

**Review Article of Peter Nolan:
China and the Global Business Revolution**

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Peter Nolan. *China and the Global Business Revolution*. New York, NY: Palgrave, 2001. Xxix, 1092 pp. Hardcover \$100.00, ISBN 0-333-80119-9.

After a dozen volumes on the Chinese economy and business, Peter Nolan, Sinyi Professor of Chinese Management of the Judge Institute of Management Studies, Cambridge University, has produced another weighty study on China. The very existence of the chair in Chinese Management reflects the vision of the institution and the expertise of the occupant. The present study evidently benefited from the author's cumulative knowledge and well-placed Chinese collaborators. Although the title of the study is *China and the Global Business Revolution*, the focus is actually on a number of case studies of China's large enterprises and government policies concerning these enterprises in the context of changing world business paradigms and practices. Thus, the title probably reflects marketing concerns for the book, rather than an accurate description of its contents.

The bulk of the study is devoted to enterprise cases in aerospace, pharmaceuticals, power equipment, oil and petrochemicals, autos and auto components, steel and coal. The degree of detail found in these cases is uneven, apparently reflecting the degree of difficulty of obtaining pertinent and accurate information from the enterprises. Although the author has used very good Chinese researchers and has excellent Chinese connections with senior government officials, there is little disclosure of the precise methodology used in the field studies. For instance, it is revealed that the author and his collaborators "lived in Shougang's 'hotel' for seven days" (p. xxi) and conducted interviews. However, no information is given about the kind of enterprise people interviewed, whether the questions were pre-specified or open, and in particular, what kind of internal documents were made available to the researchers for perusal and questioning. Judging from my own experiences, it is likely that the interviews were mostly with senior level employees and that contact with lower level workers was, at best, occasional, probably when taken on guided plant tours. Sometimes, certain internal documents are passed on informally to "friends" but the question of access to enterprise books is rarely raised since it may raise legal questions about the passing of "state secrets" to foreigners.

There have, indeed, been a number of embarrassing cases concerning foreign researchers whose zeal for exploring gold mines of information has put them in compromising positions under Chinese law which may or may not be strictly reinforced. The fact that "state secrets" are actually voluntarily offered, does not absolve the foreigner, nor the Chinese collaborator, from possible legal entanglements. The author's silence on such an issue may, therefore, be prudent, but it raises the question of adequacy of information. The limitations of the case studies are somewhat compensated for by a general survey of the industry in China and the world, where information is more readily available.

The seven case studies are accompanied by a survey of China's financial services industry by Wu Qing, of the Judge Institute. This chapter does not rely on specific case or field studies.

The enterprise and industry case studies are preceded by three introductory chapters, namely, large firms and economic development, the challenges of the global business revolution and policies to build national champions: China's "national team" of enterprise groups. The third chapter is contributed by Dylan Sutherland, also of the Judge Institute. The study concludes

with two chapters, one on the response to the challenges of the global business revolution, and the other on the long-term view, especially in view of China's entry into the World Trade Organization (WTO).

The main theme of the tome is clearly stated in the first chapter: namely, the choice between the neo-classic view of atomistic firms in pure competition and the pre-dominance of large and even larger firms. This "ideal type" dichotomy is based on theoretical constructs useful for classroom expositions but is a heroic simplification of the real world. Although, the impression that the large firm is the undisputed king in advanced market economies and in the future world is fairly prevalent, if one goes a little deeper into business history one would find that many large firms started small and many did not survive the Schumpeterian process of creative destruction. Such a historical process is still alive and well in the new economy of information technology and globalization: One need only to look at the birth and evolution of firms in the Silicon valleys and the changing guards of a country's list of 500 or 1000 largest firms in recent years.

Indeed, there are hints of such dynamic processes in the chapter on the global business evolution and in the case studies, although such hints have not been spelled out. There is no doubt that the first Fordian model of vertical integration has lost most of its advantages in the context of global competition. When parts and accessories are obtainable elsewhere at lower cost, insistence on intrafirm sourcing entails greater costs and, thus, competitive disadvantage. Moreover, the parts subsidiaries in a vertically integrated firm can also be disadvantageous in winning customers from competitors, as in the case of manufacturers. This is amply illustrated by the divestment of numerous upstream and downstream subsidiaries in integrated firms. Indeed, Boeing hardly makes any parts itself. At the same time, the sourcer's relationship with the suppliers is far more varied and complex than an individual consumer shopping in markets. The sourcer is not only interested in the best price but also in its long-term availability and reliability. Thus, in the case of original equipment manufacturing (OEM), the supplier is not only instructed exactly what and how to produce the desired product, but also how to run a business. The result is that both technology in the technical sense, as well as the art of corporate governance, is transferred to the supplier.

The above has important implications for the viability of relatively small size firms, a fact not recognized by the author. While the competitive process is admittedly keen, the chances for upgrading also present themselves. Another implication is that the boundary of a firm or its global reach extends far beyond the legal boundary. Apart from sourcing, there are numerous forms of more or less formal alliances ranging from joint research, equity and non-equity investment, to group and holding companies. The partners involved may enjoy a great deal of autonomy. The small and medium-sized firms are, thus, not as subservient and helpless as they appear to be. Neither are they all destined to be swallowed up, as per the law of the jungle. Indeed, even in the biological jungle it is sometimes the biggest and the strongest rather than those smaller who are endangered. The game of survival is not limited to "the big eats the small" but sometimes defined by mutual accommodation or the development of effective defense mechanisms by the relatively weak.

China's policies of building national champions, as described in Chapter 3, may be better understood if more attention were paid to the process of systemic transition. The large firms are

a legacy of the pre-reform era when a single firm was considered adequate for most sectors and any additional one appeared to be a duplication of effort. At the beginning of the reform process, the searching question was what to do with the inherited, largely inefficient, bureaucratic, and loss-making state-owned-enterprises (SOEs). Therefore, the “grasp the large” policy resulted more from the impracticability of reforming all the existing SOEs than from a systematic creation of national champions. Such a policy needs to be understood in the context of the absence in China, after the establishment of the People’s Republic, of a political revolution that would negate everything in the ancient regime. Thus, the approach China adopted to dealing with existing problems was to seek consensus among various power groups in order to ensure broad acceptance and to avoid serious factional struggle and social disorder. Outright privatization of weak SOEs has not been considered a serious option, even though the share of SOEs in industrial output has been allowed to decline steadily from 4/5th in the early 1980s to less than 1/4th in 2002.

Through the process of step-by-step reform and restructuring the Chinese economy has avoided the major crises typical in most other transitional economies that opted, instead, for a shock therapy approach, including the instant dismantling of price controls that resulted in rampant inflation before a market mechanism was put into place. Likewise, China has also avoided the massive transfer or loss of national assets to insiders resulting from instant privatization prior to the creation of a middle class and a sizable and functioning capital market as well as a mechanism for the evaluation of assets.

It is true that the shortcomings of a step-by-step approach anticipated by the purists have surfaced in China in more recent years. There is lack of clarity about the precise model of the country’s development. There are always laggards in certain sectors of the system that prevent the smooth functioning of other sectors. Yet, on balance, the final test is whether the economy has performed reasonably well and whether people’s lives have improved steadily.

Most observers agree that China’s economic and social indicators in the last two decades have been exemplary. Yet, there are doubters as to the believability of Chinese statistics. The falsification of statistical reporting, especially at local and provincial levels, during the great leap period and the disastrous famine has not been forgotten. While incentives for exaggeration of performance may have remained in place during the reform period, the general availability of statistics has made it more difficult for wide exaggerations to escape scrutiny. Certainly, if people are starving, a responsible government official can hardly believe that grain supply is abundant. Indeed, government leaders, who do not always follow the itinerary planned by local officials during their inspection tours, cannot all be prevented from seeing what is going on. Certainly, in Shanghai, there is a new e-mail box that any resident may use to give direct information or advice to the mayor.

In any case, the national accounts calculated by the state statistical bureau are based on sampling procedures rather than on local submissions. Neither are the inferences derived from certain assumed incongruities between high overall economic performance and other indicators such as high unsalable inventories, low inflation, high unemployment etc. convincing. It is true that the inventory of SOEs remains high; yet, in a predominantly market-determined economy, totally unsalable, shoddy goods have to be liquidated sooner or later. Thus, inventory accumulation has

been moderated, at least since 1998. The low level of inflation or even moderate price declines are consistent with a relatively high rate of growth not only in China but also in countries such as the United States as global competition and increases in productivity dampen the ability of enterprises to raise prices.

The increase in the number of furloughed workers and the unemployed is also consistent with a relatively high rate of growth as redundant workers are allowed to be shed with enterprise reforms and productivity increases. The improvement in very high energy consumption in relation to output reflects a reduction of waste with the relative increase in energy prices as well as a change in the structure of output to less energy intensive sectors. To be sure, there is room for improvement in statistical reporting. In particular the high rate of growth does not take into account environmental degradation, which Leontief has long proposed should be counted as a negative product and, thus, deducted from the aggregate national product. As yet, such a procedure has not, however, been adopted internationally. For purposes of international comparison, the figures based on traditional methods remain in general use.

If the over-all Chinese economic performance is robust, the international trade and payments situation is also enviable. The fact that Chinese large enterprises are weak has not condemned China to be internationally uncompetitive. Indeed, China's growing share in world exports and its mounting foreign exchange reserves has followed from an open policy and benefited mostly from non-SOEs. The mantra "the larger the better" is not generally supported by evidence.

This is not to deny the usual argument concerning economies of scale and scope. At the same time, market segmentation and cost advantages can help relatively small enterprises to co-exist with giants. Even innovation is not limited to enterprises with deep pockets in research and development expenditures, precisely because unorthodox ideas have a lower chance of being accepted by mainstream technology managers. Moreover, success in business is often not a result of major breakthroughs from the scientific point of view but of a series of applications of innovations in the small. Witness the commanding heights reached by such firms as Coca Cola, McDonalds, and Walmart.

The examples of these same firms also help to illustrate the point made earlier, that the competitive game in business does not have to be a case of all or nothing. It is true that for many start-up firms, whether in the new economy of information technology or in the old economy of food, beverage and retail, the average life expectancy is short. Yet, the example set by firms such as Coca Cola has induced the blossoming of many Chinese domestic firms. Although it may take a long gestation period to produce a national champion, a fairly large number of niche firms can be viable. Certainly, the "technology" of ensuring product quality, cleanliness, and accessibility to the consumer is to a greater or lesser extent being defused and absorbed. Likewise, the mushrooming of McDonald's and other giant fast food companies in China has not displaced the gourmet Chinese restaurants but has, actually, induced a large number of domestic fast food outlets with Chinese characteristics - that is, although they have copied such practices as uniformity in quality, promptness and polite service, the type of food is basically traditional.

These examples do not, of course, apply to all industries, especially where product

differentiation is unimportant, but experience shows that the fear of the global reach of the big, bad, all powerful predatory firms is exaggerated. While the author does not explicitly cite the neo-Marxist theories of dependencia and the marginalization or the condemnation of developing countries into the periphery, the fate of China and of all developing countries is, indeed, painted too bleak. This scenario results from an over-generalization of the virtues of size as well as an over-simplification of the competitive game.

The narrow focus of the volume is the underlying reason for its questionable policy implications. In reality, not only has China's over-all rate of growth in the 80s and 90s been extraordinarily high, the developing countries as a whole have also performed better than the developed in spite of great unevenness among them. Neither is the initial fear of the less developed in the European Union warranted. Instead of being totally dominated and marginalized by the big and powerful, the performance of the less developed has actually been the envy of the more powerful and other contiguous less developed which are lining up to become members. Consequently, not only has the union not disintegrated over time, it has coalesced and attracted more and more less developed members. The post-war experience of the performance of developing countries points to the potential advantages of the late-comer who do not have to reinvent the wheel and enjoy enormous cost advantages. Moreover, an open world economy enables relatively small and less developed countries to reach beyond their borders. The main question is whether the opportunities are being explored rather than whether these countries can escape from predestined unfavorable conditions and insurmountable obstacles.

In the last two chapters, the author poses a number of important questions concerning China's industrial policy under the WTO. A number of pertinent questions are raised, but they are not explicitly answered. The drift of the argument and future prospects remain pessimistic for China and all developing countries. The main reason for the pessimism is rooted in the difficulty of arriving at an appropriate industrial policy. Within this framework, China's industrial policy has failed to create and nurture national champions in the key industries and its entry into the WTO presents even greater difficulties.

From a broad policy point of view, the present reviewer would agree that industrial policy in the narrow sense of picking and nursing winners is, indeed, a questionable general strategy. To be sure, nationalist feelings persist in many countries, whether developed or developing. France and Canada, for example, have lamented the incursion of U.S. transnationals. On the other hand, even MITI of Japan has admitted that it did not have the foresight of choosing Toyota to be the champion to battle the then invincible U.S. auto giants. This is not to deny that occasional prop up or rescue policies can succeed under favorable circumstances.

In the case of China the relative weakness, with some exceptions, of giant SOEs, inherited from pre-reform days, has lingered as the reforms have moved slowly. Yet, on the whole, this weakness has been more than compensated for by the vibrancy of the non-state sector. Most of the latter have neither been singled out for special government support nor reached the size of "bigger is better". It is true many have not survived; but, for the most part, they are the shakers and movers, and some of them have even grown in size and transformed themselves into transnationals. In particular, the Chinese have a long tradition (institutional memory) of innovation, whether in technology or entrepreneurship.

Consequently, the main policy challenge for China post-WTO is not the picking of national champions in a few selected industries, but the formulation and implementation of a host of development and reform policies that would enable the Chinese economy to continue to grow at a rapid rate, compared with the historical record of developed countries. To be sure, the problems inherited from the pre-reform days, including the weak SOEs have to continue to be dealt with; yet, the emphasis must be on the articulation of a host of policies, notably macro balance, the rule of law, property rights, codes of conduct, education, rules of competition, the eradication of corruption and the establishment of a social safety network. The implication is that China's step-by-step reform has reached a point when a more comprehensive approach has become necessary and feasible. A further implication is that the role of the government remains large and crucial, except that the emphasis and content have to be changed from managing or directing enterprises to enabling enterprises to innovate, compete, and grow. Moreover, it does not imply that the government should not be involved in details except for providing general policy direction. To ensure WTO compliance alone requires the rewriting of literally thousands of laws and regulations.

On the whole, the impetus of WTO membership provides a strong external stimulus in the right direction. Evidently, China's precise WTO obligations are neither ideal from China's point of view nor totally justifiable objectively. They are the results of haggling and bargaining, often with threats of collapse after marathon negotiations in the wee hours. Yet the predictions of a disastrous impact on the Chinese economy is grossly exaggerated. Indeed, the need for WTO compliance has already unleashed a host of initiatives in the desired direction. While there is no guarantee that external or internal shocks might not derail the current trajectory, the objective conditions for China's success in the international competitive games remain apparent.

While the reviewer does not share some of the basic assumptions and policy implications stated in the book under review, as often is the case among scholars, the usefulness of the publication to all serious students of China should be explicitly emphasized. The amount of pertinent information contained in a single volume is unmatched by competing sources. The arguments presented serve as a potent stimulus for further theoretical and empirical investigations as well as policy debate.

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