The panda has two faces

Doing business in China is no stroll in the people's park—and never will be.

GOOGLE and Rio Tinto are the chalk and cheese of the business world: the former a bits-and-bites wunderkind born in 1998, the latter a grizzled mining company that has been around since 1873. But over the past few months they have both found themselves in trouble with the Chinese authorities.

To avoid censorship, Google has closed its Chinese search engine and diverted traffic from the country to its site in Hong Kong. Rio Tinto has seen four of its employees sentenced to lengthy prison terms for taking bribes from Chinese firms. Google and Rio are only the most recent of a long line of Western companies to have been bruised by China. Unilever suffered for years because it was forced into shotgun marriages with unsatisfactory Chinese partners. The government has prevented Coca-Cola from buying a local juice-maker out of seemingly spurious concerns about competition. A recent survey by the American Chamber of Commerce in China found that a high proportion of American firms doing business in the country feel that they are the victims of discriminatory or inconsistent treatment.

The most obvious reason for this is that the ruling Communist Party is a nightmare to deal with—all smiles one moment and snarls the next. The party has been wooing foreign investors for decades with access to cheap labour and a huge market, not to mention fancy office parks and world-class infrastructure: since the mid-1990s Shanghai has built a second international airport, a new subway, inner and outer ring roads, two elevated freeways and a light-rail system.

But at the same time the Chinese want their pound of flesh. The party regards foreign investment as a mechanism for acquiring foreign know-how rather than just jobs and capital; hence the insistence on joint ventures. It also regards economic growth as a tool for entrenching its own power; hence the application of the iron fist whenever business threatens to get out of control.

These political difficulties are piled on top of cultural difficulties. The Chinese emphasis on personal connections (guanxi) makes it hard to distinguish between business-as-usual and corruption. And the weakness of the legal system means that companies operate in a confusing half-light. Transparency International's most recent Corruption Perceptions Index ranks China 79th out of 180 countries.

Corruption, legal caprice and the government's determination to control and exploit foreign firms all seem to have played a part in Rio's troubles. Although the trial of Rio's employees hinged on the bribes they confessed to taking, the government's decision to arrest them in the first place came hot on the heels of Rio's decision to pull out of a deal with one Chinese state-controlled firm, and amid tense negotiations over the price of iron ore with others. The government has done nothing to bring the Chinese bribe-payers to book. In the case of Google, the government not only insisted on censoring search results, but was also thought to be behind attempts to hack into dissidents' correspondence on the company's webmail service.

All very messy. Yet the only thing more dangerous than dealing with China is not dealing with it. China is already well on the way to becoming the world's biggest market for anything you can think of. It has 400m internet-users compared with America's 240m and India's 80m. Last year car sales in China surpassed those in the United States. And the Chinese market is only going to get bigger. China's economy is growing at 10% a year at a time when the developed world looks set for a period of prolonged lethargy. No wonder more than 300,000 foreign firms have invested in the Middle Kingdom.

How can these companies boost their chances of riding the Chinese wave rather than being dragged down by the undertow? The fact that some of the world's best companies have struggled in China suggests that there are no easy answers. But several decades of corporate agonies suggest two clear rules for doing business in the country.

Just add butter

The first is that companies need to show an almost exaggerated respect for China's traditions: the Chinese are simultaneously immensely proud of their history and highly suspicious of foreigners who, in their view, have repeatedly mistreated them. This means making a long-term bet on the country. P&G took three years to become profitable in China. L'Oreal took nine. KFC spent ten years perfecting its business model before becoming the powerhouse that it now is, with restaurants in 450 cities. It also means investing heavily in politicking. Stanley Wong, head of Standard Chartered's Chinese operations, reckons that multinationals' senior representatives in China must spend 30-40% of their time buttering up officials and regulators.

The second rule is that companies should never abandon their principles for short-term gains. Freedom of information is so central to Google's identity that it was right to declare it sacrosanct and repudiate its previous willingness to negotiate it away for commercial advantage. Although the Chinese government may not accept such intransigence, as in Google's case, the odds are better if firms slavishly follow the first rule.

That is a price worth paying. There is growing evidence that the Chinese market is living up to its promise. The American Chamber reported in 2008 that three-quarters of the companies that it surveyed were finally making money in China, and almost half were enjoying margins that are higher than the global average, up from 13% a decade before. But there is equally no doubt that the Chinese will remain tough customers. They have profited mightily from their ability to squeeze concessions from Western firms. And the financial crisis has boosted their confidence in their way of doing things. There will be plenty more cases like Google and Rio Tinto in the years to come.

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