

Forming business partnerships through joint ventures remains an attractive way to do business in China. However, establishing and operating a successful business partnership is not getting easier, and the ability to anticipate, prevent and resolve challenges associated with partnerships is more important than ever.

Courting China Inc: Expectations, pitfalls and success factors of Sino-foreign business partnerships in China



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Foreword

Partnerships are becoming a compelling strategic option for many companies to drive growth in emerging markets and adjacent industry sectors. Our PwC 18th Annual Global CEO Survey recently showed that 51% of global CEOs planned to enter into new joint ventures (JVs) and/or strategic alliances (SAs) in 2015, with particular interest from the Australian CEOs at 62%.

The growing trend of Sino-Australian Joint Ventures & Strategic Alliances (JVs & SAs) is particularly driven three key factors: a deep level of existing trust and goodwill developed through long term trading relationships recently formalised by the signing of the Free Trade Agreement (FTA); the proximity of location; and strategic value both economies can bring to each other i.e. access to large Asian market for Australia, and access to Australian IP and leading practices/processes for China.

As we discussed, in our 'Science of Alliances' paper released in 2014, partnerships are extremely challenging to execute and operate, with over 50% failure rate and two-third of partnerships ending within the first two years. As a result, our ability to anticipate, prevent and resolve challenges associated with partnerships is more important than ever. Failure to identify and consider the risks in these arrangements can have a significant impact on their likelihood of success and their value to the respective parent companies.

In order to identify key success factors for prosperous Sino-foreign business partnerships, relevant to both Chinese and foreign companies, PwC commissioned the Economist Intelligence Unit (EIU) to learn more about the challenges faced by these companies when they set up a Sino-foreign JV or SA in China.

We are excited to share our new publication on JVs & SAs which presents insights around key challenges & success factors for Sino-Foreign business partnerships, based on comments from over 300 senior executives globally.



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About the report

Courting China Inc: Expectations, pitfalls and success factors of Sino-foreign business partnerships in China is a report commissioned by PwC and written by the Economist Intelligence Unit (EIU).

It explores the motives of Sino-foreign business partnerships in China (including Sino-Australian businesses), and the challenges companies face as they partner to conduct business in the world's second largest economy. It provides key success factors for prosperous Sino-foreign business partnerships, relevant to both Chinese and foreign companies.

In February 2015, the EIU surveyed 300 senior executives, 50% of whom are C-level, on a wide range of issues related to the formation and operation of joint ventures (JVs) and strategic alliances (SAs)¹ in China, both of which will be referred to in this report as business partnerships.

The study covered nine geographies (the US, UK, France, Germany, Japan, Singapore, Hong Kong, Australia and China) and 19 industries (primarily manufacturing; retail & consumer goods; healthcare, pharmaceuticals & biotechnology; IT & technology). Company sizes varied from small (less than USD500m in annual revenues) to large (more than USD10bn in annual revenues).

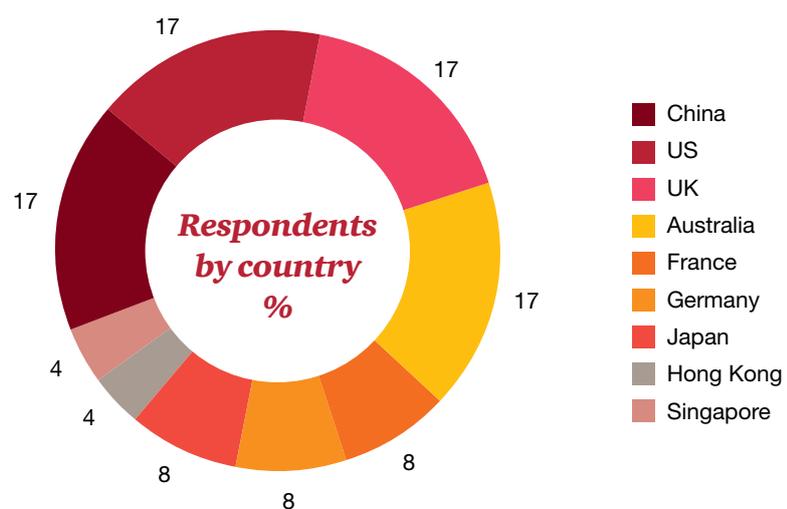
In addition to the survey, the EIU conducted a series of in-depth interviews with the following senior

executives and experts (listed alphabetically by organisation):

- Raymond Akers, executive chairman, Akers Biosciences
- David Ahlstrom, professor, department of management, The Chinese University of Hong Kong
- Thibaut Helleputte, general manager, Danone Mengniu
- Jean-Michel Vallin, president, Faurecia China
- Wu Xiaobing, regional president, Pfizer China
- Ari Mervis, managing director, SABMiller Asia Pacific and chairman, China Resources Snow Breweries
- John Kajander, general counsel, Shanghai General Motors
- Yadong Luo, professor of management, University of Miami

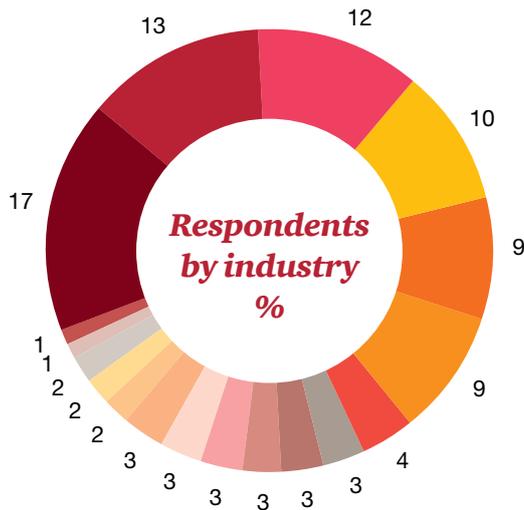
The original edition of this report provides insights around key challenges and success factors for Sino-Foreign business partnerships.

This report has been tailored to include additional insights based on the Australian senior executive respondents.



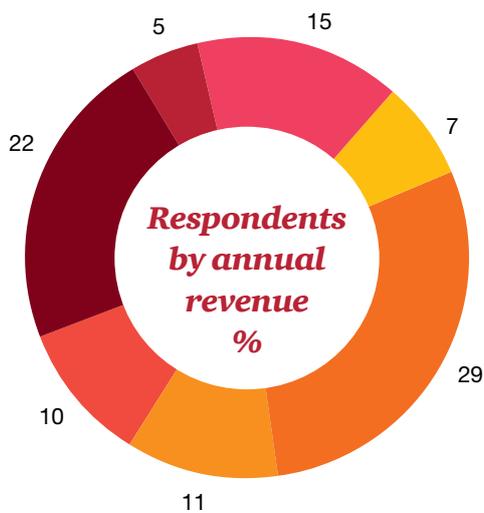
Source: Economist Intelligence Unit

¹ In joint ventures and strategic alliances, two or more firms partner and commit resources to achieve a common set of objectives. Unlike strategic alliances, (non-equity alliances and equity participations), joint ventures utilise a separate business entity to allow two or more parties to collaborate in conducting specified business activities.



- Manufacturing
- Consumer goods & retail
- Healthcare, pharmaceuticals and biotechnology
- IT and technology
- Energy and natural resources
- Financial services
- Entertainment, media and publishing
- Construction
- Telecoms
- Agriculture and agribusiness
- Automotive
- Chemicals
- Travel and tourism
- Logistics and distribution
- Transportation
- Real estate
- Aerospace/defense
- Other (including Government/public sector and Education)

.....
Source: Economist Intelligence Unit



- More than \$10bn
- \$5bn to less than \$10bn
- \$1bn to less than \$5bn
- \$500m to less than \$1bn
- \$150m to less than \$500m
- \$50m to less than \$150m
- Less than \$50m

.....
Source: Economist Intelligence Unit

Please note that not all answers add up to 100%, either because of rounding or because respondents were able to provide multiple answers to some questions.

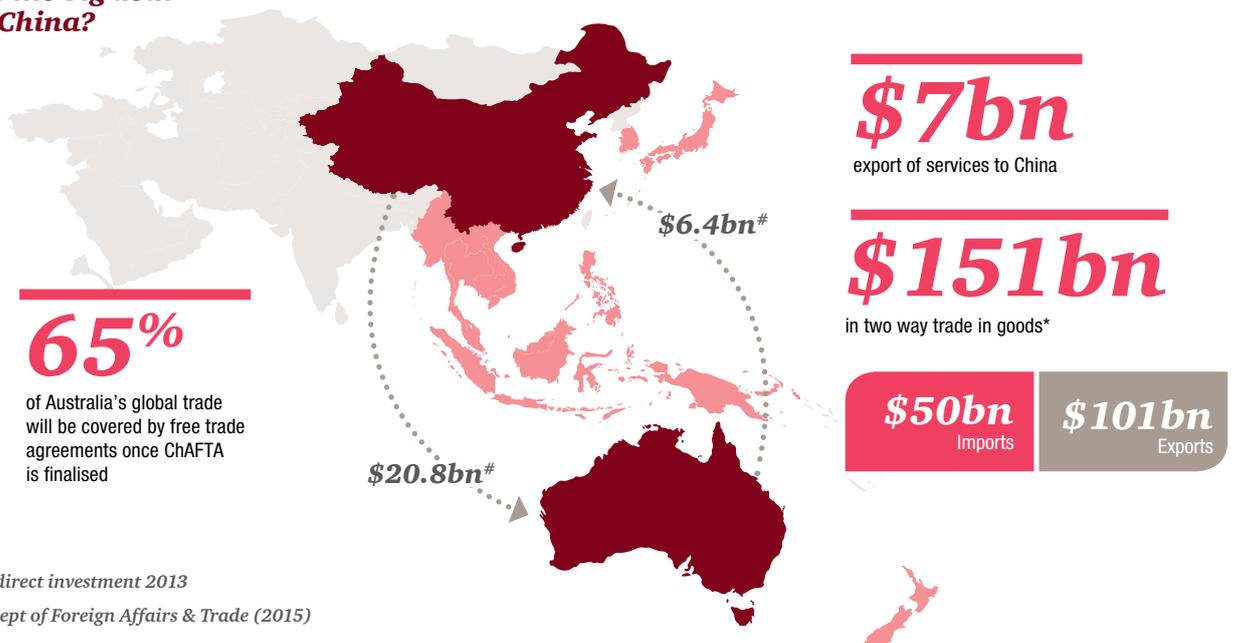
The Sino-Australia context

The biggest partnership of all: China Australia Free Trade Agreement (ChAFTA)

The signing of the ChAFTA in June 2015 is an invitation to a partnership which not only gives Australia unprecedented access to the world's fastest growing region and a firm position in China's future growth, but also provides China with reciprocal access to the Australian market.

The FTA will greatly enhance Australia's competitive advantage and attractiveness in key sectors such as agriculture and food, financial services, resources and energy, manufacturing, services and health. It will also quicken the pace of change in global supply chains and Australian companies will need to make the most of these opportunities for growth and embrace change.

What's the big deal about China?



It's all about shared value

Key to the growth in partnerships between organisations from Australia and China is the strategic value that each party can offer to the other.

Organisations in China are hungry to secure strategic supply of inputs, access to skills and capabilities, and the ability to diversify investments both offshore and along the value chain.

Conversely, Australian organisations are well positioned to fill these needs and in return get market access specifically to the evolving Chinese consumer, navigation of regulatory hurdles, and access to capital.

And there are macro forces at play too

Tempered economic growth and a lower Australian dollar is forcing Australian organisations to think more creatively to access emerging markets such as China. As Australia makes the shift from a reliance on hard commodities exports to other industries including skills and services (e.g. education and training), there is significant synergy with the Chinese market.

As China continues to develop, so too does the evolution of the Chinese consumer and we are seeing a significant increase in demand for premium Australian products and services.

Productivity gains through education and training is expected to be a key driver of opportunity in China over the next decade; Australia is seen as a key partner in developing China's next generation; the number of students from China enrolled to study in Australia continues to grow and is now well over 100,000.

“Australia is now in a position to take full advantage of China's demand for premium products”

Andrew Robb, Trade & Investment Minister

Executive summary

The key findings of this report are:

No signs of a slowdown when it comes to using joint ventures to do business in China. Despite China's slowing economy, recent scrutiny of foreign companies and rising labour costs, forming business partnerships through joint ventures remains an attractive way to do business in China (less risky, less costly and sometimes the only alternative). 76% of foreign respondents and 70% of Chinese respondents are planning on entering into a business partnership in China. For now, there are enough opportunities to go around. A significant majority of respondents describe the prospects of a partnership in China as good or excellent.

Divergent objectives can exist from the very beginning of a JV or SA partnership. The main strategic focus of foreign companies is access to China, while for Chinese partners it is international expansion. This requires leveraging the capabilities and competencies of the partner (notably distribution channels and market knowledge) and therefore requires a high level of trust and openness between partners. Interestingly, more than one third of the Chinese companies are still forming JVs/SAs to strengthen their competencies and capabilities in China, notably as they want to be able to satisfy a more demanding Chinese population.

For foreign respondents, the primary driver of choosing JVs & SAs business model versus other entry modes is because of the regulatory requirements in China. Nevertheless respondents say JVs/SAs also offer the benefit of sharing resources and skills at a reasonable cost while limiting risks.

Both foreign and Chinese partners are worried most about the costs and complexities of setting up a JV or SA. As with most business ventures, costs remain a key point for all parties and an important area of consideration prior to establishing an operation. Foreign investors are also concerned about the risk of JVs & SAs failure, whereas this is less of a concern for Chinese respondents. However, they are more focused on the lack of personal connection with their partner and their partner's reluctance to share its technology and R&D capabilities.

Foreign companies are focusing more on their business's compatibility with potential partners in China than in the past. When considering their Chinese partners, foreign firms are looking beyond local business, political and social networks and focusing more on strategic features of Chinese companies, such as their market responsiveness and open-mindedness. This will likely be a growing trend as Chinese companies increase in sophistication and capabilities.

Strategy misalignment and cultural differences are among the main reasons why partnerships are not formed. Both foreign and Chinese parties agree that the chances of being successful are almost nil without a shared strategy and the ability to deal with cultural differences.

Financial performance is now a top concern for business partners in China. No matter how complementary the relationship between partners, the JV or SA must ultimately deliver on financial objectives once it is off the ground. Poor financial performance is the top factor cited by survey respondents why partnerships in China may have to be terminated early.



Introduction

China's rapid growth trajectory has shifted in recent years. GDP expansion, while still relatively robust for a country of China's size, has slowed considerably. The pace of infrastructure investment and industrial output has cooled.

None of this is to say that opportunities for foreign companies are on the wane. China is currently trying to climb up the value chain and focus its economy on domestic consumption and more knowledge-based innovation. This structural change has brought with it a need for international experience, knowledge and talent and has resulted in a shift in M&A strategy and execution.

While wholly foreign-owned enterprises (WFOEs) are still the dominant method of entry and operation in the Chinese market, forming JVs and SAs with local partners has remained a viable option for foreign multinational companies (MNCs) in recent years. According to data from China's Ministry of Commerce, business partnerships remain the second-largest mode of utilising foreign direct investment after wholly foreign-owned enterprises.

At the same time, establishing and operating a successful business partnership is not getting easier. A 2015 study from management consultancy Vantage Partners found that 59% of business alliances completely or partially fail to meet their objectives, mainly due to execution challenges².

Given these hard realities, why pursue a Sino-foreign business partnership in China? What are the challenges and success factors foreign and Chinese companies should take into account?

This report explores these questions from both foreign and Chinese perspectives. The first chapter covers the key drivers of JVs & SAs formation. The second chapter covers the challenges and the third chapter discusses the important lessons learned from the research.

² Kliman, Stuart and Price, Stuart. "New Alliance Management Study - Success rates increase but challenges remain", Vantage Partners (2015) p1.

1. Choosing the JV& SA business model to address the Chinese market

1.1 The attractiveness of China’s ‘world-class consumers’

China is in the midst of a massive economic transformation, shifting focus from exports and heavy investment to a greater reliance on domestic consumption. In the past, foreign companies sought to establish factories in China to export goods and components. Today, they are increasingly formulating strategies to serve the fast-growing consumer market. The resulting impact on companies looking to do business in China is to push them further up the value chain. Chinese consumers have become more demanding as they look for more innovative and high quality products. “Customers [in China] have become very well-educated about the products,” said John Kajander, general counsel at Shanghai General Motors. “They’re world-class consumers.”

1.2 The relevance of the JVs & SAs model in China

From the 1980s to the 1990s, regulatory restrictions in China required foreign investors to partner with Chinese companies in many industries. However, easing of restrictions on foreign investment, especially after China’s World Trade Organization (WTO) entry in 2001, helped the number of newly contracted WFOEs to rise and exceed that of equity JVs.

The survey highlights that the top reasons why foreign companies choose a JVs & SAs business model over others are regulatory requirements (4.0), cost reduction (3.9) and access to their partners’ resources (3.8). Similarly, Chinese companies choose the JVs & SAs business model over others to access their partners’ resources (3.9), to reduce costs (3.8) and to adhere to regulatory requirements (3.8)³.

“As the Chinese middle class swells, there has been much made of Australia’s opportunity to transition from the “mining boom” to the “dining boom”... the rising Chinese middle-class will need more than just resource and energy security.”

Ahmed Fahour, CEO, Australia Post

Figure 1: Top reasons for choosing JVs & SAs model

Scale: 5=very important and 1=unimportant



Note: Results are based on average scores.

Source: Economist Intelligence Unit

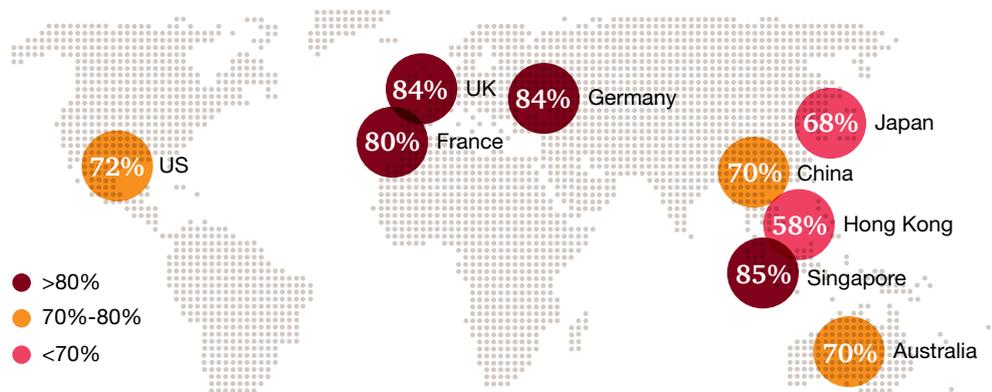
³ The rankings are based on averages of a scale in which 5=very important and 1=unimportant.

Interest in forming JVs and SAs will grow, with 70% of Australian survey respondents planning to enter a new business partnership in China – Economist Intelligence Unit.

It is clear that regulatory requirements are still driving the need for establishing JVs/SAs in restricted industries. However, the fast pace of consolidation in some Chinese industries has driven deal values higher and also contributed to foreign companies turning to JVs as a less costly and less risky way of accessing the Chinese market (notably as the quality of potential partners has also improved⁴). JVs/SAs also provide an appropriate structure to access a partner’s market or to be more competitive in China.

In line with these observations, the survey indicates that interest in forming JVs and SAs will grow, with 75% of respondents (foreign and Chinese) saying they are planning on entering a new business partnership in the country.

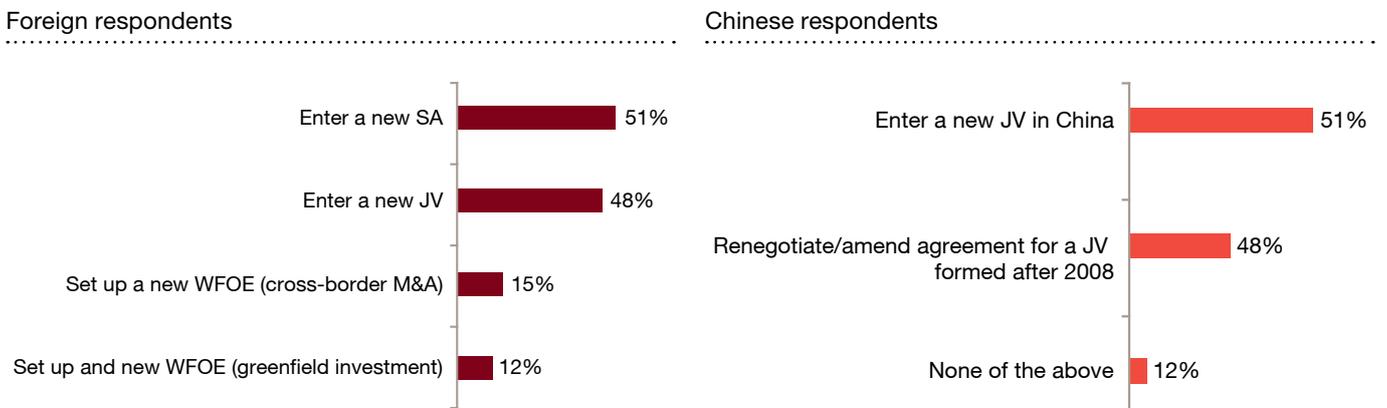
Figure 2: Percentage of respondents planning to enter a JVs & SAs in China by country



76% of foreign respondents and 70% of Chinese respondents surveyed are planning to enter into a business partnership in China.

Source: Economist Intelligence Unit

Figure 3: Business partnership plans in China



Source: Economist Intelligence Unit

⁴ Davies, Ken. “China Investment Policy: An Update”, OECD Working Papers on International Investment (2013) p14.

1.2.1 The weight of regulated industries

There are still some restricted industries for foreign companies in China that require the formation of a JVs & SAs. The most commonly cited example is the automotive industry. Since 1983, any foreign automaker that has wanted access to the local market has had to set up a JV with a domestic firm, in which the Chinese ownership must be at least 50%. A more recent example occurred in 2013 and 2014 after the removal of a game console ban in China that lasted from 2000 to 2014. The two giant console makers Microsoft Corporation and Sony Corporation had no choice but to partner with Chinese companies to enter the Chinese market, and announced their JVs with BesTV New Media and Shanghai Oriental Pearl Group, respectively.

Looking at other sectors, market access is a key driver for foreign respondents from the healthcare (72%) and energy/natural resources sectors (71%). Both segments are benefitting from China's growing middle class: more Chinese are demanding and paying for better quality healthcare, while more natural resources are being consumed by the country's new infrastructure and growth in automobile sales.

However, companies from these sectors have faced market access barriers, making it important to find a local partner. In healthcare, onerous clinical trials and regulatory hurdles that affect data protection and competitiveness have been challenges for foreign firms seeking to enter China. In the energy/natural resources sectors, inconsistent access at the provincial and local levels can make market entry difficult.

China's central government is opening up domestic industries to foreign investment, but progress across the country will be gradual. The 2015 Catalogue for the Guidance of Foreign Investment Industries significantly cut the number of industrial sectors that are currently restricted to JVs and partnerships from 43 to 15, and decreased the number of sectors that require a Chinese minority shareholder from 44 to 22.





1.2.2 Market access and competitiveness in China

The survey shows that foreign companies keen on partnering with a Chinese firm primarily aim to play a role in the Chinese market. Indeed, access to the Chinese market (54%), improved market position in China (47%) and access to Chinese consumers (40%) are the key strategic drivers sought by MNCs. Foreign companies pursuing consumer opportunities in China often require the experience and resources of a local partner to negotiate the local market.

Access to customers is an especially important strategic motive for respondents from Asia Pacific countries excluding China and from industries where delivering a personal service offering is important, such as the retail/consumer goods (47%) and financial services sectors (46%), according to the survey.

Conversely, Chinese partners are looking beyond China. The survey shows that nearly three quarters of Chinese companies (72%) enter business partnerships with foreign businesses to improve their market position in international markets and/or to access international markets. This is the China outbound trend. The implication of these survey results is that many Chinese companies are still not fully equipped to succeed in the international marketplace on their own. Since China's entry into the WTO, Chinese firms have increasingly pursued business partnerships with foreign partners to access international markets without having to compete directly, and to gain necessary capabilities and knowledge that later will enable them to enter these markets without a foreign partner.

“Australia is a premium brand in China and the Chinese consumer is seeking Australian”

Robert Poole, Deputy Chairman, Australian Dairy Council

Interestingly, one third of Chinese firms (34%) also intend to set up a JV with a foreign partner to improve their market position in China. By establishing partnerships with foreign companies, Chinese companies often benefit from their partners' resources and capabilities such as technology, R&D capability and capital (34%), to differentiate from local competition. For example, in 2012, Chery Automotive, an automobile manufacturer in China, set up a JV with Jaguar-Land Rover to acquire production, project-execution and innovation capabilities.

1.2.3 An alternative to increasing M&A values

The slowdown in the Chinese economy has translated into overcapacity in certain industries (e.g. shipping, construction, auto parts). This situation contributed to a wave of consolidation. Companies became larger and their market value increased, making it more challenging for foreign MNCs to consider acquisitions. As a result, companies targeting China may consider the JVs & SAs model as a cheaper alternative to reduce the upfront investment.

The beer market in China is a good example of how industry consolidation can transform the playing field. Consider China Resources Snow Breweries, the JV between SABMiller and China Resources formed in 1994, which produces China's top beer brand Snow. “Over the last 2-3 years, there have been a few developments,” said Ari Mervis, managing director. “The consolidation game has almost played out – four brewers have close to 70% market share.”

Foreign companies pursuing consumer opportunities in China often require the experience and resources of a local partner to negotiate the local market... conversely, Chinese partners are looking beyond China.



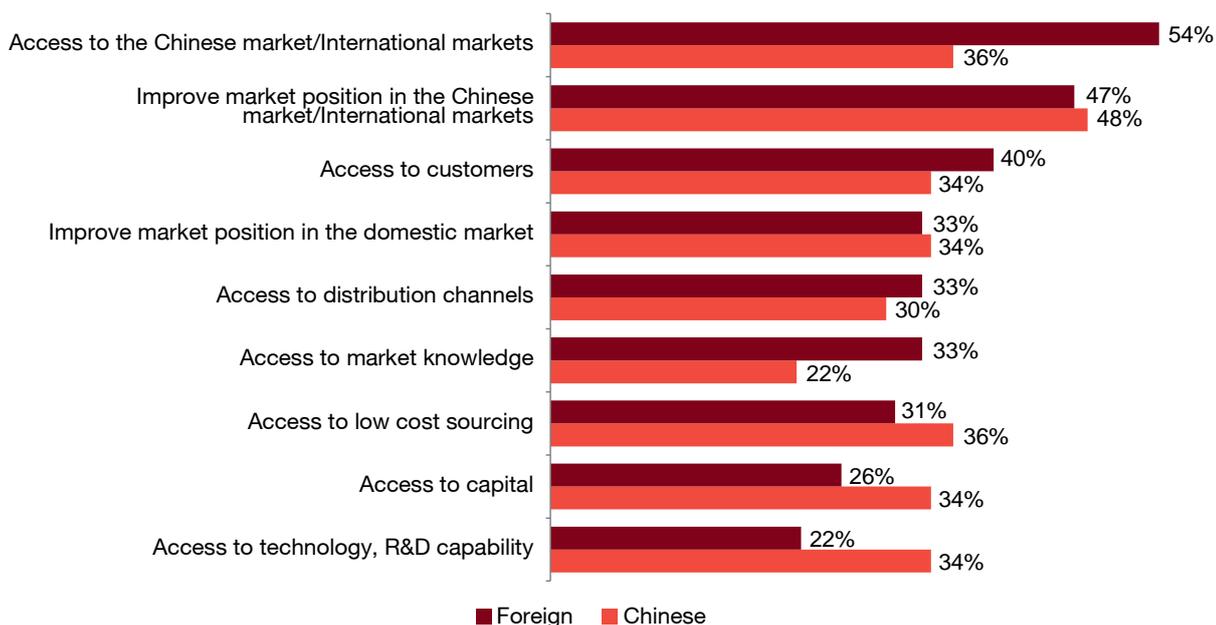
1.2.4 Leveraging the best of both partners

The clear advantage of JVs & SAs business model is that it combines the strengths of both partners. The strategic motives cited by foreign firms establishing partnerships with Chinese firms included capitalising on their partners' resources and capabilities such as distribution channels (33%) and market knowledge (33%). Key strategic motives for entry into China for Australian Corporates were – access to customers (68%) and distribution channels into China (52%).

For example, Pfizer formed a JV with Zhejiang Hisun Pharmaceuticals in 2012 that allowed Pfizer, which

was globally affected by patent expirations, to enter the fast-growing Chinese generics market. Akers Biosciences, a US-based manufacturer of medical diagnostic equipment, found the benefits of local expertise and market knowledge were attractive enough to set up a JV in China in 2014. “We did evaluate other business models,” said Raymond Akers, executive chairman, Akers Biosciences, which currently runs a medical testing JV with Hainan Savy Investment Management. “But at the end of the day, all sales and marketing are local, everywhere around the world, so if you’re going to do a good job you need people on the ground there that are local and know the market.”

Figure 4: Most important strategic motives for forming a JVs & SAs in China raised by foreign and Chinese respondents



Source: Economist Intelligence Unit

Foreign and Chinese companies ranked the cost and complexity of establishing a JVs & SAs in China as a significant risk.

1.3 Risks related to JVs/SAs

Firms seeking partnerships in China are optimistic about the opportunities, as more than two-thirds of foreign and Chinese respondents (69%) describe the prospects of a JVs & SAs in China as either good or excellent. However, for the JVs & SAs establishment process to succeed, it is important to have an understanding of the risks associated with the business model.

Respondents from both foreign and Chinese companies ranked the cost and complexity of establishing a JVs & SAs in China as a significant risk. However, they have different views on other risks related to forming a business partnership in China.

Foreign respondents tend to see growing competition in China (3.9) and JVs & SAs failure (3.8) as important risks, whereas Chinese respondents highlight changes in domestic demand (3.9) and rising labour costs (3.8) as key risks.⁵

In addition, Chinese respondents perceive a reluctance of their partner to share resources and capabilities, such as technology and R&D (3.7), as an important risk. Foreign respondents did not place such a high importance on the same factor (3.4). This suggests knowledge transfer could fester as an underlying issue for business partnerships unless explicit terms are created within charters.



⁵ The rankings are based on averages of a scale in which 5=very important and 1=unimportant.

2. Complexities and challenges raised by the JVs & SAs business model

From defining a strategy and selecting a partner to developing a contract and finally operating the partnership, the survey results highlight the main challenges of the process.

2.1 Selecting a partner

Partner selection is an important variable influencing the performance and viability of the alliance, especially in restricted industries. “In the automotive sector at the OEM manufacturing level, a foreign entity has to partner with a state-owned entity, which has to have at least 50%, so everybody gets married in the automobile sector,” says GM’s Mr Kajander. “The strategic question is who do you get married to?”

The survey reveals that good reputation, good legal standing and alignment on commitments are critical to both foreign and Chinese companies when it comes to some desired characteristics of a business partner. However, there are also some differences. The factor cited by the most foreign firms (41%) is being aligned strategically, though this is not a top factor for Chinese companies (22%). Conversely, Chinese companies are more concerned about control and profit distribution (38% vs 24%) and ensuring compatibility between corporate cultures. Being unaware of these expectations can lead to misunderstanding and raise complexity when selecting a partner.

The survey reveals that good reputation, good legal standing and alignment on commitments are critical to both foreign and Chinese companies when it comes to some desired characteristics of a business partner.



When it comes to partner selection, alignment of strategies is particularly important for foreign healthcare companies (62%). China’s healthcare sector has seen sharp growth from a low base in recent years, thanks in part to income growth and urbanisation as well as the government’s focus on healthcare as a strategic priority. Healthcare expenditures in the country grew from 4.8% of GDP in 2003 to 5.6% in 2013, according to the World Bank. Still, distribution channels, facilities and government policies in the sector remain at a relatively early stage of development, making it important from the outset for business strategies to be in sync.

Wu Xiaobing, regional president for Pfizer in China, explained that after screening “hundreds” of companies, they decided to work with Zhejiang Hisun based on its strategic position in the industry. “They share a similar vision to increase the quality of local Chinese generics, and to demonstrate that China can manufacture high quality drugs. This view is aligned with our vision,” he said.

2.2 Negotiating partnership terms

Once the strategy is clear and a partner has been selected, the next step is to discuss and agree on the key terms of the partnership. All parties have to reach an agreement on objectives, activities and respective contributions but also control, governance, profits distribution (for JVs only) and length of the partnership.

The contract negotiation process can ultimately be a matter of give and take. “Some industries are especially looking for financial capital, so companies have to be a little strategic about what they can give the local partner and what they have to hold back – it’s kind of a delicate negotiation,” said David Ahlstrom, professor at the department of management, The Chinese University of Hong Kong.

Figure 5: Most important criteria for selecting a JVs & SAs partner in China raised by foreign and Chinese respondents



Source: Economist Intelligence Unit

Both foreign and Chinese firms cited the lack of alignment on the strategic purposes of the JVs & SAs as a top reason why partnerships fail before being formed.

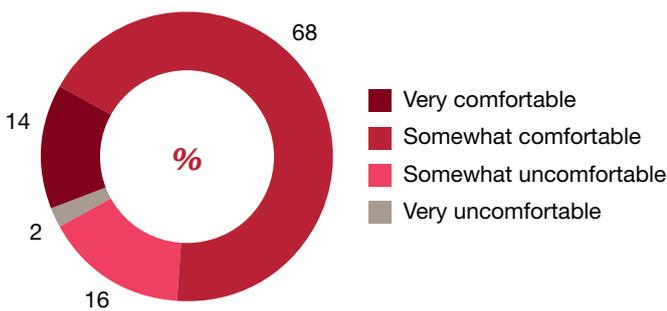
Strategic alignment

Both foreign (45%) and Chinese firms (44%) cited the lack of alignment on the strategic purposes of the JVs & SAs as a top reason why partnerships fail before being formed. If not handled properly at early stages, this lack of alignment might lead to misunderstanding between the partners, frustration and loss of confidence. Ultimately, 26% of respondents (28% for foreign and 18% for Chinese) consider strategy issues a reason to terminate an existing JV or SA.

Control and governance

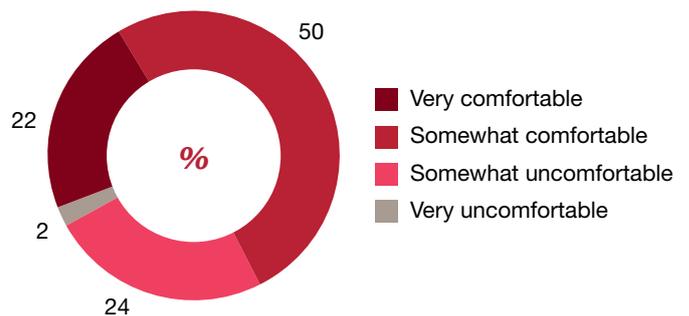
Consideration must also be given to the day-to-day management of the JV and the procedures and instances that will allow it to make major decisions (governance) regarding the business and future strategy of the partnership. The survey results do not reflect sensitivities regarding control of the partnership, with 80% of respondents saying they feel either somewhat comfortable or very comfortable being a minority shareholder, 100% of Australian respondents were in this bracket.

Figure 6: Comfort as minority shareholder in a JVs & SAs with a Chinese partner raised by foreign respondents



Source: Economist Intelligence Unit

Figure 7: Comfort as minority shareholder in a JVs & SAs with a foreign partner raised by Chinese respondents



Source: Economist Intelligence Unit

Duration and termination

Though many of the companies interviewed for this report did not set a desired lifespan for their partnerships from the outset, foreign and Chinese respondents had somewhat similar views on JVs & SAs lifespan. About two-thirds of them expect their JVs & SAs to last 10 years or less. Interestingly, Australian respondents took a longer term view to these partnerships with almost two thirds expecting them to last more than 10 years. This is reflective of the emerging conversations across Australian board rooms that long term growth will require ongoing partnering with China and broader ASEAN countries. It is nevertheless essential to agree upfront on the duration of the partnership and how a premature termination would be handled.

Pre-formation planning

More generally, poor pre-formation planning is also cited as a key reason for JVs & SAs early termination (29% of Chinese and 20% of foreign companies). The results suggest that rushing too quickly from strategy to execution without investing enough time and resources on performing analysis supporting the strategy and elaborating a clear implementation plan can result in negative outcomes for partnerships.

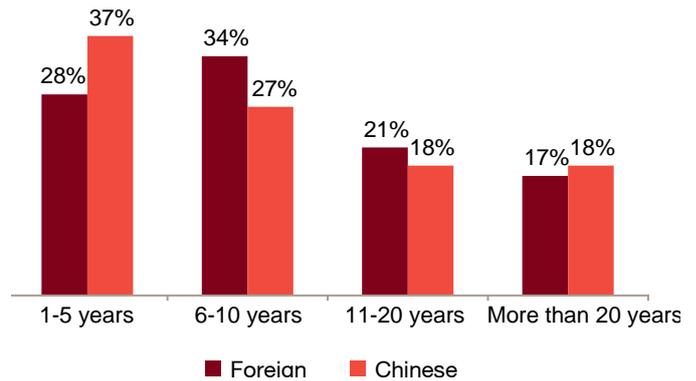
2.3 Operating the JVs & SAs

Once an agreement is reached, the focus shifts quickly to smooth operation and spotting signs of trouble that can directly impact the JVs & SAs performance. Financial results are usually considered as the best way to monitor the performance of a JVs & SAs. 39% of the survey respondents cited poor financial performance as the top reason why partnerships in China have to be terminated earlier than expected. This could be due to one or a combination of factors that had not been properly addressed at pre-formation stage.

A majority of respondents say their JVs/SAs are meeting their expectations (76%). Only 21% say their JVs/SAs are either exceeding or significantly exceeding their expectations. The key issue for foreign and Chinese companies is to identify factors conducive to superior JVs & SAs performance.

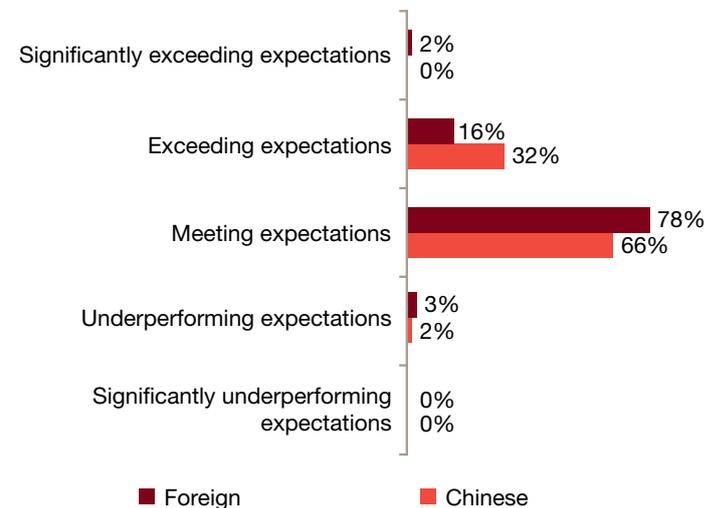
The performance of a JVs & SAs is strongly reliant on the management team and its ability to make the partnership successful. Here are a couple of success factors mentioned by the interviewees.

Figure 8: Expected lifespan of JVs & SAs in China



Source: Economist Intelligence Unit

Figure 9: JVs & SAs performance vs expectations



Source: Economist Intelligence Unit

39% of the survey respondents cited poor financial performance as the top reason why partnerships in China have to be terminated earlier than expected.

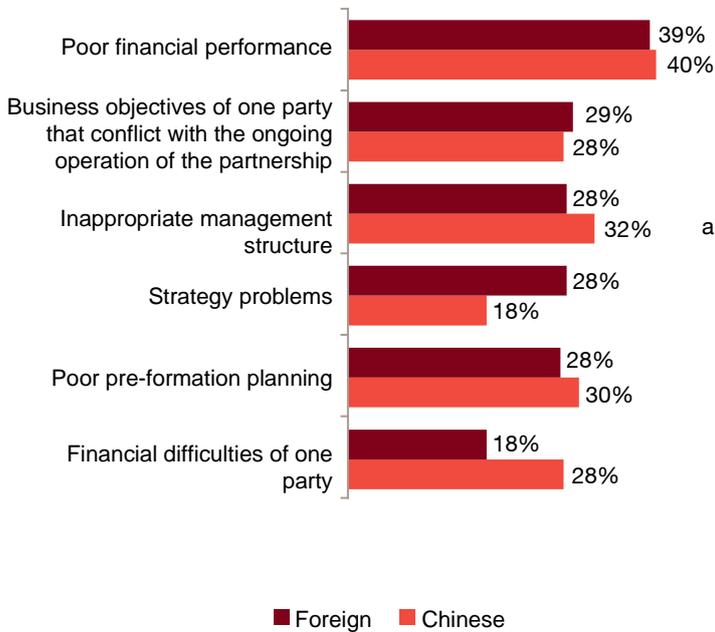
Incentivising partners

Some companies try to ensure at the very beginning of a partnership that the JV structure incentivises both partners to outperform. “Akers Biosciences and my co-chairman Thomas Knox own 44% of the JV between us and the JV partners own the rest. By doing it that way we give them incredible incentive to not only generate revenues but also then to have a real equity piece that can be a difference-maker for them,” says Dr Akers. “That’s really a key reason for doing this, because otherwise you would penetrate one of the largest-growing diagnostic markets in the world at a snail’s pace.”

Be involved in operations to ensure quality

Other companies take a different approach and make sure they have operational control at the onset, in order to guarantee that the quality of the JV’s products and services matches the quality the company offers in other, more developed markets. “We wanted to ensure that our partners would give us operational management,” said Jean-Michel Vallin, president of the China operation of French automotive parts maker Faurecia. “Our partners understand and welcome the fact that the JV Management, for which the GM role is given to Faurecia, would follow Faurecia procedures and processes to ensure the quality of our products, and that we would go on delivering the level of quality we have been delivering for years.”

Figure 10: Main reasons to terminate a JVs & SAs



Source: Economist Intelligence Unit

Figure 11: Main reasons to abort a JVs & SAs



Source: Economist Intelligence Unit

3. Key takeaways

The insights below are based on interviews and an analysis comparing survey results from executives who said their JVs/SAs outperformed with respondents who said their JVs/SAs either only delivered on expectations or performed below expectations. The gaps between the cohorts informed some recommendations on how to produce positive outcomes with regard to business partnerships in China.

Consider various criteria to assess your partner, such as reputation, alignment of goals and values

The need for *guanxi*—professional and political connections—notably figured low on the list for successful foreign respondents. This may be evidence of an important shift in the way foreign companies are approaching potential partners and perhaps an acknowledgement that companies in China have become much more sophisticated in their capabilities.

“Previously, foreign companies tended to focus more on relationship-building capabilities, from business networks to *guanxi*, from business-government ties to social capital,” says Yadong Luo, professor of management at the University of Miami. “But today, I would suggest that foreign companies need to look at both transactional and relational competence possessed by Chinese partners. Transactional competence would include innovation skills, market response, brand and organisational image, entrepreneurial orientation, learning effectiveness, strategic leadership and an open-minded culture.”

Manage divergence in values and culture

Obviously corporate values and culture will vary between foreign and Chinese companies and the survey indicates that Chinese firms should consider pairing with foreign companies that share the same corporate culture and values.

If identified and properly addressed, cultural differences will be less of an obstacle to success. “We have different teams and different cultures,” Mr Helleputte of Danone Mengniu said. “It is difficult but also an opportunity. It is understandable that you can look at the same reality, but the way that a European, or a Chinese with an international background would describe it, or a Chinese with a local background, would be different. It doesn’t mean one group isn’t telling the truth. It means they are seeing the same reality with different eyes.”

Be open about discussing conflicts or concerns arising from the partnership early in the process

Frank discussion about objectives and areas of concern, such as IP protection for foreign companies and control for Chinese companies, early during the negotiation process is optimal. In addition, this would allow all parties to become aligned on the main features of the partnership and potentially identify regulatory issues upfront. “Some companies get this idea that they’ve got to do a deal in China because it looks like such a huge opportunity, and they push things that will become issues later on to the side. But there has to be clarity as to the roles of the different parties,” says Mr Mervis of SAB Miller Asia Pacific and China Resources Snow Breweries.

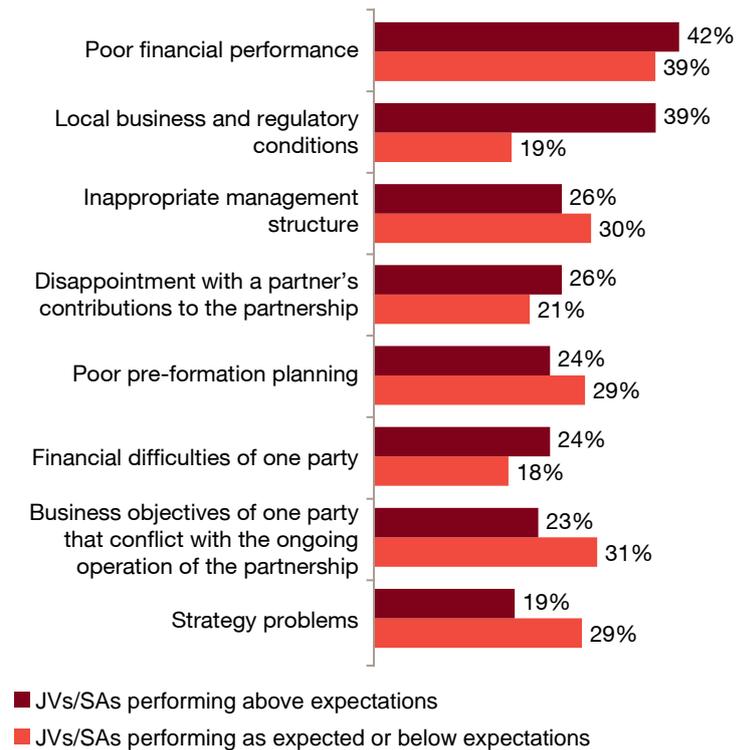
Be flexible and regularly review the objectives of the partnership

Objectives for business partnerships can change over time in response to changing conditions in the marketplace. “We have a long history in China and not all of our partnerships were a success so the challenge is how we ensure that we don’t go down that road again,” said Mr Helleputte.

Agree on dispute management

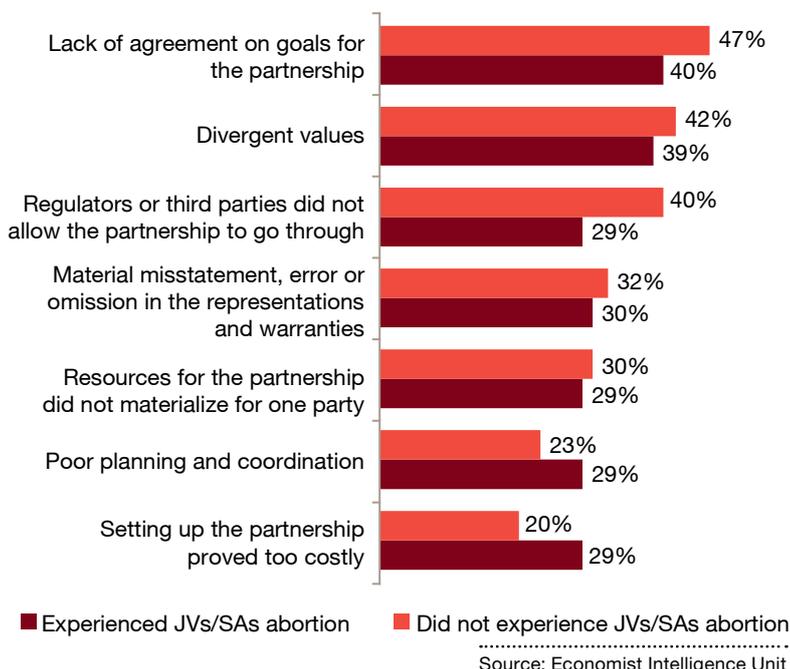
To facilitate communication, partners may want to agree on dispute resolution mechanisms to ensure that misunderstandings do not take root between them and damage the business’s growth momentum. Faurecia’s Mr Vallin says, “Every other month, we have shareholder meetings. We meet with our partners and with the JV’s general management in order to put everything on the table. For us, this has been a big success factor, in order to avoid things being misunderstood for a period of time, leading to issues.”

Figure 13: Main reasons to terminate a JVs & SAs (based on JVs & SAs performance)



Source: Economist Intelligence Unit

Figure 12: Main reasons to abort JVs & SAs discussions (based on prior experience)



Source: Economist Intelligence Unit

Conclusion

China will undoubtedly gain further importance in the global economy as it shifts its focus from infrastructure and export-led growth to domestic consumption. Foreign and Australian businesses interested in the opportunities that this evolution affords will have to anticipate the expectations of China Inc, understand and exploit complementary strengths with Chinese businesses and take a long term view to create sustainable growth partnerships.

Like any marriage, forming and running a JV or SA in China requires trust, commitment and communication. The complexities that this study reveals could translate into future challenges for both international business leaders looking to capitalise on opportunities in the Chinese market and for firms in China seeking to internationalise.

The survey shows how different viewpoints of foreign and Chinese firms are focused on three main areas: choosing a business partner, deciding to make investments and forming business strategies – with further differences highlighted across specific industries and views of what makes a JV partnership successful, as well as factors that could derail a JV's launch at the starting gates.

At the same time, the survey shows multiple areas of common ground between foreign companies and Chinese firms, including identification of risks relating to business partnerships in China and factors that are important when choosing a partner.

The evidence suggests that JVs and SAs are not only here to stay for the foreseeable future, but may be an increasingly popular China market entry strategy for years to come.



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