Prologue

THE IDEA OF WRITING A BOOK like the one you are holding was born more than a decade ago, when I was a part-time MBA student at a leading business school in the UK in 1991. I consciously invested in my personal development to prepare myself for a China-related business career. As I read management guru Tom Peters' *In Search of Excellence*, I thought that maybe one day I could write its China version. However, the experiences I gained at a British-based multinational not only illuminated the limitations of Tom Peters' research-based approach; they also helped me develop the *feel* for the *whole* nature of business, which has served as the foundation of this book.

The multinational I joined in January 1995 was a food conglomerate (FC) with an annual turnover of about £4 billion, 55,000 employees, and businesses in Europe, Australia and North America. Although publicly traded, over 60% of the multinational was owned by a billionaire family, the head of which had been chairman and CEO of FC for twenty-five years and nicknamed "the Boss". Recognising the economic potential in Asia, he set the grand vision of "building another FC in Asia within ten years" and gave the spearheading task to the CEO of his leading British company (BC), which contributed half of FC's profits. In late 1994, the CEO appointed Tony, his former director of research and development, as Asian director to set up an office in Hong Kong.

I was appointed as business development executive, assisting directors at the "nerve centre" of BC to make China-related investment decisions. On my first day at BC, the CEO personally came down to the “nerve centre”, introduced himself and welcomed me by shaking my hand. I felt very warm. But soon, I discovered that what drove the corporate behaviour of BC was one word: “logic”. The directors seemed to be in debates about everything, yet they acted co-operatively once decisions were made. One such decision was to develop BC’s struggling starch subsidiary in the Chinese context through forming a joint venture with a local partner. It was an “investment logic” that convinced everybody at BC because, using the joint venture as a foothold, the starch subsidiary would have access to a market that could be predicted only to grow. It was also the norm for junior staff to challenge senior staff – even the secretary challenged the directors when the former had a piece of truth or logic in hand. In short, it was logic that made BC an organised entity and ensured everyone’s efficiency.

In China, however, the biggest lesson I learnt was that, for better or for worse, it is people who are central to everything. As such, the China investment challenge is a **people challenge** in nature, as demonstrated by my experience of being at the heart of developing and running one of BC’s multimillion-dollar joint ventures.

People’s disruption of the logic based on which an investment decision should be made. As published data on the China starch industry were extremely scarce, BC’s director of starch development and I had to rely on *guanxi* (i.e. people one already knows), including a German equipment supplier and my personal friends in China to arrange visits for us in China. But logic did have a place – I spotted a potential partner in a Chinese statistics book, a Chinese company (CC) that was China’s largest producer of a flavour ingredient from starch. In March 1995, we visited a few ministry officials, and some major starch producers and users. Located in rural central China, CC was state-owned. Its chairman Mr Chen told us that CC had just imported equipment for a new starch plant, which could be built and run jointly by BC and CC, with BC contributing know-how and CC buying the produced starch. Upon hearing our report back in the UK, BC decided to pursue Mr Chen’s proposal.

The following eight months saw streams of BC staff travelling to CC for visits and discussions, during which, while BC strove to check every technical detail, Mr Chen wanted to get on with making the decision to establish the relationship. Then the dire prediction by Lester Brown of the Worldwatch Institute that China was to have problems with feeding its growing population caused “the Boss” concern over investing in China starch. My on-the-ground investigations, however, showed that the plant would have a secure maize supply. Of course, central to all these activities had been the effort of a BC accountant to assemble a financial model based on local operating conditions, but he had no way to verify the reliability of the data provided by CC staff.

In November, Mr Chen visited BC in the UK. We also took him to see “the Boss” in London. I was struck by the very plain style of the billionaire’s dress and office, which was in sharp contrast to the extravagant style of many newly rich Chinese I had encountered. “The Boss” first asked Mr Chen about the ownership of CC, showing concern that as CC was owned by the state Mr Chen might not be CC’s chairman in a few years’ time. Mr Chen answered that that was true in theory but in the Chinese reality his job was almost guaranteed for the rest of his life. Satisfied by Mr Chen’s answer on ownership, “the Boss” then advised that as “competition” would soon erode margins in starch production, it might be worth BC and CC considering an integrated starch and derivative facility. Mr Chen said that CC had achieved its success through “rolling a snowball”, but accepted his logic. Following further discussions, BC and CC agreed to target a starch derivative (SD) that was being produced by just one Chinese state-owned enterprise using technology and equipment imported from Europe.

A technical expert and I were given two weeks to complete the market research, which confirmed the potential of SD, but we also pointed out that the key success factor was to build a marketing capability because neither BC nor CC had any. Upon returning to the UK, we found that it was up to John, director of overseas operations, to read our report due to a reshuffle. As John had rarely been involved in starch, he relied on his director of sales and marketing to digest our report. With neither direct experience in the sales of SD nor first-hand feel for the China market for SD, he only asked us a few questions of a logical nature.

BC’s engineers, meanwhile, negotiated with a Danish equipment supplier (ES) on the supply of technology and equipment for the SD business, and agreed with CC’s technical team, led by Mr Zhang, that

BC was to supply some refurbished centrifuges through ES to reduce capital expenditure. Then came the Chinese government announcement to abolish import duty exemption for foreign investments approved from 1 April 1996 and to require any import 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 sign the supply contract with ES before forming their joint venture! As there was always the possibility that the joint venture might fail to be established, BC and CC shared the contract cancellation charges according to a 51:49 equity structure by facsimileing ES jointly signed memorandums.

Meanwhile, we struggled to assemble a satisfactory financial model for the CEO, who wanted it to show a return-on-investment (ROI) of over 20% by the fifth year before presenting it to "the Boss". The biggest uncertainty was with the forecast of sales volume because nobody had any SD sales experience while CC maintained that they could sell any volume of SD. BC and CC also struggled to agree on the transfer prices of starch by-products the joint venture would have to sell to CC. To break the negotiation deadlock while realising the vision of "the Boss" to target added-value starch business, John saw that the "most logical thing" to do was to take the starch plant out of the joint venture proposition. He consulted the CEO, whose view was that it was not until one left the negotiation table that one was able to find the bottom line of one's opponent. John then instructed Tony to tell CC that BC only wanted to work with CC on the SD business and that if CC did not accept this new position there would be no joint venture. He also added: "This should hurt them." Mr Chen then accepted the former.

As if this wasn't enough, the ROI figure of the financial model for the SD business was still less than satisfactory. John then asked us to "improve" it, so technical staff scaled down the scope of imported equipment while Tony raised the forecast sales prices.

There was one more hurdle: project cost stood at US$18 million, exceeding the US$10 million provincial approval limit, but we had no hope of obtaining central approval before 1 April. Backed by its legal advisor, BC accepted CC's idea of dividing the joint venture into two and seeking provincial approvals. Due to Mr Chen's *guanxi* in the province, it took only three days for CC to secure all the approvals, with the joint ventures obtaining the business licences on 27 March 1996.

People's disruption of the logic based on which the invested venture should be operated. At the first board meeting of the CC–BC joint venture on 15 May 1996, Mr Chen, Mr Zhang, John, Tony and I became directors of the joint venture with Mr Chen and Tony approved as the chairman and the deputy chairman. We also approved CC's nominations of Mr Zhang as the deputy general manager, and Mr Yu as CC's financial representative who, Mr Chen proudly explained, would work part-time for the joint venture because he was also a deputy chief of the local tax bureau. However, Tony's hiring advertisement in Hong Kong had so far only led to the appointment of Victor as the financial controller due to the lack of applicants for the general manager job.

Victor was Canadian-born, Cantonese/English-speaking. After establishing himself at a hotel owned by CC, he reported to Tony in Hong Kong that CC had transferred some employees to the joint venture without consulting BC. Tony did not arrive at the CC hotel until 6 August because, on completing the formation of the CC–BC joint venture, he had been asked by BC's headquarters to develop a new business in Indonesia. At his meeting with Mr Chen, Tony frankly pointed out that according to the joint venture contract, the joint venture would publicly recruit employees, and that he expected the two parties to discuss matters before taking any action. Mr Chen said CC could not afford not to do anything until BC's technical team arrived. He also added that Victor's Cantonese was not helpful in local communication.

On 12 August, BC's technical team – made of one and a half engineers because one of them also worked on the Indonesian project – arrived in Guangzhou for the first technical meeting. In contrast, Mr Zhang brought an interpreter and nine people to the meeting. When BC's engineers asked Mr Zhang about CC's plan for the starch plant that was to supply the feedstock to the SD plant, Mr Zhang emotionally replied, "This is not your business" – after all, CC had kept its expensive, imported equipment packed for over eight months in vain.

Back in the UK, John got very uneasy about the situation. Following internal discussions, BC decided to nominate me as the general manager of the joint venture, supported by an on-site technical specialist.

John wanted me to relocate my family to a local city close to the joint venture, but with a newly born son I could only rely on intensive trips between the UK and China and constant telephone calls and faxes to run the business. Tony also withdrew Victor so that I could appoint a young, Mandarin/English-speaking financial controller from Shanghai.

My new financial controller's first discovery was that as a way of contributing its 49% equity, CC had used BC's injected cash as the deed of security to open a letter of credit (LOC) to pay for the imported equipment from ES. Everybody at BC got very nervous about it but Mr Chen explained that it was "very normal" in China. This was resolved by Mr Chen, Tony and me signing a memorandum for the local bank spelling out CC's sole responsibility for the LOC. Later on, Mr Chen complained to me: "You British are doctrinaires."

Civil construction had been in good progress but problems in purchase seemed to be endless. Too many electrical cables had been ordered, while the diameters of flanges differed from those of pipe work. An assistant cook told me that he suffered from hepatitis and should work in purchase, but my investigations showed that kickbacks were the real reason. I thus decided to review the budget and established a reforecast of US$20.5 million, which included both missing items and import items previously regarded as local. I then obtained board approval for a document specifying purchase procedures and approval limits, and persuaded Mr Chen to replace dominant deputy general manager Mr Zhang with co-operative Mr Huang. I also began to build a marketing team. As the sales person Mr Chen recommended even struggled to make a phone call to potential customers, I recruited a bright marketing manager, Mr Deng, from another joint venture in the northeast.

Then came the commodity inspection bureau's declaration that the imported five centrifuges and several other items were not allowed to be used because of defects. At the third board meeting, Mr Huang said that the five centrifuges were industrial waste, while Mr Chen explained that the incident had adversely affected CC's reputation. They even brought a lawyer to advise on any legal action against ES. John's new finance director, who attended the meeting with his proxy, said nothing while Tony and I had to pretend to be angry. The resolution was for me to lead a team to negotiate with ES. On 1 April 1997, we reached an agreement for ES to repair the items in its workshop in Shanghai.

In early May, ES completed its repair work, but while I was away to relocate my family base to Shanghai, Mr Huang overstepped his authority by signing a contract worth RMB5 million with a local tank fabricator nobody had even visited. Mr Yu refused to reimburse some business trip expenses of Mr Deng's because I had refused to authorise the reimbursement of some of his personal expenses at local restaurants. When I saw Mr Chen, he said that it was time for the joint venture to take legal action against ES, and that he trusted Mr Huang and his fabrication contract because BC's technical specialist always wanted to use expensive contractors. He also complained about my recruiting sales people from other provinces on the grounds that they cost too much, even though I told him that the local sales person he recommended was incompetent. On hearing my report, John advised that BC was to send a panel of directors to review the SD project and I could discuss these issues with them. Given the pressure I was under, the review panel later decided to let Tony take over my job.

The tank fabrication contract had indeed been a disaster. Tony resolved the issue by re-importing stainless steel from Europe and choosing a fabricator in Shanghai to do the job. Following intervention from the provincial governor who met the CEO during an official trade mission in the UK, the inspection bureau declared the repaired items qualified for use on 1 April 1998, but CC did not pay the last LOC instalment. In August 1998, the police arrested Mr Huang for soliciting bribery – one piece of evidence was that he had used the joint venture's civil contractors to build two new houses for his family as side deals.

Entering 1999, the plant was commissioned as ES had promised in its contract with the joint venture but the joint venture had no working capital to keep the plant running. With little hope to obtain any bank loan and CC refusing to increase its equity, BC had no choice but to increase its equity share to 57% by injecting an additional US$2.5 million. Then, after expatriate Tony was replaced by a local director of another state-owned enterprise on cost grounds, Mr Deng left because he felt the company was no longer a joint venture under the new general manager. In 2000, following the sale of its UK starch subsidiary, BC sought to sell its stake in the joint venture to CC, but Mr Chen offered an unacceptable price. Following consultation with a consulting firm, BC decided to withdraw all its personnel from the site, provide the joint venture with a shareholder's loan, and leave its operation to CC.

Being a China executive as a personal challenge. During four years of hard work to develop new businesses in China, I worked with people ranging from the once fourth richest person in the UK to peasants in the poorest regions in China. I made over forty return journeys between the UK and China, and covered much of China. After transferring my job to Tony in late 1997, I moved on to co-ordinate the establishment of BC's second food ingredient joint venture in Southern China and steer its management development work, with my family base changed to Hong Kong. One day, I was knocked down by carbon monoxide from an inferior gas-fired shower unit when I was having a shower in an expatriate flat on the joint venture site and only regained consciousness two hours later after being taken to a distant hospital.

Yet, along with many of my colleagues, I could not escape the irony of our initial "investment logic". In March 1998, FC announced that its annual turnover had dropped by 5.5% and its annual operating profit by 7.6% for the first time in the 1990s. Its joint venture in Indonesia had to be mothballed because of the financial meltdown in the country. In China, the food ingredient joint venture established in May 1995 had also suffered from an oversupply in the market. "The Boss" thus decided not to make further investments in Asia, but to consolidate the ones already made. This meant redundancies, and I became a candidate at the end of 1998. BC's personnel director flew to Hong Kong and offered me a choice between a redundancy package and a new start back in the UK through retraining. On deep reflection, I decided to choose the former: I remained convinced that making an investment in China was the most challenging business task in the world, and that no real effort had ever been made by anyone to tackle it. I strongly felt that I should be the one to play this role.

Will what follows in this book help the CC–BC joint venture (and, indeed, many other foreign investment ventures in China) find a way forward, and millions of existing and potential China executives rise to the China investment challenge?