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Publication Date

2007-03-02

Service Consulting in China: Challenges and Best Practices for U.S. Multinationals

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UCB iSchool Report 2007-012
March 2007

Available at: <http://www.bryantsao.com/files/isd.pdf>

Abstract

The sale of American services in China is an important growth area for U.S. corporations and the U.S.-China balance of trade. Firms such as IBM and McKinsey have been successful at adding value to clients in the U.S. by tapping into their wide networks of human capital and applying them in appropriate situations. However, because of China's relatively closed network economy and distance from the U.S., firms such as IBM and McKinsey's greatest challenge is in developing human capital capable of effectively applying their companies' networks of resources in China while, for reasons of efficiency, remaining relatively autonomous from company leadership in the U.S.

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Services in China

With the growth of the services sector in the U.S. economy, the increasing outsourcing of jobs to Asia and the rise of China as an economic superpower, the question of how to effectively run a services business in China is a crucial one for Western multinational service firms. Services are still a relatively small portion of Sino-American trade – in October 2006, the most recent month for which data is available from the Census Bureau, the U.S. and China traded a combined \$271 billion in goods, while only \$64.1 billion in changed hands in the service sector. But tellingly, the U.S. posted a \$65.1 billion trade deficit in the goods sector, while posting a \$6.2 billion trade surplus in deals for services, making the success of U.S. service companies in China significant not only to industry leaders such as IBM and McKinsey, but to the U.S. economy in general.

Doing business in China as a service company presents a number of challenges, including unfamiliar business terrain, language barriers, differing consumer markets and knowledge management, which are exacerbated by China's lack of quality business education and experience. However, it's important to note that the nature of the challenges facing businesses in China is not fundamentally different than those facing businesses in Russia, Brazil or any other foreign country. Foreign businesses invariably face challenges of unfamiliar business practices, cultural norms and proper delegation. Rather, it is the scope of these issues facing foreign businesses in China that poses a unique challenge to multinational firms.

The scope of these factors manifests itself in China's services industry in many ways. Many Chinese companies refuse or are reluctant to work with individuals who are not fluent in Mandarin, while many common business practices, such as gift giving, fall outside the normal accepted bounds of business in the Western world. (Yu) This problem is compounded by the relative lack of native Chinese with the proper business or technical preparation to effectively work in a company like IBM or McKinsey; a McKinsey report estimates that Chinese university graduates possess only 60 percent of the skills necessary to be productive. (Grant) This in turn compounds the knowledge management, sharing and delegation issues that global services firms must address.

How Services Add Value

In examining these challenges, the China operations of IBM Global Business services and McKinsey are illuminating. IBM Global Services, which accounts for over half of IBM's revenues, and McKinsey are both highly successful consulting companies in the U.S. that have already established significant presences in China. (IBM report) While adding value in slightly different ways, both are service companies that provide value to clients by providing comprehensive solutions to business problems using their unique expertise. Both companies offer global on-site human resources to analyze business processes, with IBM lending more expertise in delivering integrated IT solutions, and McKinsey relying more on its global network of human capital and contacts. While those capabilities are valuable in any context, the reality of doing business in China does present unique challenges to service companies such as IBM and McKinsey.

Lack of human capital

While little research has been done into the challenges in delivering service value in China, the lessons learned by companies off-shoring manufacturing process can add insight, as can the Powell's network theory for explaining business. Taken together, it is clear that the main challenge facing American service firms is overcoming the lack of individuals who are both integrated into the network that is the Chinese economy and qualified enough in Western business practices to be trusted enough to make high level decisions independent of the home office.

Additionally, establishing that business structure while simultaneously effectively leveraging benefits from cross-silo, horizontal connections within the firm's own network of assets add another layer of complexity to the challenge of creating a firm that is well positioned to succeed in China. Lastly, for companies emphasizing IT solutions, usability concerns around software developed outside of China in a different language should also be addressed in order to improve quality.

Put simply, in addition to investing capital in creating a toehold in China, firms must find people who are familiar with China's business terrain, possess the necessary skills to add value for clients, and place them within a business structure that is independent enough to operate autonomously, but not so independent that it is unable to derive benefits from the firm's global assets, while also being cognizant that different cultures impact not only human issues, but also technical issues.

China's Network Economy

Powell's theory of network economics can help explain why it is simultaneously especially important and difficult for services companies to smoothly establish themselves in China. Network economies, classically exemplified by the Silicon Valley's cluster of venture capital firms, elite universities and established technology firms, involve groups of companies whose interactions are governed not strictly by market pricing or hierarchical relationships, but rather mutually beneficial, reciprocal, long term relationships. (Powell, 305) These relationships are particularly crucial in the service industry, where the efficient, reliable flow of information is paramount. (Powell, 304)

According to Yu, the services industry in China fits the network model very well, as business decisions are driven not only by pricing, by relationships a company's reputation based on previous interactions. According to Wong and Chan:

The conceptual framework is that *guan xi* elements are perceived to be a dichotomy of Outsider/Organisation and Insider/Individual. An outsider aims to establish or enter into a "*guan xi*" connection with an individual or group who own the desired resources. Being an insider, that is, within the network, means that information exchange and mutual understanding are enhanced or exchanged substantially and smoothly.

Because many of the norms necessary for such effective communication and collaboration are both unwritten and highly distinct from Western norms, the aid of insiders is crucial for success. (Wong and Chan, 109) This lesson has been learned by McKinsey experts in dealing with offshore manufacturers, who wrote in a special report (Hexter and Narayanan):

To get what they want from their Chinese suppliers, top companies have learned that they must meet with them on a regular basis. We found large differences between competing companies – in one case a 36-fold difference – in time spent on the ground with suppliers. It is important to shift from the practice of "supplier management," which consists of oversight and modest support, to "supplier

development,” which involves helping suppliers to perform better and achieve the required levels of cost, quality, or lead time.

Establishing oneself in these networks is especially important because networks tend to be reinforcing, and once established, often endure. (Powell, 305) As the service industry in China develops, establishing a foothold in China is crucial for multinational firms who hope to be players down the road.

The Importance of People

Consequently, developing human resources in China is the largest challenge facing American service consulting firms in China. Because co-producing value in the modern information service economy relies so heavily on being integrated into networks, employing those who have experience in China is especially important to Western service consulting companies such as McKinsey and IBM. However, knowledge of China’s business terrain is obviously not the only requirement.

An examination of case studies IBM's projects in China demonstrate that shows that they add value by leveraging their experience in customizing integrated hardware and application solutions, tapping their vast application and platform libraries and using their global reach to provide on-site consulting for their clients. (IBM) A prototypical case would be IBM's use of pre-existing IBM WebSphere Information Integrator software and IBM pSeries servers to implement tax reform and simplify the process of collecting taxes for the Shandong Local Tax Authority, which allowed the local government to improve tax compliance, deliver higher revenues and gain access to previously unavailable tax data. (IBM)

On the other hand, McKinsey is known for tapping its global knowledge base, human capital and far-reaching relationships to help clients improve their businesses. (McKinsey) For McKinsey a prototypical case is their project with local and regional authorities to revitalize the historic Nanking Road shopping district of Shanghai. In the project, McKinsey consultants gathered data from business owners, shoppers, as well as McKinsey experts in retail and urban planning and. In addition, they were able to tap contacts around the world, such as the architects of a similar project for Paris’ Champs-Elysees and Chicago’s Michigan Avenue Association, to develop benchmarks for world class shopping districts. Then, they used the data to provide the framework of analysis to generated recommendations and a plan for implementation that have been adopted by the stakeholders, and used their strong brand to attract potential partners, such as Louis Vuitton. Their recommendations are currently being implemented. (McKinsey)

Other firms, such as Infosys (included because of its success and acceptance in the U.S. and the strong British influence in India) or Boston Consulting Group fall on various points in the continuum of technical to strategic solutions, but all consulting companies likely rely on some combination of the aforementioned capabilities to add value. Building a China workforce that possesses sufficient human capital to perform those functions while also possessing having enough local knowledge in China to network effectively is one of the central challenges facing Western consulting firms.

Not Enough Capital

Firms looking to hire highly capable professionals with Chinese connections either need to draw from the relatively limited expatriate pool in the U.S. and Canada, or hire native Chinese people with professional skills. Unfortunately, while the Chinese education system is rapidly catching up in teaching technical skills, their ability to train competitive business professionals still lags demand significantly. (Roberts) According to a recent study conducted by recruiting firm Universum Communications, fewer than 20% of corporate recruiters in China describe Chinese MBA graduates as “good” or “excellent,” and even only 34% felt that their quality had improved over the past three years. Corporate recruiters say that Chinese students lack leadership skills, and that outside a handful of top rated universities, such as Beijing or Jiao Tong University, the quality of China’s estimated 230 MBA programs is very uneven, lowering the value of the degree. (Roberts) Collectively, Grant estimates that within 10 to 15 years, demand for business leaders in China will rise to 75,000 positions, with only 3,000 to 5,000 such professionals on hand today.

One solution, in addition to the obvious (and expensive) one of identifying promising Chinese managers and sending the back to the U.S. for training is to deepen collaboration academia in China. IBM has a long history of working with academia on its high level research initiatives, such as the collaboration between its Almaden Services Science research lab and the School of Information at the University of California, Berkeley. (Sporher) Additionally, IBM has implemented a training program whereby experts from the United States train IBM employees in China on domain specific knowledge, who in turn train other IBM China employees. (Yu) However, the process is cumbersome at best. (Yu)

The cultivating of more and better Chinese managers is acutely important, given the level of autonomy that is required for a Chinese business unit to achieve maximum efficiency. As a McKinsey special report states, “A much higher level of trust is needed when executives realize that they must rely on people they do not know, who often do not speak English well.” (McKinsey)

Structuring For Success

Additionally, not do firms need sufficient capital (of all forms) to network and add value, in order to maximize their efficiency, they also need to be structured such that they can act autonomously in China, while also being integrated enough into the company as a whole to leverage worldwide assets, as the McKinsey team did in the Nanjing Road project. The autonomy is necessary to reduce project lead times, generate better decisions by allowing those with both management skills and an on the ground understanding of the Chinese network to make decisions, and for increased company efficiency in general. A recent McKinsey special report on manufacturing offshoring in China demonstrated the importance of autonomy, showing that companies could reduce product development times by keeping most of the decision-making process in China and not forcing them to wait for approval from across the Pacific. (Hexter and Narayanan) Additionally, companies that allow more local flexibility on issues such as gift giving or control of intellectual properties have been more successful at winning business in the Chinese market. (Yu)

In the case of China, McKinsey has also found that autonomy is also important because it leads to better decisions. Again due to the very distinct nature of China’s

economic networks, units on the ground in China often have a better grasp of conditions. However, structuring an organization such that some sub-units can act independently – but not too independently – is difficult, according to McKinsey (McKinsey report, 6):

Companies must also address the cultural dimensions of the changes that result from local decision-making. A much higher level of trust is needed when executives realize that they must rely on people they do not know, who often do not speak English well. It is also necessary – and can be quite difficult – to manage the human aspects of the transfer of power – when someone in New York, London or Paris is no longer making the decisions.

This task is especially daunting in light of the importance of maintaining enough internal connections to take advantage of a firm's worldwide resources. One model that has been successful in improving cross-silo interaction is Infosys Consulting's policy of having key team members regularly rotate through different areas of the firm in order to facilitate flat collaboration between units. (Pratt) This autonomous structure also reinforces the importance of developing strong human capital.

Lastly, increased autonomy also helps reduce the burden on top decision makers. Given the current state of telecommunications, a main challenge of global service firms is to prevent senior executives from becoming overwhelmed by a constant deluge of queries from different time zones around the world. (Pratt)

Lost in Translation

In addition to the mostly human elements already discussed, the usability of software solutions developed outside of China and in a different language should also be addressed. Because usability issues often differ drastically with different user bases (Van House), software designed in the U.S. is almost certainly not optimal for Chinese users. Because decreased distance between system designers and users leads to better design, IT oriented firm should decrease the usage of completely pre-packaged software and involve clients in software development process to the extent that it is practical. (Merholz and Wilkens)

The Game Plan

In conclusion, it's clear that U.S. service companies, particularly those with lesser pedigree and resources than the likes of IBM and McKinsey, face significant challenges in developing the people they need to be successful in China, as well as structuring their firm to maximize autonomy while maintaining connectivity. However, by studying the thus far successful practices of IBM and McKinsey in China (as well as Infosys Consulting in India and the U.S.), certain best practices can be adopted. From an IT standpoint, firms should involve the client in the development of software as much as possible. From a human perspective, firms should cultivate relationships with Chinese academia; hire local managers from top programs and give them the freedom to make the correct decisions quickly and independently; and periodically rotate key employees in and out of China to help maintain cross-silo communications.

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