

Lettera

Club The European House-Ambrosetti

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China

CHINA - A GIANT IN EVERY WAY

Matteo Ricci - Italian, a native of Macerata and the first and among the greatest experts of Chinese culture - arrived in China in 1583.

At that time, China was virtually unknown in the West, despite the fact that it was the largest economy of the period.

But, even though Deng Xiao Ping opened the country to the rest of the world once again in 1979, the real China remained virtually unknown to the West.

Today, thirty years after that opening, we have all internalized a "stereotyped view" of China: it is big; it is different; it offers tremendous opportunities and tremendous risks; it copies shamelessly; it is the world's manufacturing platform because its costs are very low; we need to enter into joint ventures with the Chinese.

Many believe in this stereotyped view, perhaps with some slight variations. Unfortunately, however, although there is a basis of truth in these beliefs, the reality is much more complex and subtle. In addition, failure to comprehend this complex reality is often the very thing that has generated serious political, business and operational errors in relations between China and governments and companies alike.

China is big. China has a big population. But China also has big goals and big potential to meet these goals. China is currently the second largest economy on the planet. It is the nation with the third largest space exploration capacity, with ambitious goals for human colonization of the moon and also Mars. It has become the third geo-political pole in the world, and its area of influence continues to expand.

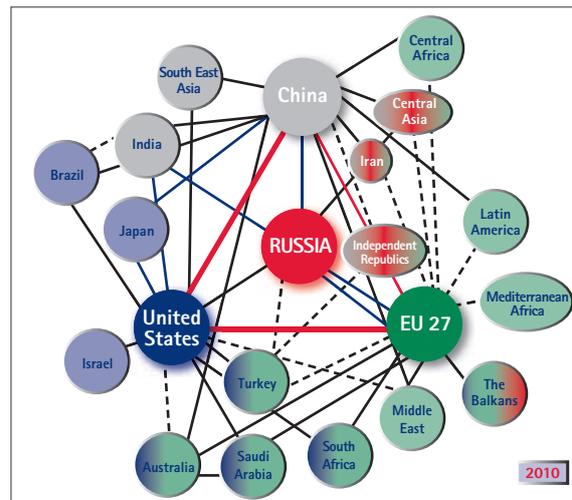


Figure: The changing geopolitical role of China over 25 years, from marginal player to new protagonist on the world chessboard.

(Source: The European House-Ambrosetti)

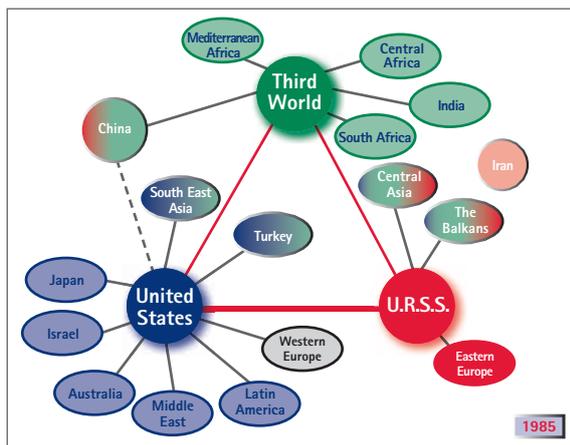
From being a major attractor of Direct Foreign Investment, it itself is becoming one of the top foreign investors. In just over five years, it has become one of the most important partners (and in some cases, *the* most important) of almost all African countries, thus assuring itself a supply of raw materials, as well as political and commercial influence. It has just offered Greece (a part of the European Union!) to massively intervene on a financial level to help it through its current crisis.

It is also using the Confucius Institutes as a means of spreading its culture and influence. But, unlike its competitors (Italian Culture Institutes, the Spanish Cervantes Institutes, the German Goethe Institutes, etc.) it has made a major innovation in the way they operate: instead of being institutes financed by their home government, China jobs them out as "franchises" to major universities in the host country. Using this formula, in just a few short years, it has been able to open a hundred Confucius Institutes in virtually every country in the world.

CHINA IS FUNDAMENTALLY DIFFERENT

In 1583, Matteo Ricci said:

"China is tremendously different from other countries and peoples because it is a wise people, very prone to study and little to war; it is very intelligent and now, more than ever, has doubts about its religions or superstitions..."



China is truly different. For example, its language is profoundly different. Languages such as Italian, English, German, Russian, Persian, Hindi, Sanskrit, Latin, Armenian, Greek – as well as many others, both living and dead – all derive from same “mother” tongue: the Indo-European family. All these peoples have a common origin. Chinese does not belong to this group of languages because the Chinese culture has an unusual origin: it was born on the banks of the Yellow River tens of thousands of years ago, while the “Indo-European” culture was born in Mesopotamia on the banks of the Tigris and Euphrates rivers. The Chinese language and its culture are drastically different from the others. Decades of close contact with the country are needed to begin to understand how profound and special it is.

Its culture and behavior are completely different. There exist scientific experiments which show that the Chinese (and other Asian cultures “connected” with the Chinese culture) perceive more the context surrounding the detail, while Westerners perceive detail more than its context.

Their idea of strategy is profoundly different. Westerners create an ideal, rational plan and try to “adapt the context” to their strategy. The Chinese do not want to be constrained by and drawn into pre-set plans which then turn out to be short-lived and hinder the ability to accommodate change which, for them, remains continuous¹.

CHINA IS MUCH MORE THAN A MANUFACTURING OR BUSINESS OPPORTUNITY

China offers tremendous opportunities for producing at low cost. The emerging internal market of over 1,300,000,000 consumers who are embarking on the road to well-being is (and will increasingly be) one of the most attractive markets in the world.

China also wants to be one of the great technological powers. Its government is investing heavily in scientific and technological research (of which space and military investment are also a part) and is pushing the top universities in the country to become centers of international excellence in all areas of study.

For example, in just a few years, China has become a world leader in high-speed rail systems (over a short period of time it has built the most extensive high-speed rail network – over 7,200 km) and intends expanding it even further (to over 16,000 km) within the country to make full use of its own 500 km/h train, but also to connect Beijing and Shanghai with the main capitals of neighboring Asian countries. It is also developing a very high-speed train line between Beijing and Berlin across Central Asia to connect all the capitals. In addition, it is becoming a world leader in solar energy.

China wants to go beyond its development model based on low-cost production to become, instead, an innovative, creative nation. And its government’s efforts to accomplish this are enormous.

For example, in Shanghai, in just a few years, 75 creative parks have been built. They are incubators of small-sized companies (with support from local universities), but each park is specialized in what are classified “creative” sectors: design, publishing, fashion, computer animation, software, architecture, etc. The city of Shanghai has created the association, “Creative Shanghai”, the goal of which is to have Shanghai become – over the coming decade – one of the most creative cities in the world.

The Chinese system of government, based on the leadership of the Communist Party, is experiencing a mix of authoritarianism (towards the population), democracy (within the party) and strict meritocracy (within the party and the government) that not only gives – for now – good economic results, but also attracts the interest of other emerging countries with the problem of a population “not yet ready” for democracy.

ITALY MUST HAVE A STRONG RELATIONSHIP WITH CHINA

A strong political and commercial relationship with a country with these characteristics represents a great opportunity. China could be a fundamental driver for development for Italian companies and institutions constrained by the small size of Italy itself.

Culturally and historically, China has very warm feelings for Italy. The flexibility of Italians and their “art of improvisation” are certainly more appreciated by the Chinese than by the Anglo-Saxon world. In addition, the strong points of Italy’s economic system – from the entire “made in Italy” sector to its food, healthcare, agricultural consortia, etc. – are points of interest for China.

This should be reason to declare China a “privileged strategic partner” (following the lead of the United States with a number of countries) and not put it on the same level of all other countries with which Italy has strong economic relations.

WHAT ITALY CAN DO AS A COUNTRY

Italy has a long tradition of “pioneering” ties to China: from Marco Polo and Matteo Ricci, obviously, but also the Bank of Italy for China (from 1905 to 1943) and Montedison which even during the Maoist period had significant operations in China. Italy was also the second Western country (after France) to re-open diplomatic relations following the Mao Tse-Tung era. But, although Italy has a pioneering tradition in China, it also has a tradition of not being able to consolidate its hunches and cutting-edge initiatives.

In fact, the history of these last thirty years has seen a series of actions to promote export of Italian products (prevalently so-called “made in Italy” goods) that are often erratic, uncoordinated and lacking follow-up. Attempt has also been made on more than one occasion – often with the support of national and local government – to launch multi-brand and multi-product retail initiatives (“Italy united”).

¹ François Jullien: “A Treatise on Efficacy: Between Western and Chinese Thinking”

SUMMARY

China – a giant in every way

- China has a big population.
- China also has big goals and big potential to meet these goals:
 - It is the second largest economy on the planet.
 - It is the nation with the third largest space exploration capacity, with ambitious goals for human colonization of the moon and also Mars.
 - It has become the third geo-political pole in the world, and its area of influence continues to expand.
 - From being a major attractor of Direct Foreign Investment, it itself is

becoming one of the top foreign investors.

- In just over five years, it has become one of *the* most important partners (and in some cases, the most important) of almost all African countries, thus assuring itself a supply of raw materials, as well as political and commercial influence.
- It is using the Confucius Institutes (now present in over 100 countries) as a means of spreading its culture and influence.

China is fundamentally different

- Its language is profoundly different and does not belong to the Indo-European family.
Chinese culture has different origins: it was born on the banks of the Yellow River tens of thousands of years ago, while the "Indo-European" culture was

born in Mesopotamia on the Tigris and Euphrates rivers. Its culture and behavior are completely different. There are scientific experiments which show that the Chinese perceive context differently than Westerners. Their idea of strategy is profoundly different. Westerners create rational plans. The Chinese do not want to be constrained by and drawn into pre-set plans.

China is much more than a manufacturing or business opportunity

- China offers tremendous opportunities for producing at low cost.
- But China wants to be one of the great technological powers. Its government is investing heavily in scientific and technological research (of which space and military investment are also a part) and is pushing the country's top universities to become centers of international excellence in all areas of study.
For example:
 - world leader in high-speed rail (with already over 7,200 km which are planned to become over 16,000 km)
 - emerging world leader in solar energy
 - world leader in production of scientific equipment.

- China wants to go beyond its development model based on low-cost production to become, instead, an innovative, creative nation.
For example, in Shanghai, 75 creative parks have been built – incubators of small companies specialized in "creative" sectors.
- The Chinese system of government is experiencing a mix of authoritarianism (towards the population), democracy (within the party) and strict meritocracy (within the party and the government) that not only gives – for now – good economic results, but also attracts the interest of other emerging countries.

Italy must have a strong relationship with China

- A strong political and commercial relationship with China is a tremendous opportunity and could be a fundamental driver for development for Italian companies and institutions limited by the small size of Italy itself.

- In addition, the strong points of Italy's economic system – from the entire "made in Italy" sector to its food, healthcare, agricultural consortia, etc. – are points of interest for China.
- This should be reason to declare China a "privileged strategic partner".

What Italy can do as a country

- Italy has a pioneering tradition in China, but it also has a tradition of not being able to consolidate its cutting-edge initiatives.
- In the last thirty years, Italy has undertaken a series of actions to promote export of Italian products (prevalently "made in Italy" goods) that are often erratic, uncoordinated and lacking follow-up. Attempt has been made on more than one occasion to launch multi-brand and multi-product retail initiatives

("Italy united"). These initiatives have all failed because of their excessive lack of professional study of context, market and local culture.

- Italy should leave to private initiative support for individual companies wishing to export to or invest in China.
- It should focus on framework agreements – in accordance with the relevant business organizations – to support the Chinese central government or regional governments in their large-scale development projects.

What Italian companies can do and how to do business in China

- In addition to producing in China to lower their costs, Italian companies should rapidly set out to conquer the Chinese market (the largest in the world within a decade).
- However, penetrating the Chinese market at significant levels requires:
 - scrupulous, detailed study of the market and context;
 - scrupulous attention to the local culture;
 - ability to operate "like Chinese", while maintaining an Italian-European soul;
 - ability to strategically manage their own brands, positioning them correctly within Chinese perception.
- These last two points are key and few Italian companies (or Western companies in general) are able to do this well.

- Those companies which succeed in winning significant shares of the Chinese market will have the chance to significantly increase their size and profitability.
- In China, companies must also maximize their ability to acquire new ideas, for example, by drawing on the intellectual capacity of the scientific and creative talents of the younger Chinese generations: through building their own research centers in China, collaborating with Chinese universities and delegating research and design functions to their departments located in China.
- Italian top management must decide to invest, even before deciding if and how to operate in China, in order to be in a position of understanding how different China is.

Conclusions

- The opportunities and risks in China are very big.
- China is extraordinarily different from the world we are used to knowing.
- The opportunity is not only to produce and sell, but also to put oneself in the condition of operating at the center of what will be one of the world's important poles of influence in the 21st century.
- It is time to face China, bearing in mind its potential, but also its diversity.
- The time for doing this is running out because, increasingly, in China there will only be room for the Chinese, or for those who have been accepted as such in the preceding decades.

Italy should meditate on a 4-character saying of Chinese wisdom from the Zhou dynasty (770 – 476 BC):

日暮途穷

"The day is waning and the road is drawing to an end"

These initiatives have all failed (including the most recent, highly important one, “Piazza Italia”) because of their excessive superficiality, improvisational approach and lack of professional study of the context, market and local culture.

WHAT ITALIAN COMPANIES CAN DO AND HOW TO DO BUSINESS IN CHINA

In addition to producing in China to lower their costs, Italian companies should rapidly set out to conquer the Chinese market which is growing rapidly and will probably become, within the next decade, the largest market in the world.

However, penetrating the Chinese market at significant levels, requires:

- scrupulous, detailed study of the market and context;
- scrupulous attention to the local culture;
- ability to operate “like Chinese”, while maintaining an Italian-European soul;
- ability to strategically manage their own brands, positioning them correctly within Chinese perception.

These last two points are key and few Italian companies (or Western companies in general) are able to do this well.

Those companies which succeed in winning significant shares of the Chinese market – as some have already done – will have the chance to significantly increase their size and profitability.

A case in point is Jack Perkowski, American financier who in less than ten years after having abandoned his career on Wall Street, has built in China a major components group from zero which, over the next few years, will probably become the largest group worldwide in its sector.

The group is comprised of Chinese companies that operate like Chinese in China and throughout the world, but whose mentality and management style is totally American.

The foreseeable increase in Chinese technological and innovative capacity also means that companies operating in China must also maximize their ability to acquire new ideas, for example, by drawing on the intellectual capacity of the scientific and creative talents of the younger Chinese generations. This means building their own research centers in China, collaborating with Chinese universities and delegating research and design functions to their departments located in China.

More generally, Italian top management must decide to invest, even before deciding if and how to operate in China, in order to be in a position of understanding how different China is. As long as attempts are made to apply to China the same criteria for comprehending and decision-making used (successfully) in the rest of the world, the risk of committing serious strategic errors will remain very high.

CONCLUSIONS

The opportunities and risks in China are very big.

China is extraordinarily different from the world we are used to knowing.

The opportunity is not only to produce and sell, but also to put oneself in the condition of operating at the center of what will be one of the world’s important poles of influence in the 21st century. It is time to face China, bearing in mind its potential, but also its diversity.

The time for doing this is running out because, increasingly, in China there will only be room for the Chinese, or for those who have been accepted as such in preceding decades.

In the Chinese language, there are over three thousand idiomatic phrases (called *cheng yu*), composed of just 4 characters, which encapsulate much of Chinese wisdom. The *cheng yu* Italy could perhaps meditate upon may be that of the Zhou dynasty (770-476 bc):

日暮途穷²:

“The day is waning and the road
is drawing to an end”

² Literal translation: “day – sunset; road – limit”

The next *Lettera* will be dedicated to “Promoting merit in Italy”.

The European House-Ambrosetti *Lettera Club* draws on the analysis, theses and solutions developed as part of Club activities and, more generally, the professional activity of The European House-Ambrosetti Group. We are aware that we offer an observatory of information and relational network, including on an international level, that is extremely high-level, but at the same time we are cognizant of the fact that we are not the sole “repositories of truth”. In order to be of assistance to Italy and Europe—one of our key commitments—we sincerely hope that each *Lettera* will provide the basis for a large number of critical suggestions, both in terms of content and more generally, from those who receive it. Please send your suggestions and comments to letteraclub@ambrosetti.eu. We thank you in advance for your invaluable collaboration.

If you are interested in the activities of The European House-Ambrosetti Club, please contact Silvia Lovati at the e-mail address: club@ambrosetti.eu or call: +39 02 467531.

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