

The China Experience Gap

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I have come to understand that the biggest challenge to success in China is adjusting to what we call the China Experience Gap. Whether a company is selling, producing or sourcing in China, understanding the China Experience Gap is the first and most important challenge to success. If a company doesn't adjust for it, the risk is underperformance or even failure. The good news is that navigating the China Experience Gap is not difficult once its unique effects on your business model are understood.

It is easy to travel China and marvel at the mega-cities such as Shanghai, Guangzhou, and Shenzhen. It is difficult to remember that not much longer than twenty years ago, almost none of the physical sophistication existed anywhere in China. In 1993, Pudong Shanghai was farmland and not the dense industrial concentration it is today. There were almost no "interstate-quality" highways in Shanghai and the airport was a small dingy place with more obsolete Russian planes flying than Western aircrafts.



Top is the same view of Shanghai in 1990 and twenty years later.

With all the advanced infrastructure in China today, it is tempting to believe that China is now a modern country. That misperception is the cause of countless problems encountered by Western companies in China.

In the West, our sophisticated business processes are the result of a multi-generational knowledge transfer process. Western business professionals have their formal education and their personal experience. However, much of what we take for granted in Western business practices is the result of people and organizations learning from mentors, who learned from mentors, in an evolutionary process that has continued for generations and even centuries. The legal system in the U.S. has its roots in English Common Law and the signing of the Magna Carta in 1215 – over 800 years ago.

On a personal level, didn't each of us start our careers after school, working with little or no practical knowledge? Didn't we learn practical business from older coworkers, some of who had decades of experience? Western companies benefit immeasurably from having multiple generations of staff working as a team. The result is an organic development process and it is the core of the sustained strength of Western business. China does not have this foundational process and simply can't for decades to come.

The fact is that China has been engaged in Western-like business for only a little more than two decades with any depth or breadth and primarily only in major cities such as Shanghai, Guangzhou and Beijing. Move relatively short distances from these cities even today and the commercial environment remains very underdeveloped by Western standards.

The Experience Gap has commercial, institutional and even individual dimensions that need to be understood by companies doing business in China.

Commercial – Many common practices between customers, suppliers and employees that are taken for granted in the West have not developed equivalent maturity in China. These practices have evolved over decades and centuries of Western economic development, becoming embedded "business DNA."

One example –

You ask a supplier for 10 product samples that meet a defined specification. You get samples that look great, award the business and place an order for 50,000 pieces and 50% of the pieces you receive are out of specification. You react and find that to get the 10

samples, the supplier sorted through the production to find the best samples. The supplier answered your literal request, but did not understand your intent that the sample be a random selection to test the production distribution and general quality level than can be expected in normal supply.

This is just one example of scores of practices that happen by habit between companies and people in the West every day that have just not achieved the same commonality in China. If a Western company assumes these practices are common in China, painful disappointment is too often the outcome. Easy solutions exist in almost all cases as long as the potential disconnect is identified before a problem emerges.

Institutional – In the West, institutions and processes such as banking, insurance, capital markets, judiciaries and the regulatory fabric of the legal system are generally well-developed and predictable, creating a confident common playing field where business is conducted in the West.

The parallel systems in China are not as developed or common throughout the country. In the U.S., whether a company operates in Los Angeles, New York or Dothan, Alabama, business is generally conducted to a fairly common set of rules and paradigms. Sure, there are differences by state and municipality, but not major differences. In China, laws and regulations – even local interpretations of national laws – can vary widely between cities and provinces. The banking and insurance systems are much less developed than in the West and this is a fundamental reason why China is unable to have a freely convertible and floating exchange rate. Financial reporting transparency and capital markets remain embryonic by Western standards. As with commercial issues, it is necessary to invest the time to understand how these differences will affect your business and adjust accordingly for success.

Individual - The Experience Gap has also had a profound effect at the individual level. If I had been Chinese and a member of a college-educated family in 1966 during the outbreak of the Cultural Revolution, my life would have been radically changed at the age of thirteen. Almost all formal schools, universities and libraries closed for more than a decade. Educated professionals were exiled by the millions to the countryside and placed into political “re-education programs” which were essentially rural labor camps.

The educational infrastructure did not restart until 1978, when the Cultural Revolution ended and Deng Xiaoping began to reopen China to international interaction. In 1978, I would have been 25 years old, with an 8th grade education and few prospects because the infrastructure did not exist to allow me to rewind and retool my education and skills. This is the experience of the “Lost Generation” of China and it dominates the life experience of people over the age of 50 in China today – a prime managerial class in Western society.

When I work in China and interact with Chinese businessperson of my age, it is often hard to adjust my thinking to this reality. We meet in well-appointed offices; often travel in luxury cars and entertain generously. It is almost inevitable that I project that my local Chinese counterparts have a common business experience level, but the facts are that they do not.

The Experience Gap Reality

When I first started working in China in 1993, not only was the modern infrastructure missing in big cities like Shanghai, the rudimentary capabilities and “rules” of business did not exist. There was essentially no accrual accounting practice. The accountant in our first joint venture in China still used an abacus and did all recording on rice paper accounting ledgers. ERP systems, MRP inventory management, quality systems, cost accounting practices or almost any of the business tools that were in routine use in the U.S. at the time did not exist in China. Even today, the use of common Western tools like MRP in China – even at relatively advanced companies, is uncommon and rudimentary at best.

In 2016, there are essentially zero local Chinese managers with over 20 years of Western grade experience. There may be the occasional foreign expat on staff that helps, but that does not fill the gaps. Chinese companies are most commonly managed by employees who have, on average, much less than 10 years of “equivalent” Western grade experience and the business system infrastructures they are operating are far less developed than we expect in the average U.S. company.

This is the China Experience Gap. It relates to people and processes. The China commercial environment is simply far less developed and sophisticated than we take for granted in the West. This is not a criticism of China, just an objective observation based on over 25+ years of starting and

running companies and assisting over 300 clients to develop and execute business strategies in China.

Adjusting for the Experience Gap

Many foreign companies struggle in China because they do not understand or adjust for the China Experience Gap. They fall into the trap of believing that paradigms and processes that work well in the Western markets are directly transferrable to China. If a company enters China and expects that a China supplier, customer or employee can quickly adopt sophisticated business processes and management disciplines, the foreign company is simply not being realistic. Companies that insist on this approach inevitably confront “innocent mismatches” of expectations – many of which undermine business performance and in some cases result in disastrous consequences.

Adjusting successfully to the China Experience Gap is not difficult and it is key to sustained business success. The first step is accepting that the gap exists and then exploring how it impacts your specific business situation and objectives. The second step is understanding that with the more sophisticated process experience, it is up to the Western Company to adjust expectations and processes to close the gap.