contracts for the two joint ventures in Shenzhen, with party secretary of CC's hometown signing as a witness.

Technically, obtaining the necessary Chinese government approvals was the responsibility of the Chinese party, with the details of the approval process generally regarded by Chinese officials as an "internal" matter and therefore not being open to direct intervention or participation by the foreign party. However, Lee advised BC that without a clear conception of the relevant Chinese approval process, and the patience and persistence to follow it each step of the way, the foreign party could be in for some unpleasant surprises. William therefore did some investigations into the approval process and kept in close touch with Mr Zhang.

But what happened in getting the CC-BC joint venture established could be classified as a miracle. Lee re-drafted the LOI that BC and CC signed in November 1995 and advised CC to use the newly signed copy (dated 22 December 1995) as a project proposal. Within two days, CC organised to get the two separate feasibility study reports prepared in Chinese, and after BC's financial advisor symbolically turned a few pages of the two reports, Tony simply signed them. The rest was almost solely the result of the work of Mr Chen and Mr Zhang. On 25 March 1996, the provincial pharmaceutical administration bureau approved the proposal of the "pharmaceutical" company, the State Administration for Industry and Commerce (SAFIC) issued registration notice of name to both the "glucose" and the "pharmaceutical" companies, and the provincial planning commission approved the feasibility study of the "glucose" company. On 26 March, the provincial planning commission approved the feasibility study of the "pharmaceutical" company. On 27 March, the provincial foreign trade and economic co-operation department approved the establishment of both companies, the provincial people's government issued approval certificates, and SAFIC issued business licences. On 28 March, the Tax

Administration Bureau issued tax registration certificates. On 29 March, the Customs Authority issued customs registration certificates.

The Happiest Moment for Everybody

During the "honeymoon" that followed, everybody involved in the CC-BC joint venture project felt a strong sense of achievement. For BC staff, the great risk associated with equipment import that they had taken on well before the formation of the JV had all gone. CC people, on the other hand, were immediately indulged in happy pictures like the prestigious JV status, more jobs and better pay. Mr Chen commented to the local press: "We are delighted to have a genuine Western conglomerate as our partner that will bring in capital and advanced technology to make this project a success." In EC's press release, "the Boss" said: "We are impressed with CC's development record and are convinced that CC is a strong partner, which we can rely on to develop across China." BC's financial advisor happily received 1% of the total investment from BC as its commission. The legal advisor of BC had also been paid handsomely by BC.

The formal start-up of the CC-BC JV was marked by the first meeting of the board of directors held at the Shangri-La Hotel in Shanghai on 15 May 1996. The key item on the agenda was to approve nominations from the two parties, including Mr Chen, Mr Zhang, John, Tony and William as directors, Mr Chen and Tony as chairman and deputy chairman respectively, and Mr Zhang as deputy general manager. According to John, William's responsibility was mainly to co-ordinate partner relationship and to act as a trouble-shooter. Other approvals were BC's nomination of Victor Lee as financial controller and acting general manager because few applicants in Hong Kong for the job of general manager were willing to be based on the JV site in this remote part of China, and CC's nomination of Mr Yu as CC's financial representative in the JV. Tony introduced Victor, informing everyone that he was a Canadian Chinese, could speak Chinese, and had been an accountant at a company in Hong Kong, while Mr Chen confirmed that Mr Yu was an existing deputy chief of the local tax bureau and was to work part-time in the JV. Suggested by Mr Chen, Dr Song was also appointed as advisor to the board. CC also accepted BC's proposal to appoint an international accounting firm as the auditor of the JV. To show his support for the JV, the CEO of BC attended the lunchtime dinner organised by BC at the J C Mandarin Hotel. In private, he told William that his purpose of attending this meeting was “get to know Mr Chen” - William thought he was smart!

After the first board meeting, Mr Zhang managed to make the company seal and the financial seal for the JV. Victor and Mr Yu opened a foreign exchange account at a Chinese bank in Zhengzhou and a RMB account at another Chinese bank in the town. Meanwhile, Tony had rapidly developed a very “friendly” relationship with Dr Song “because he could speak English”. He even suggested to John that BC could use Dr Song as BC’s advisor on other joint venture projects by paying him several hundreds of US$ a month but John was not convinced. As BC was required by law to make at least 15% of its capital contribution within ninety days after the issuance date of the business license, it made its first cash injection into the foreign exchange account on 20 May 1996. But when Tony phoned up Dr Song to remind him that CC needed to do the same, Dr Song said that, instead of injecting cash, CC preferred to contribute its equity by way of opening a Letter of Credit (LOC) to pay for the equipment imported from ES. A LOC would require CC to pay ES in instalments over a period of time. Having consulted BC’s legal advisor in Hong Kong, whose view was that so long as the LOC was secured on CC’s assets the proposal should legally be fine, Tony accepted it.

The groundbreaking of the JV business took place on 6 June 1996. This date was chosen because, according to Mr Zhang, all the numbers associated with the date were lucky numbers in Chinese tradition, with “six” implying “smooth” and “nine” “long-lasting”. Mr Zhang was in a police car with a flashing light and a siren, and led cars containing BC guests to enter the town with hundreds of school pupils standing by the sides of the street with flowers in hands to welcome them. On the site in the suburb, a band played happy, lively music. But halfway through the ceremony, it began raining heavily. The band had to be called off, the speech from the director of the provincial planning commission cut short, and John had to joke that he had brought the rain from the UK. But the ten-meter-long “meg-firecrackers” resisted the rain with fearless bangs. The grand banquet was held at the CC hotel that evening. William accompanied John and Tony to sit at the table with Mr Chen and several provincial officials. One of the junior officials gave face to the director of the planning commission by saying that the director had abandoned his birthday party to attend this banquet. The director then returned face to his subordinates by saying that Mr Chen was an entrepreneur and that his planning commission had an obligation to support Mr Chen’s project. But strangely, Mr Chen then left the dinning table silently and never returned. William later realised that he left because he felt that he had lost face – he was also an official.

To draw the banquet to a close, the director of the planning commission referred to the water melon on the dinning table and expressed his good wishes for the JV: “round” implied “satisfactory”, “red” “prosperous”, and “sweet” “harmonious”. They all applauded his wisdom. But, in the absence of Mr Chen, the representative of the Chinese party of the JV, how long could the two partners’ celebration really last, and would the lucky numbers and wishful words indeed bring any luck to the JV? And would the rain “brought” by John from the UK indeed mean anything to the JV, well, according to Chinese *fengshui*?

End of the Honeymoon

Shortly after the groundbreaking ceremony on 6 June 1996, Victor relocated from Hong Kong to the CC Hotel. When he visited the JV site for the first time using a car and its dedicated driver borrowed from CC, he only expected to find where it was. But to his surprise, many people were busy building temporary offices and access roads. One man told him that they had been transferred from CC to the JV. Victor could not believe it, because, according to Tony’s briefing, this was a green-field site project and the JV would publicly recruit staff and workers. He therefore reported the situation to Tony in Hong Kong.

Tony did not arrive at the site until 6 August 1996 because on completing the formation of the CC-BC JV, he had been asked by BC’s headquarters to develop a new JV business in Indonesia. William also flew from the UK to attend his meeting with Mr Chen. At the meeting, Tony frankly pointed out that according to the JV Contract, the JV would publicly recruit staff and workers but he understood that CC had transferred some employees to the JV. Mr Chen confirmed it and said that if Tony felt that the JV did not need these people, he could call them back. Tony quickly reacted by saying that the JV did need some people from CC but he expected the two parties to work as a team and consult and discuss with each other before taking any action. Mr Chen agreed with Tony in principle but added that CC could not wait forever. Tony then got a red face because by then, BC had not assembled an appropriate technical team. William softened the atmosphere by explaining to Mr