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# The Uncomfortable Journey: German Companies in China

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In May 1999, the Spiegel published an article on German companies in China which was meaningfully titled "Uncomfortable Journey" (Unbequeme Reise) – with the subtitle: "Many German investors are disappointed; instead of the expected profits, engagement in China only leads to losses and many troubles." Even in 1999, over half of German companies operating in China showed losses, and if at all, profits could only be achieved after an average of five years. From this description of profitability in China learning effect might be expected and, thus, for the flux of investments to China to slow down or even to stop.

Despite difficulties, however, the run for investments in China has anything but stopped in the following years. On the contrary, it seems to have accelerated and also increasingly involved small and medium-sized enterprises in addition to the large manufacturers and their immediate suppliers.

Nevertheless, the results of a study of the Delegation of German Industry and Commerce (AHK) in China show that investing in China is still associated with uncertainty. According to this study, 30% of the companies with their own production plants needed between two and four years to reach break-even point. For another 20% it took at least 4 years of market presence in China to break even; a heavy burden especially for SMEs. A further 20% of German production firms in China were making no profit at all. Why does being profitable in China, if it can be achieved at all, require so much time? Public opinion tends to quickly come up with one basic answer: it is because of China itself. The problems of opportunistic behavior and the dangers associated with joint ventures and plagiarism are already very well known and have been documented both in journalistic investigations and academic studies. These, however, are not the only challenges for western companies operating in China. Less present in public opinion are the challenges in "everyday" working life, starting from the fact that companies can hardly count on their workforce because of the high voluntary turnover, and the fact that markets and prices are not transparent enough and constructing networks is as difficult as it is necessary. Added to these challenges is the legal framework with which managers have to cope, something which is changing but not reducing legal arbitrariness substantially. Hence, the costs of attempting to adapt to China are high enough to undermine efficiency despite the huge market potentials and theoretically low labor costs.

This is of course an important part of the story, but if we want to tell the whole story, it is necessary to take the decision-making processes about going to China into account as well. In order to explain the lack of profitability, just let me come back to the article on the Spiegel of over ten years ago and play with the metaphor of the uncomfortable journey a little bit.

When we think about uncomfortable journeys that we or our friends have experienced, the imagination immediately recalls pictures and feelings of infernal climate and suitcases too heavy to bear and always packed with the wrong things.

The more we think, the more we might recall situations in which, once arrived at a destination, we discover that our hotel is overbooked – which is not infrequent in the high season in highly fashionable holiday locations – or that the standard does not fit the one booked or anticipated, at least on the base of the catalogue's pictures. And what about the unpleasant travel mates?

A journey, however, is not limited simply to traveling time. It begins before, when we start to plan it and continues to when we are back home and give account of it or show the pictures to others. Given the fact that bad experiences can affect traveling anywhere and that there is always an imponderable margin of uncertainty, it is true that in some contexts, risks might be higher than in others and the capacity with which we can address the situation depends on how well prepared we are. Preparation, however, depends on the picture we have of the place we have decided to go to.

After coming back home from the uncomfortable journey, we have possibly to address the questions asked by relatives, friends and colleagues. They are all curious; after all, we had announced the trip proudly in advance and everybody had looked at us with a mixture of admiration and envy. There might be incentives to present the journey much better than it was.

What does this extended version of the Spiegel metaphor tells us about investing in China or in other (developing) countries?

The field research that I have carried out in China within the framework of the research program on Market Sociology at the Max-Planck Institute for the Study of Societies in Cologne shows that the challenges that have to be addressed in China are certainly a matter of a different and, to a certain extent, adverse institutional and cultural context. At the same time, however, there is also evidence of weaknesses in the preparation of companies investing there, especially small and medium-sized companies. These weaknesses go side by side with very high expectations about China, and particularly about the opportunity for profit. These expectations are based on the picture of China that circulates in Germany. Although the trend has now been inverted and, for at least two years, China has often been associated with plagiarism, the same could not be said for the middle of this decade, when a euphoric mood was widespread in public opinion and China was considered a "must" if companies wanted to stay on the market. The euphoria, sustained by arguments about the huge market potentials and the opportunity to reduce costs, was also reinforced by "travelers" within the business community and their reports, all of which meant that going to China became an increasingly legitimate option. If an organization strategy becomes legitimated, the companies' barriers for adopting that strategy become much lower, leading to decisions being taken uncritically. Legitimation and the possibility of high profitability also help when companies are (or feel) compelled to follow their customers and decide for China. In this case, the barriers are also lowered even though initially the decision to invest in China might have been perceived as the product of external pressure rather than of one's own will.

I now provide some examples in which the main arguments pro China in the discourse have been associated by interviewees with weaknesses in the management in China. The myth of low costs, which far fewer entrepreneurs would now be ready to subscribe to as being one of their initial goals, has, for example, encouraged disputable decisions in the field of human resource management, and particularly in the choice of managers for the Chinese subsidiary. If entrepreneurs are convinced that China is cheap and cost reduction is one of the desired effects, companies might not want to believe that expertise has its price and hire underqualified Chinese nationals. Previous sale agents, interpreters engaged in fairs, friends of other Chinese managers, graduates from Chinese universities become general managers of the Chinese branch very quickly. This is even more surprising if we think about the outstanding requirements needed by new employees and managers when it comes to hiring in the certainly more familiar German context. After a while however, it is clear that the success of the Chinese subsidiary becomes a question of luck.

Together with the myth of low (labor) costs, the myth of the huge potential market is also able to jeopardize the efficiency of a company in China. While it is certainly true that China has a potentially huge market, it is also true that it is very competitive since the high growth rates are no insider tips anymore and the whole industrialized world is present in China. Moreover, other rules of competition or preferences reign. Products with which companies are very successful in mature markets might not be required in the same sophisticated forms in China. But when it comes to deviating from the high market segment which they dominate elsewhere, entrepreneurs are unwilling to adapt since this would mean undermining an important side of their corporate identity. In some cases, the need for a particular product is not there yet and has to be created, which requires time. Even having business access to the booming construction sectors implies entering networks that are not that transparent. This is no easy task either for German or Chinese managers unless they already have some channels, which cannot be assumed ex ante.

The high expectations in market opportunities as well as the myth of low costs in China can also jeopardize the efficiency of the Chinese company because they generate conflicts between headquarters in Germany and the managers in the Chinese subsidiaries. Those conflicts - that derive from expectations that do not match reality - can take the form of systematic tensions, but they often end up with the breaking up of an employment relationship, which in turn is associated with further costs and loss of precious time for the company.

Pointing to the weaknesses on the German side in addition to the challenges of the Chinese context in business in China is not intended as a plea for renouncing the benefits of globalization. Rather, it is an appeal to deepen knowledge about China and to see a commitment in China as a long-term strategy made of small but stable steps instead of as quick way to make profit.

This appeal might come late at this point but maybe not too late. In fact, it is still an open question whether the financial crisis in autumn 2008 will lead to a structural deceleration of investments in China or whether companies are simply waiting for better times. Moreover, China is potentially not the only investment target country in which high expectations in terms of low costs and market opportunities arise. Business moves on, and history sometimes repeats itself.

**Essential bibliography**

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