

China's Mittelstand man

Why have German firms been so successful in China?

(Interview by: Jürgen Kracht, Chairman of Fiducia Management Consultants)

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Why have German firms been so successful in China? Jürgen Kracht explains

Jürgen Kracht's first visit to China was in 1972, when he attended the Canton Fair. He recalls it was like "entering another world". It was a time when the red songs and Maoist movies still dominated and the word capitalism only entered conversations in a purely derogatory sense.

In the ensuing decades he has witnessed profound changes in China. In 1982 Kracht founded Fiducia, a consultancy that helps European firms – predominantly from German-speaking countries – to establish and run business operations in Hong Kong and China. It's a role that put Kracht, the German businessman, in a unique position to observe one of the world's most profound industrial revolutions: the growth of the modern Chinese economy. This is exemplified by the fact that China's foreign trade has grown massively. Germany has been a major beneficiary: nearly half of all EU exports to China come from it.

Here Kracht – who is Fiducia's chairman – discusses his experiences in China and why German manufacturing firms have proven so successful in the country.

How did you get started?

I arrived in Hong Kong in 1971 to work with Jebesen, a trading house that represented big European companies like BASF and I initially sold dyes and other products.

Back then China was a closed country, but there was limited China trade through Hong Kong. Jebesen sold machinery and chemicals to China. And they had European cus-



Kracht: made first trip to China in 1972

tomers, who bought products from China like intestines to make sausages or feathers for duvets. Transactions would occur at the twice yearly Canton Fair and my trips there were my first experiences of doing business in China.

In the early eighties as a result of China's opening I noted a growing

interest overseas in China trade. For example, in 1982 BASF established its own company in Hong Kong and their first representative offices in China. That was the start of a major trend.

In the same year, I opened Fiducia with the goal of helping foreign companies to access the Greater

China market, i.e. Taiwan, Hong Kong and increasingly China.

Typical assignments were searching for customers and suppliers and negotiation support. Much of our work was to bridge the cultural differences and to illustrate this, I always open a meeting with: “The distance from Beijing to Guangzhou is the same as from Copenhagen to Palermo. So do not think of China as one market. It is a multitude of markets. Also a Cantonese person is very different from a Beijing person.”

By the late eighties there was a greater interest in operating in China itself, so we opened offices in Beijing, Shanghai and Shenzhen. We provided European firms trade and investment advice and hands-on support, such as company incorporation and book keeping.

A key issue was to help clients to navigate the challenges. For example, we had a German client who wanted to employ the son of the owner of a Chinese restaurant in Stuttgart to be general manager for their Shanghai office. I didn't say they were crazy, but I did say it would not work because whilst the candidate is native Chinese he has never been to China!

Which were the first German companies to set up in China?

Volkswagen was a pioneer with a joint venture in 1984. At that time no other foreign firm wanted to build a car factory in China. In the final meeting with the top leaders, it asked to raise the import duties on cars to 100% which was granted. Thus, Volkswagen had a head start.

It then shipped its Santana factory from Brazil, box by box. In fact, when the equipment was removed from the crates in Shanghai, they decided not to waste anything – they built desks out of the crates, even for the German managers. Such moves created a lot of the good



Guten tag, Sichuan: Kracht (right) on a trip to Chengdu in January 1985

will among the Chinese.

German multinationals were quite smart in staffing: rather than sending people from Germany directly, the company posted executives who worked in places like Moscow or Jakarta – i.e. they knew how to operate in challenging markets.

German firms' success is traced back to their approach, patient attitude, and the willingness to wait for results.

German politicians were supportive of these pioneers too. For example, Helmut Schmidt [former chancellor of Germany] visited China every year and formed very good relations with Deng Xiaoping and Jiang Zemin.

Do Chinese have a positive perception of German companies?

I think German firms are viewed as a reliable business partner because of their actions. Their word is their word, a handshake is a handshake. Chinese know that German goods are more expensive but they recognise that they are of high quality and reliable. That image is strongly embedded in China.

One of the chief reasons for Germany's success in China is the strength of its manufacturing. A big part of that comes down to the

country's *Mittelstand* – the thousands of small and medium-sized industrial firms that are the heart of the German economy. There is a growing awareness in Beijing that the backbone of a healthy industry is not the massive companies but the family companies like those of the *Mittelstand*. In fact, the Chinese government views the German economic structure as a model.

I understand that the Economics Department of the Chinese Embassy in Berlin mirrors the structure of the German manufacturing industry. Their task is to observe and understand how German companies tick, particularly the *Mittelstand*.

A big part of our business is advising those *Mittelstand* manufacturing companies. They are not shy about going to China, but value our support and advice.

So there's been a big expansion in *Mittelstand* firms entering China?

Yes, the big expansion of companies opening Chinese factories was between 2000 and 2010 after China permitted subsidiary companies besides joint ventures. As an example, the city of Taicang in Jiangsu province today houses 120 German companies mostly from the Stuttgart area. They are all *Mittel-*



Little Germany: 120 German manufacturing firms have based themselves in the city of Taicang

stand manufacturing firms, and they all know each other from home. The companies agreed not to poach each others' staff; also they have set up an apprentice scheme just like back home. All in all, this is a successful model in the challenging China environment.

Why did so many German firms cluster around Taicang?

Former Prime Minister Spaeth from the state of Baden-Württemberg wanted to open a 'German' manufacturing hub in their partner province Jiangsu. I was part of the visiting delegation travelling to Suzhou. The government official in charge of attracting investment into Taicang – his name was Elvis – saw an opportunity to pull in German investors and granted generous investment terms. For the opening party of some factories, German TV was invited, resulting in positive publicity back home.

Taicang officials then did seminars in Germany and began to get really good at figuring out how *Mittelstand* companies think and work. For example, Elvis developed a one-chop policy. He said: "Come to me and I do all the licences for you, and so the company will be ready in

three months time."

Are there other cities where German companies have clustered?

Yes, there are several – for example Qingdao where around 100 German manufacturing firms operate. We have a client there that makes medical disposables. It has 2,000 staff and an impressive factory.

Today you have to be careful in which city or area you locate a factory. The key issues are the cost structure, staff availability and infrastructure. In Shanghai the staff turnover is about 20-30% per annum, in Qingdao it is maybe 6%.

Another city where there is a big German presence is Shenyang. There are around 200 companies there. But even in Shenyang it is a challenge today to attract workers because other industries are more attractive employers.

Of these, the biggest German firm in Shenyang is BMW...

That's correct. And that's been a big success story too.

The BMWs made in Shenyang today are of an impressive quality. One client of ours from Stuttgart manufactures leather for BMW car seats in Germany, and does the

same in China too.

The multinationals have been a key pull factor for some *Mittelstand* companies to China, since they are their trusted suppliers in Germany. It works well for both sides, because they have a long history of working together which facilitates product development and ensures quality.

Actually, there's now a Lufthansa flight from Frankfurt to Qingdao and on to Shenyang. That tells you how many German firms are in those cities.

So there's almost a convoy effect: the big firms leading the small to China?

Yes. We are currently working with a *Mittelstand* company which is opening a subsidiary in China, their first operation abroad. It makes air filter systems for factories – to get rid of the dirty toxic air from paints and such like.

Back home it's a small family-owned firm, which developed a smart technology to clean the air in factories without having to exchange the air. This is cost-effective and environmentally-friendly. Why China? It is because of the demand from its major German clients and enquiries from Chinese companies.

Are German companies not worried their technology will be stolen?

Yes. But one proven approach is to have core elements, which have sensitive intellectual property, still made in Germany, and the remaining components are purchased locally.

Actually the key issue today is the growing competition from Chinese firms who are quite good today.

Until 2005, no German firm even spent one second thinking about Chinese competition. Then suddenly overnight this changed. That was quite an experience for our clients. They were manufacturing in China and the only competition they had was another foreign firm. Then a former staff member or a fast-growing Chinese company became their competitors, and price-wise they were cheaper.

On the whole I don't view Chinese competition as a problem. It has led German firms to reinvent themselves. For example, a strong industry structure has been developed around Shanghai with Chinese suppliers, who employ German engineers, making components just for German companies. This helped our clients to cut costs and to become more flexible.

Our sweet spot is advising manufacturing firms, mainly from Germany, but we also have clients from Austria and Switzerland (as well as some other European countries). The other day I was having a discussion about Chinese competition with an Austrian client who manufactures sophisticated car components and has a factory in Dalian.

In its case, the firm believes it would be hard for a Chinese firm to become a competitor. The reasons being: the need for joint development of new products with the car company (which takes about four years), their state-of-the-art technology and the highly au-



German *Mittelstand* firms have moved to Shenyang to be near BMW

tomated manufacturing process. And it wouldn't just be a question of copying their technology, since the firm is constantly innovating – both its products and its manufacturing process.

So on the question of being copied, I take the view that you have to be innovative. You can't stand still. You can't sell yesterday's machinery in China.

Is it getting tougher or easier for German firms to make money in China?

The answer is both. It is getting easier because the market size is increasing and so is the potential customer size.

But it's also getting tougher because of competition. A client of ours said: "You know, we have certain competition in the US, and certain competition in Europe. But in China we compete against everybody from around the world and on top of that we face Chinese competitors who have the advantage of being local."

Some German companies have reacted to the increased competition and to the fact that buying power is markedly different within

China by developing products "designed in China and made in China". In essence, these are "good enough" products which are sold, for example, in western China, sometimes as a dual brand. This was certainly a major change in philosophy.

Siemens is a case in point with their [China-designed] CT scanner machines which have proven to be successful and are now also exported to Brazil and India.

Any final observations?

Over the years, everything has changed in China, except the distance and the cultural differences within the country.

For me, it is always useful to remember Deng Xiaoping's saying: "Learn to seek truth from facts".

One of the things I have found interesting is watching how operating in China changes German companies. For example, a century-old family firm today makes bold strategy decisions it would not have dreamt of just a couple of years before.

China's huge market will continue to be attractive but challenging over the next 10 to 20 years, and that is going to be fascinating. ■