

The “Three Avoids” for Venture Capitalists

Even companies that have been operating in the People's Republic for years are sometimes guilty of making basic strategic misjudgments in their China operations. Venture capitalist Shaun Rein shares a set of principles he calls the "Three Avoids" — rules that may save your company from faltering when your competitors are forging ahead.

A FEW WEEKS AGO, I found myself preparing to share podium time with some of the region's best-known China investment experts. We were to discuss investing strategies at a weeklong conference for members of the Institute for Private Investors, a high powered New York-based group (40 percent of IPI members have a net-worth above US\$200 million). I was to speak first, followed by Ronnie Chan, CEO of the Hang Lung Group, the real estate developer of Shanghai's Plaza 66. The following days would feature Vincent Lo, CEO of the Shui On Group (developers of Xintiandi), Andy Xie, chief economist for Morgan Stanley Asia-Pacific, and U.S. Ambassador to China Clark Randt.

Put in musical terms, it was like heading on-stage to open for Pavarotti. Frankly, as I waited for my turn amid the unabashed magnificence of the Hong Kong Mandarin Oriental, I was wondering what exactly to say.

What happened after I started speaking came as a surprise. I was to talk for 15 minutes, sharing the lessons my company, Inter-Asia Venture Management, had learned in 32 years of operating as a venture capital firm in Asia and 12 years in China. But soon after beginning my speech I was interrupted for a question by a distinguished, white-haired gentleman from the southern United States. "I've been burned in China," he grumbled. "What are the key mistakes that foreign businessmen make? I don't want to keep losing money here — too many fortunes are being made for me to be left out!" Flummoxed, the man then discussed some of the direct investments he had made in China in the beverage and consumer products sectors — horror stories reminiscent of a Freddy Krueger movie.

After his outburst, the session shifted into a passionate Q&A on how to avoid making mistakes in China, and my 15



THE RIGHT STUFF? One common error MNCs make in China is hiring the wrong management team. Even returning Chinese with university degrees and work experience in the West may have little practical knowledge of China's unique business environment.

minutes grew to 90 minutes. As I listened, I realized that several investors had mentioned succumbing to problems I like to call the "Three Avoids." These are factors that cause otherwise healthy businesses to fail in China, reasons that differ from the common challenges complained about by expatriate businessmen — currency convertibility, accounts receivable, corruption and a weak legal structure.

Avoid Lazy Localization

The first "Avoid" which I see Western executives violating in China is hiring the wrong management team. In the



1990s, it was *en vogue* to hire Taiwanese, Hong Kong, and expatriate managers to run China operations. Many of these executives, however, had problems navigating the Chinese markets and managing their teams. When PRC nationals began returning from abroad with MBAs, many international firms thought they had found the ideal solution: hiring senior management from the ranks of returnees. The logic is that PRC nationals who collect graduate degrees and work experience in the United States and then return home offer the best of both worlds: an understanding of both Chinese culture and American-style best management practices. Many U.S. venture capital firms have begun backing China start-ups run by returnees with Silicon Valley experience.

But this solution is just too simplistic. Many returnee managers experience serious culture shock back in China, in many cases suffering more severely than expatriates who do not expect to seamlessly integrate here. Many of today's returnees left China in the early to mid-1990s. Returning today, they are taken aback by the changes that have consumed the nation since then. The upshot: just because a manager speaks both Mandarin and English and is well versed in U.S. business theory does not mean he or she knows how to do business in China.

It is critical that CEOs evaluate their managers' actual experience in China. In fact, some of the most successful companies are run by local managers who do not speak English but do have the practical knowledge and the networks to get things done. Other firms are managed by expatriates who have dedicated their professional lives to being in China, or by returnees who have survived in China for two or three years before joining the management team. The thread that runs through these winning management teams is specific knowledge of today's China. It might seem like an obvious point, but it is surprising how many firms neglect to follow it.

Avoid "First Mover" Disadvantage

U.S. business schools are famous for introducing their students to the concept of "first mover advantage." But in China, where regulations tend to be vague and open to interpretation, it is often better to be the second mover. I advise firms to let the first mover head into the trenches to secure official support and to convince the domestic market of the need for its products and services. Second movers can watch the pioneer make mistakes, then set their own strategies.

For instance, a famous American venture capital firm recently became the first foreign entity to take a controlling stake in a company in a highly regulated sector. While the ROI of this investment remains to be seen, the VC firm itself spent years seeking regulatory approval from Beijing and along the way got ensnared with a nasty lawsuit. The result for the firm, after spending several years and lots of money in this pursuit, was little more than a bad name as a troublemaker.

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After a precedent has been set, the next foreign company seeking to invest in this sector will spend far less time and money on approvals. Perhaps more importantly, the second mover can focus on building a business rather than on carefully and cautiously seeking government approval.

Avoid Rushing In

Shocking as it may sound, not all foreign companies should be in China. Right now, many MNC board chairmen are pressuring their CEOs to develop a China play simply because everyone else is doing it. These business leaders fear that if they do not enter China, they will soon be reading about themselves in a Business Blunders book or fielding questions on the 18th tee such as, "How could you not have entered a market of 1.3 billion people?"

The fact is that firms must do their homework. Have their supply chains moved to China? Is the China market ready for their products and services? Target markets might be smaller than are expected. Regulations can limit returns in certain sectors.

As I was answering the American investor's questions back at the Mandarin Oriental, I could see him getting worked up as he recognized several of the "Three Avoinds" in his own projects. Not to worry: I could also see his desire to try again to seize the dream that is China. 3

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