

The Xerox Experience In China

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How a large U.S. company has achieved objectives; principles that guide negotiations

I feel right at home because the modern Xerox Corporation had its beginnings in a licensing agreement. In 1946 the Haloid Company, our predecessor, paid \$25,000 to license development rights to the xerography process. The result was the first automatic plain paper copier, the 914. It was an instant success.

Keep in mind that it took from 1946 to 1959 — a full 13 years after the original licensing agreement — to produce this “instant” success, with a few interim products in between.

This underscores a point I will be making — patience pays off. Licensing, done right, takes time.

Also, in 1946, the Haloid Company had annual revenues of only \$100,000 a year, but it took the risk of spending \$25,000 for licensing rights. This is another point I will make today: Licensing involves risks — and rewards. The Haloid Company was little known outside Rochester in 1946, but today the Xerox Corporation has annual revenues of more than \$17 billion and operates worldwide.

We used licensing agreements and joint ventures during the past four decades to build Xerox into a global enterprise.

Rank Xerox, our European, Middle Eastern, and African venture, was established in 1956, and Fuji Xerox, our Japanese and Southeast Asian enterprise, in 1962. In 1984, we began negotiations on a joint venture and a related high-technology licensing agreement in the People's Republic of China.

It took almost four years of negotiations to reach an agreement on the Xerox Shanghai joint venture,

including a technology license, which was established in late 1987.

It has not been easy. But during the past eight years, Xerox Shanghai has become a profitable, high-quality operation. Along the way, we learned some lessons about doing business in China. I'd like to share some of these lessons with you today.

One thing we have learned is that almost everything in China is on a much larger scale than anywhere else. China is truly a land of extremes. Consider the population: China has 1.2 billion people, one-quarter of the world's population. Nearly one out of every four people on Earth is Chinese. Enough babies are born in China each year to equal the population of New York City, Los Angeles, Chicago, Montreal, Toronto, Dallas, Houston, and Philadelphia — combined.

◀ Growth Rate ▶

Consider China's tremendous economic growth rate: 12 to 14% in recent years — the fastest growth rate of any major country. Even if China's growth rate slows to only 7 or 8% per year, it means that its economy will double every 10 years. This will have a far-reaching impact not only on East Asia, but on the entire world. In an often-heard quote, Napoleon said that China was a sleeping giant, and that the world would tremble when it awakened. Today, we see a country of 1.2 billion people and a 14% annual economic growth rate. We also see unmistakable signs of awakening.

After two centuries of exploitation, civil war, foreign occupation and the failures of central planning, China is becoming a world economic power — and it has very ambitious goals. In the next 10 years China wants to be at world bench-

mark levels in industry. As one observer noted, “They are 25 years behind in technology, so they want to leapfrog into the future using licensing and joint ventures.” Western businesses sense this opening and obviously want to benefit from it. They want to provide foreign investment and Western technology.

Author Raymond F. DeVoe Jr. has said that for centuries the lure of the large, untapped Chinese market has captivated Western business executives. “China casts a spell over Westerners,” he said. “Western businessmen look at the raw numbers of the population and begin to dream wild dreams. Mid-19th century New England mill owners said if everyone in China lengthened their shirttails one inch, it would save the mills of Manchester.” Today, of course, people in Manchester are wearing shirts made in China.

As business becomes more international, more global, the new opening of the world's most populous country and largest market could be a missed opportunity. I say “missed” because the admission price to this biggest of all markets isn't small. There are great risks. China is a unique market. To be successful, Westerners must take the time to understand Chinese history, culture, and traditions. And be willing to be guided by them.

In our case, before we began negotiating in China, our team studied history. We studied in three basic eras: (1.) Ancient China, (2.) the 19th century, and (3.) the Communist period that began in 1949.

Each period has had an impact on Chinese attitudes, attitudes you will

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face if you do business with the Chinese. Ancient China was by far the most advanced civilization in the world.

Inventions such as paper and the printing press were taken back to Europe from China by early explorers. (Fortunately, the Chinese custom is to share technology freely with others. Otherwise, the ancient Chinese might have demanded royalty payments.)

Ancient China was so advanced that the Chinese thought of it as the "Middle Kingdom" between heaven and earth, the only civilization worthy of the name. Those who lived outside China were considered "barbarians." Of course, many people think that their country ranks above others. But in China, the lingering effects of this ethnocentrism still can affect negotiations.

At times Chinese negotiators can behave as if China deserves concessions or special treatment because of its long history and ancient cultural achievements.

Another legacy of China's long history is the complex and oppressive bureaucracy. As someone once said, "The Chinese have had 4,000 years to perfect bureaucracy, and they have." This rigid authoritarian bureaucracy makes Chinese negotiators hesitant to make decisions without approval from above.

For example, American schoolchildren are told, "The early bird catches the worm." Chinese have a similar but opposite saying: "The first bird in the flock is the first to be shot." This stifling bureaucracy hinders risk-taking and personal initiative.

Their long history also means that the Chinese have a different perspective on the time needed for negotiations. It is not uncommon for Chinese negotiators to use delaying tactics and last-minute problems to encourage the anxious Western negotiators to make more concessions. As one Western businessman said, "In China, they don't think of time as money, they think of time as a weapon." After all, if you have 4,000 years of history behind you, what's another two weeks?

The second major historical era that has affected Chinese attitudes

is the 19th century. This was the time when foreign powers used military force to carve out their own trading areas and exploit China's workers and resources. This exploitation led to the Opium Wars and the Boxer Rebellion, when the Chinese attempted to expel the ones they called "foreign devils."

Many Chinese even today are suspicious that Western businesses may be trying to exploit China. At other times Chinese negotiators may imply that Western negotiators should make concessions in a bargaining session because of past Western exploitation. This is known as the "poor orphan" negotiating tactic, which is based on the Chinese custom regarding relationships. In any relationship one party is weaker than the other, and in Chinese culture, the stronger party is expected to make concessions to the weaker party. It will not be surprising for you to learn that in China, Westerners are almost always cast in the role of the stronger party, and are expected to make concessions accordingly.

◀ Communist Impact ▶

The modern period of Communist rule has also affected negotiations and operations in China. In a Stalinist, controlled economy, the focus is on production rather than quality. Under Communism, China was a seller's market: China had so many people that finding customers wasn't a problem.

Now that China is taking steps to become a market economy and a source of exports, Chinese factories are starting to think about quality more than quantity.

One of Xerox' major challenges in China is to convince our Chinese partners that they cannot achieve their objectives — foreign exchange and modernization — without first achieving our major objective, quality. Quality is our bedrock principle.

Another problem stemming from the Communist era is the promise of a lifetime job. The overmanned and inefficient state industries almost never fired anyone for poor performance. This tradition of job security works against efforts to achieve quality. These residual ef-

fects of China's 4,000-year history have to be kept in mind when Western business executives begin doing business in China.

Professor Dennis Rondinelli of the University of North Carolina said, "Americans have not quite learned to appreciate the Chinese way of doing business, and have not always made adequate efforts to adapt to China's business environment." On the other hand, he also noted, "The perception that China as a complex, difficult, and uncertain trading partner is reinforced by the vacillating nature of Chinese economic reforms."

Professor William Newman of Columbia University said, "Poorly motivated local workers, high expectations, pressure for immediate results, limited foreign exchange, and uncertain supply systems make it difficult to make profitable investments in developing countries."

Some experts have noted that the success rate of joint ventures in developing countries is quite low because of these and other problems. But at Xerox, our story is the opposite. Xerox Shanghai is successful.

It has been recognized as a model joint-venture operation by magazines such as *Sales and Marketing Management* and *The China Business Review*. But, it took more than understanding history to achieve this high-water mark. It took dogged persistence. We have been selling fully manufactured copiers to Chinese customers through our Hong Kong operations since the 1970s. We began high-level contacts with Chinese officials in 1979 and started negotiations in 1983. We signed the agreement in September 1987. The negotiations were adversarial, controversial, repetitive, endless and complex.

◀ Roller Coaster ▶

The experience was like a roller coaster: One day up, another day down. The talks were marked by frustrating renegotiations on issues that we had thought were settled. After going through this exasperating process several times, we learned how to use these tactics for ourselves; how to be repetitive and

hesitant. At key points in the talks, we needed to use dramatic moves to resolve "problem" issues, so we would arrange a visit by a senior Xerox executive and ask him to make an "executive decision" as he visited the talks.

We needed those high-level "concessions" to be done by senior executives to get the talks moving. The Chinese negotiators would then respond in kind, and the talks would proceed. The government bureaucracy was so complex that we sometimes found ourselves introducing Chinese negotiators from different agencies to each other to help speed up negotiations.

It is critical to have alliances with local and central government officials who are several levels higher than the Chinese officials with whom you are negotiating. When you have a close relationship with Chinese officials, it is known as a "guanxi" relationship. China is so large and bureaucratic that it is only through "guanxi" relationships with government officials, suppliers and others that you will be able to make relatively smooth progress on various issues.

For example, I will never forget October 22, 1986. We were ready to leave. We had been there three years and we had not produced anything because we were still in negotiations. On that day we had a serious problem on one clause and we were absolutely deadlocked.

The man who was in charge of economic relations for the Shanghai government sat in on an evening session of negotiations at the hotel. His presence and a comment he made gave a strong signal about how important it was to settle the deadlock in negotiations.

It happened to be the same night that he had been invited to dinner with Queen Elizabeth on the royal yacht *Britannia*, then visiting Shanghai. He made the statement that he would rather come to the meeting and resolve the Xerox issue than have dinner with the Queen. When he said that, the mood changed among the other negotiators. We then began to make progress to solve the problems — and we did. Without his comment — and his willingness to skip din-

ner with the Queen — we might still be in Shanghai negotiating!

What has always fascinated me is that when we finally reached agreement, there was a sudden and drastic attitude change in the Chinese. The negotiators we had been wrestling with for four years suddenly became our closest partners and allies, and they worked vigorously to get our joint venture operating as quickly as possible. They were adversaries one day, solemn partners the next.

When our contract was signed in 1987, it was the largest light industry joint venture in China, and it remains one of the largest today. The contract called for a 30-year joint venture, with a 10-year renewable licensing agreement.

Xerox invested more than \$15 million in three plants in Shanghai: an assembly plant, a toner plant, and a photoreceptor plant. The Chinese also made contributions worth \$15 million to the joint venture. We trained and developed local employees, suppliers, and independent dealers, and produced our first machines in 1988. Our 800 employees now produce 25,000 copier machines, 40,000 photoreceptors and one million pounds of toner annually.

Since then Xerox has invested more than \$5 million in two additional joint ventures:

1. An Engineering Copier Systems operation in Suzhou.
2. And a Facsimile Products operation in Wuhan.

◀ Achieves Goals ▶

From 1991 to 1993 Xerox Shanghai revenue has increased from \$46 million to more than \$100 million. The joint venture achieved its profit goals three years ahead of schedule.

While Xerox was negotiating its equity joint venture and technology license, some of our competitors completed technology licensing agreements in China. We had five competitors operating by the time we started operations. Despite the head-start advantage our competitors had, Xerox Shanghai in two years went from zero market share to capture 40% of the domestic

market, the leading market share of any company. This is because there is a big difference between a 30-year, long-term commitment of a joint venture with solid Chinese partners and a short-term technology transfer agreement.

In some technology transfer agreements, the Chinese company gets boxes of drawings at high cost and little else. That isn't the kind of patient, long-term commitment we think is needed for success in China. The main reason why Xerox was able to gain market share rapidly can be summarized in one word: Quality.

From the first days of negotiations, Xerox executives insisted that the operation could not be successful unless it was a high-quality operation. Employees and suppliers were selected partly on the basis of their commitment to quality.

It has also achieved ISO 9000 certification and has been honored with the Shanghai Municipal Government Quality Award. Xerox Shanghai also has achieved:

1. A successful record of exporting to Latin America and Europe.
2. Success as the first high-technology joint venture company in China to design and produce two new products for export and domestic sales, the 5416 and 5421 desktop copiers.

This track record was achievable because we built the business on three basic rules on which there would be no compromising:

1. Insist on achieving world-class quality.
2. Provide technical support and training to suppliers.
3. Develop strong relationships with local authorities.

I'm sure you'll agree that those are good goals. But how do you implement them? We have found that if we are patient and persistent, if we plan carefully, and if we are flexible in adjusting to the special requirements of doing business in China, that we can succeed in this frustrating and sometimes difficult environment.

In fact, I have come up with four basic guidelines or principles for operating in China.

Anyone who has taken a marketing course in college will remember

the well-known "Four P's" of marketing: Product, Price, Place, and Promotion.

◀ Principles ▶

I would like to summarize my principles for operating in China as, "Xerox's Four P's for Success in China." Let me tell you a story that illustrates some of these "Four P's."

At one point the negotiations on the proposed joint venture were deadlocked on an issue involving salaries to be paid to Chinese managers. The Chinese wanted Xerox to pay wages equivalent to 100% of expatriate managers, but we thought that those rates were out of line in view of the experience and background of the managers. We had been negotiating this issue for more than a year, but we still had not resolved the issue. It looked as if this issue could delay or even scuttle the talks.

Jim Shapiro, the Xerox executive who was a leading figure in the Xerox Shanghai negotiations, had thought about how to settle this issue. He researched the topic and had a good idea of what the Chinese might settle for. He evaluated the Chinese strategy and developed a strategy of his own. It was the kind of issue that Jim would have given his right arm to solve. And, in a way, he did.

Before going into a late-afternoon negotiating session, Shapiro told our team, "No matter what I say, stay quiet and give me your full support. We are going to get this thing settled today."

Jim's plan involved the use of a dramatic negotiating tactic. Shapiro entered the hotel conference room, sat down, and greeted the Chinese negotiators. After a moment, he made his move.

He thrust his hand out over the table and said to the chief Chinese negotiator, "Name any number and Xerox will pay those wages. Name any number, from zero per cent to 100 per cent, and we will pay those wages."

The scene was simple: Jim was sitting on one side of the table, his hand stuck over the table, ready to shake hands with the Chinese negotiators on a deal.

The Chinese were stunned. After a few moments they began to buzz among themselves. Our Xerox team members remained silent and stone-faced. Jim just sat there, waiting for someone to shake his hand on a deal. Then both sides sat in silence.

After about 15 minutes, Shapiro repeated his offer. The Chinese again conferred quietly among themselves, but still did not respond. A half-hour later, there was still no response from the Chinese.

Jim kept his hand out over the table, ready for someone to make an offer. He began to use his left arm to prop up his right arm. (By this time, Jim was giving an entirely new meaning to negotiating term, "holdout."). His hand remained poised in midair, waiting for a Chinese response.

The Chinese negotiators sat quietly, frowning, thinking. Our Xerox team members remained silent. By now, Shapiro had taken a coffee mug and placed it under his wrist to give his tiring arm a rest.

More time passed. Shapiro kept his hand out, ready for the Chinese to make a deal. The Chinese occasionally buzzed among themselves, but mostly remained silent.

It may be that the chief Chinese negotiator did not have the authority to make a deal. Or, that the Chinese negotiating style is to discuss any deal thoroughly outside of negotiations before making a counteroffer. In any event, the dinner hour came, and the Chinese, who usually insisted on a dinner break, remained silent, looking at Shapiro's outstretched hand.

No one left for dinner. From time to time, Shapiro would repeat his offer. The chief Chinese negotiator kept silent. Another hour passed.

By this time Jim was wondering if the coffee mug was making a permanent impression on his wrist. Still no response from the Chinese. Another hour passed. Still no response.

Just before 9 p.m., after nearly four hours of non-negotiation, the chief Chinese negotiator asked Shapiro if a certain number — 80% — would be acceptable.

Shapiro said yes.

The Chinese negotiator shook his

still outstretched — and very tired — hand and the issue was settled.

The negotiation had lasted four hours, Jim's arm was almost ready to fall off, but the issue was resolved. (You might want to say hello to Jim if you see him at one of these conferences sometime. You'll recognize him because his right arm is about two inches longer than his left, and has a coffee mug still attached to his wrist.)

◀ Planning ▶

Shapiro's actions demonstrate the first "P" of our "Four P's": Planning. Because of his planning, his research, and his careful assessment of the Chinese position, Jim Shapiro had an idea of what the Chinese wanted. He developed a plan for negotiations: Present the Chinese with an offer that they could hardly refuse. He took a risk, but it was a risk based on careful thought and planning. It's possible that even if we had spent many more months negotiating the issue, we could have ended up with about the same deal.

Successful negotiators develop a negotiating strategy, determine their moves in advance, anticipate objections, and approach talks with a confident, assertive attitude.

The Shapiro story also illustrates the second of the Xerox "Four P's": Patience. How much patience does it take to hold your outstretched hand, propped up with a coffee cup, over a negotiating table for four hours? A lot. But that is exactly what is needed when you negotiate in China.

One veteran Xerox negotiator put it simply: "There are three things you need to negotiate in China: 'Patience, patience, and patience.'"

Owens Thomas, writing in *Small Business Reports*, has observed that, "No licensing deal can work without a solid contract, but a written licensing deal also depends upon a cooperative relationship between the strategic partners." Our feeling is that if we are going to be "married" to our partners for the duration, we should have a solid foundation. So, if you are negotiating with the Chinese and become discouraged at the lack of progress

in the talks, keep your mind on the half of the glass that is full, rather than the half that is empty. And with patience will come the payoffs.

Shapiro's endurance also is an example of the third "P": Persistence. Western companies must be persistent in negotiating with the Chinese. Doing business in China is not for those who are easily discouraged. Smart companies, during the planning process, decide on the essential elements that must be included in any negotiated contract, and they are persistent in refusing to make concessions on these essential elements.

We didn't give up on our key objectives during nearly four years of negotiations. On some issues we negotiated the whole time before reaching agreement. You have to be willing to look beyond the deadlocks to the next turning point in the talks.

There were days during our negotiations when we walked away from the table and went back to our hotel, letting the Chinese know that we were ready to end the talks for good. It wouldn't be too long before we would receive a call inviting us to return to the negotiating table, and we would.

An example of persistence and sticking to our position is the day the Xerox and Chinese negotiators were deadlocked on an issue, and our Xerox people had to leave to catch a plane home. We held to our position, and left for the airport with the issue still deadlocked. Then the Chinese became the ones to show persistence. The Chinese negotiators jumped in a car and followed our Xerox team to the airport and continued to negotiate while our executives waited in line for customs clearance. With only minutes left before departure, we and the Chinese officials agreed to terms.

Just before boarding time, one of our people took out a cocktail napkin and wrote the essential elements of the agreement on it. Both sides signed the napkin, and our Xerox team made the plane and the deal went through.

Another example of persistence involved the construction of our facilities in China after our joint

venture agreement was signed. We wanted high-quality and modern building standards. The Chinese, in an effort to reduce foreign exchange requirements, wanted to build a less-expensive facility according to Chinese standards. This was not acceptable to us.

We brought four different groups of people together to work on this issue: Xerox staff people, a U.S. architectural firm, a Chinese design firm, and people from Xerox Shanghai. We persisted, and in the end, a new, modern facility was built. But, at the same time that you are being persistent on important issues, try to make concessions on other issues to avoid damaging your overall objectives.

The Shapiro story also demonstrates this fourth "P" of the "Four P's": PFLEXIBILITY. (I use this spelling with apologies to the Price Pfister plumbing company.)

How could we be more flexible than allowing our counterparts in a negotiation pick any number, with our assurance that we would accept the figure? This is the *ultimate* in flexibility. Your opposite in negotiations names the price, and you agree.

But practically speaking, you must remain reasonably flexible because a joint venture in China is really an opportunity for continuous negotiation. You will have to negotiate on various issues with any number of government agencies, Chinese suppliers, dealers and others after the joint venture agreement and technology transfer agreement is signed. That the Chinese count on the flexibility of Western partners is indicated by a particular phrase that you will see in various contracts.

The wording is this: that disputes will be settled, "through friendly negotiation and mutual agreement." To Westerners, this vague language seems insufficient. But, the Chinese believe that trust between partners is essential for a joint venture to succeed. They do not put much faith in the legalisms of a typical Western contract. The Chinese believe that it is the joint venture partners who must interpret the contract language and make the joint venture work, not the lawyers.

Patience, planning, persistence and flexibility are always important in negotiations, but they are especially important in negotiations with the Chinese because China is a special case — unique because of its extraordinary history and culture, its large population, and its plans for rapid economic and technological development.

It is also a land of extremes in regard to its business cycle, something we've needed to watch very carefully. We've had to learn how to use careful "business-cycle management" techniques to cope with pressures caused by various internal and external factors, not the least of which are our governments. For example, we have to constantly watch for restrictions on foreign exchange, devaluation of the currency, government restrictions on the sales of certain products, including copiers, and changes in joint venture laws or tax laws. I'd call those internal Chinese factors, and they take a lot of watching.

External to China, we track our country's annual renewal of most-favored nation status, concerns about human rights, concerns about balance-of-trade with China, political risks, and issues involving intellectual property rights. Each year brings different challenges in regard to these and other problems in China. But, despite these many problems, China has made considerable progress in recent years.

There are hopeful signs in almost every area. First, recall that negotiations for our first equity joint venture dragged on for four years. In contrast, the negotiations for the two other joint ventures lasted only 18 months. Further, when we started hiring Chinese workers for Xerox Shanghai, it took from three to six months for the workers to obtain official permission to leave their former jobs for a position with us. In recent years, that process has taken just a couple of weeks. Also, there are indications that the market-oriented incentives associated with modernization are improving worker motivation and other aspects of doing business in China. It is clear that China is changing.

Let me conclude with several recommendations if you plan to do

business in China. First, stress quality: Xerox insistence on quality has been critical to success in China.

Second, develop close relationships and connections with your Chinese partners, employees, suppliers and dealers.

Third, do your homework.

One complaint the Chinese have about Western negotiators is that they do not spend the time to learn about China. Don't make that mistake.

It is vital to learn about Chinese history and society before negotiations. But don't only look back.

Look ahead, because the road is turning.

Last June, *Business Week* magazine said, "Just as China's economic boom has brought increased prosperity to millions, so too is life for the ordinary Chinese becoming easier and freer." This is important because a freer, more developed China is a more stable China. Doing business in China can help bring this about.

In the *Wall Street Journal* last May, Christopher Patten, governor of Hong Kong, wrote: "If we can help make these (developing) countries

more prosperous, we can help make them more stable. We can help create foundations for social progress and good government. Neither the U.S. nor any other foreign power can ensure stability in China, but we can help create the right conditions for it through trade and investment. And by helping them, we help ourselves, by making the world safer. A stable China would be a cornerstone for a more stable East Asia."

We at Xerox believe Governor Patten is right. And we're doing our part to make that happen.