China: Different Institutions, Different Corporate Management

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Whereas Nicholas Lardy of Peterson Institute for International Economics analyzes the unabated growth momentum of the Chinese private sector with massive aggregated data at the macro level, Thomas Hout, Professor of Monterey Institute of International Studies, Senior Lecturer of the Fletcher School of Tufts University, and former Partner of Boston Consulting Group, brings to the talk series "Critical Issues Confronting China" a micro perspective on how private Chinese enterprises grew from an unfavorable business environment dominated by state owned enterprises (SOEs) in the 1980s to today's prosperity. He predicts that future great Chinese companies will not be any of the state champions or any SOEs, but come from this group of very dynamic and resilient private companies that are used to maneuvering under shackles, overcoming all kinds of difficulties and making the system work for them.

The leaders of this group of private companies are usually not well educated. They often come with a very marginal social background. Not only they did not have any state protection, they also suffered state bias favoring SOEs. Wanxiang Group (万向集团) is such an example. It was started more than 30 years ago by Lu Guanqiu (born in 1945), then a blacksmith, as a township and village enterprise (TVE) to repair automobiles. For many years, it could not hire university graduates or get into steel business because those resources were all allocated for SOEs. Now it has become one of the largest auto parts suppliers in the world, expanding into Chicago and Detroit through acquisitions in America. One can only imagine how many obstacles the founder had to overcome along the way. The characters of such successful private Chinese companies - energetic, flexible and efficient - to a large extent, reflect the passion, the vision and the drive of their founders, many of whom are still alive.

As a former business consultant, Hout asks, does the success of some Asian companies teach us something about management? He compares these vibrant private Chinese enterprises with those of Japanese which became renowned in the 1970s. Successful Japanese companies taught us continuous improvement in their relentless pursuit of quality and just-in-time inventory management to be lean in any production. Chinese companies are different, Hout concludes. Their experiences don't give us any such definitive or substantive lessons to draw.

According to Hout, Private Chinese companies have what Harvard's Paul Lawrence and Jay Lorsch call "organic management". This is because they grew up in a very messy environment in the 1980s when there were no clear rules. They had to be very entrepreneurial, resourceful and adaptable. They are polar opposite to the highly
structured management of large American companies, epitomized by IBM, which operate in a mature market system with well established rules and regulations. Private Chinese enterprises improvised solutions as they encountered problems. NeuSoft (东软集团), a Chinese IT service company like EDS of the U.S., is a case in point. In order to preempt potential competitors, it expanded rapidly across China throughout the last two decades, without developing much middle management and becoming a very fl at organization. To fuel its expansion, it needed a large number of computer engineers and IT trained people. When it could not find enough qualified people to hire, its solution was to build a school itself, called NeuSoft Institute University. It deliberately does not want to replicate those elite universities in Beijing, but focuses on technical training while encouraging entrepreneurial spirit. Now it enrolls 25,000 students, every one of whom has to come up with a business plan in order to fulfill the graduation requirement.

Hout admits that China’s single-party political system will not go away any time soon, but is optimistic that Chinese entrepreneurs have learned how to go around the system or make the system work for them. NeuSoft established itself from nothing partly because one day a local Party branch office called the founder and asked for some computer services. The founder immediately realized that this was an excellent opportunity to make his company indispensable to the local government. This is how local government and private companies lean on each other to achieve their own objectives respectively. In the late 1990s, under the leadership of President Jiang Zemin, entrepreneurs were not only allowed but also encouraged to join the Communist Party. Joining the Party thereby became a stepping stone for many entrepreneurs to better navigate official channels for business purposes.

The relationship between the Party and Chinese business entrepreneurs is different from the arms-length relationship between government and business in the U.S. In China, officials often have considerable discretion. They can decide whether a private business survives or not, and often use this discretion to enrich themselves. Chinese entrepreneurs have found ways to protect themselves from government extortion. One private Chinese company in negotiation with a foreign company proposed that the foreign company buy more than 50% stake of their joint venture so that the intellectual property owned by the Chinese firm would not get into the hands of the local government. The Chinese are ingenious when trying to make the system to work for themselves.

Local Chinese officials also want some private companies to rely on them so that they can get certain things done and reach certain policy objectives when needed. For example, in the aftermath of the 2008 financial crisis, Some Chinese officials worked to prevent foreign companies from laying off workers. A local Party official would talk with a CEO of a foreign company. The CEO would use this opportunity to complain about some hassles with the Chinese tax authorities or the difficulty of obtaining some operating permit. The official would solve these problems for the CEO, and the CEO would in return keep his work force intact during the economic downturn. Is this corruption or simple deal making that would occur anywhere? The line is blurred. Hout
calls it "coping" rather than corruption. He would not label the Chinese economy as state-led capitalism, but rather "municipal capitalism", since it is local governments that fed flourishing private enterprises.

Hout sees strong futures for private Chinese companies such as Huawei and Lenovo, as well as many smaller companies. He thinks that the entrepreneurs of these companies are no different from America's Henry Ford and Bill Gates, spending most of their time and energy competing in the markets and pre-empting their rivals. Speaking like a seasoned investor, Hout says that the future of private businesses is just like a numbers game - the more start-ups there are, the more are likely to survive and succeed, and the more are likely to make it to the top world-class companies. By now there have been so many inspiring role models in front of a younger generation of Chinese that the entrepreneurial base in China will only expand - more and more Chinese entrepreneurs will spruce up, thriving not only in Chinese markets but also in world markets.