

Is Your Company a “Boiling Frog?” What Should Be Done Before It’s Too Late?



There is a popular metaphor in business circles about a 19th century experiment in which researchers concluded that frogs, when thrown into a pot of boiling water, would jump out to survive; but if the frog was placed in a pot of cold water where the temperature was raised slowly, the frog would be unable to sense the small changes in temperature and would eventually boil to death. The science behind this experiment has since then been debunked, however the “Boiling Frog” story remains a useful metaphor to describe the current situation faced by many companies in China.

BY NICHOLAS V. CHEN AND JUAN CARLOS MADRIGAL

Not long ago, China was the world’s dominant economic powerhouse and the factory floor of the world. For decades, Chinese companies enjoyed access to low cost labor, easy bank financing, endless global purchase orders and expansion prospects with no horizons. Annual double-digit profits and growth rates were common. Companies with good connections in government and State Owned Enterprises both benefited from privileged power dynamics. The frogs in this pond were very happy.

China companies today swim in a very different pond. Many companies now find their domestic market climate to be increasingly challenging. Many domestic companies have seen their market positions eroded by rising labor and operational costs, increased borrowing and regulatory costs, the cost of corruption and government inefficiencies, and the relocation of low value added manufacturing (along with those purchase orders) to lower cost countries. The past ways

to make money are not necessarily sustainable in the future. The advantages of the past seem to be gone, or slowly fading. Today, many competitors encroach upon the pond, and it is becoming increasingly difficult to survive in this new ecosystem by sticking to the traditional way of doing things.

Given this trend, bosses and leadership teams look for government guidance, and they are being encouraged to “go out” and seek opportunities overseas. As the whole world knows, companies have followed this advice, and in 2014, China’s official Outbound Direct Investment (“ODI”) amounts exceeded official Inbound Direct Foreign Investment amounts. This trend will continue for the foreseeable future.

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It has become clear that for a wide variety of companies, particularly those in traditional manufacturing sectors, that ODI is a viable strategy to secure access to new markets, new

revenues, management and technical talent, and new products and technologies. These are a pathway for future enterprise survival.

Few companies are able to develop an ODI strategy alone, which is understandable, since in the past they have been able to succeed and prosper by relying on their knowledge of the local market and business environment. Developing and implementing a successful ODI strategy takes input from many professionals to maximize the chance of success, and very few companies, whether in China or overseas, have the required mix of skills in-house. Faced with the daunting prospect of investing in foreign markets they do not know, smart companies have started to hire professional teams specialized in ODI to safely guide and team with them to plan and implement successful overseas investment strategies. Without such skilled teams, it is very dangerous for Chinese companies to try to go it alone without help. Chinese companies already operating overseas also need this kind of support.

In past decades, when many foreign investors came to China, it was common to hear frustrated comments from PRC executives about how the lost foreigner refused to listen to recommendations of their advisors and made negotiations or operations unnecessarily difficult. In some cases, the lost foreigner also jeopardized the viability of the project with their lack of cultural sensitivity, lack of familiarity with the local business environment; they often assumed that things should work the same way in China as they did in their home country.

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Today, Chinese companies going overseas find themselves in the shoes of those foreign companies coming to China in the last few decades. It is up to every boss/management team to decide whether they will invest the necessary resources, time and commitment to become a culturally sensitive and attractive business partner to potential partners/targets overseas, or will they just become another lost foreigner making things difficult for everyone and eroding the chances of success.

“The more we sweat in peace, the less we bleed in war.”

-Vijaya Lakshmi Pandit

We are now seeing media reports about companies that chose to “save money” by taking a haphazard, passive and opportunistic approach to ODI, which rarely generates satisfactory results, and can end in disaster when the future of the company is on the line. It is theoretically possible to win the lottery but the chances are small. If a company takes a leap of blind faith, no matter how confidently executed, the belief in a soft landing is not realistic.

James MacGregor’s book “No Ancient Wisdom, No Followers” describes the process of how, for years, the Chinese government’s industrial and multi-lateral development policies favored local companies and by whatever means necessary helped China to get where it is today. Unfortunately the book shows that the methods used in the past will not necessarily be effective in the future. Many incremental economic and market reforms could have been implemented piecemeal over the last two decades in a relatively painless manner, but instead, reforms have been either half-heartedly implemented or just relegated to nice sounding policy goal setting pronouncements.

MacGregor’s title refers to the Tang Dynasty expansions into central Asia. The Tang dynasty generals led their armies beyond the passes of

the Pamir mountains into central Asia without any prior reference points, reports, guides or maps. They went bravely but blindly hoping for the best, and needless to say, the results of such an unplanned strategy were less than ideal. Today Chinese companies cannot afford to go abroad without any prior reference points, reports, specialized ODI guides or maps. Now, just like then, company executives journeying overseas into uncharted territory must seek reference points, local specialized guides and have detailed strategic and operational plans to implement.

It is clear that the water temperature is rising for companies in China, and many are currently at risk of boiling if they continue to “wait and see what happens.” When the business environment changes, the company’s strategy must change accordingly. Chinese companies that feel these temperature changes must start to prepare, sooner rather than later, and with assistance from experienced ODI advisors to ensure that they succeed at this critical juncture. Preparing is a must. Preparing earlier and taking the initiative is even more important.

***If You Won't Go Into the Tiger's Lair,
How Can you Catch the Cubs?***

-Han Dynasty proverb 202BC-AD220

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