Doing Deals In China

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If you're in business, you can't ignore China. The economy is booming and it is the manufacturing capital of the world. In the last six years as founder and CEO of Kogan, I've travelled to China countless times. Each time, I fall more in love with it. It's developing very quickly and has rapidly become a global commerce hub. A lot of people still think of China as cheap and dirty – this may have been the case once, but not anymore. The hotels I stay at in China are nicer and more luxurious than any hotel I've seen in Manhattan.

In this two-part series, I'll share the lessons I've learned and the approaches that have worked best for me to avoid hassle, find great deals and ensure our products remain the best value money can find.

In part one, I'll share some killer tips that I've learned during my time in China – all of which have helped me keep the upper hand in critical business negotiations. In part two, I'll share practical advice to help you navigate China's complex business landscape.

Negotiating

Create a Win/Win

Always understand the incentives of your Chinese business partners. Understand how they are benefiting from the cooperation and ensure every deal you do in China results in a win/win scenario for both you and your Chinese partners.

When I first started Kogan, I had no money in the bank and no start-up capital. When I was asking factories to provide quotes for the production of TVs, I told them my order was for 10,000 units. Once all the factories had submitted their tenders, I picked the best factory and price offering. I then told them my order was going to be a "trial order" and that I would only be ordering "80 units". They laughed at me. Assembly lines rely on mass production to achieve efficiencies. Large and professional factories would never accept a small order – they would not make any money from it and it would mess up their schedules.

The manager at the factory I had chosen had no desire to work with me. There was no commercial benefit for him. I lost a few nights sleep trying to work out how to convince him to work with me. Then it hit me. All Chinese factories I had been targeting were huge organizations – they were multi-billion dollar companies. But all the correspondence I had received from them was in “Chinglish” and very unprofessional. Their pricing spreadsheets used 15 different fonts and colours, and nothing was aligned or consistent. The product brochures barely made sense. The images were all misaligned. The user manuals for all the TVs had no logical flow and were missing many diagrams.

I stayed up for a few days and redid all of this documentation for the factory. I sent it to them and said: “I may not be able to give you commercial value through a large order, but I can help you in other ways to make this a mutually beneficial business arrangement”. The factory manager replied within hours, accepting my order of 80 units, put them on a priority schedule and gave me an even better price than we had previously agreed.

A week later, the manager told me that his factory had just won a huge customer in the USA. The reason? Of all the factories they had encountered, his was by far the most professional and the documentation was the best by a long margin.

Looking for a win/win does not always mean the deal will go ahead. Often I will be negotiating in China when I get asked: “Why are you not accepting the order? We are offering this to you for below cost price!” I tell them: “I am not accepting the order because you are either lying or stupid. If you are lying, I don’t want to deal with you. If you are stupid, I don’t want to deal with you. I need my supplier to be making profit so they are still around in years to come”.

Think Outside the Box

I was once sitting in a boardroom of a big Chinese factory and was the only representative from Kogan. I was sitting there in jeans and a t-shirt. On the other side of the boardroom table were five senior managers of the factory all suited up. Only one of the managers spoke English.

The meeting started. I would speak English with the only Chinese manager who could speak English and then he would translate to his team and they would discuss among themselves. The discussions were of a very serious nature – pricing for a new large order, payment terms and quality control procedures.

Every few minutes, they would all laugh hysterically among themselves. It made me feel very uncomfortable because nothing in our discussions had been funny. Naturally, I was curious as to what they were discussing and thought to myself: “how good would it be if I had a translator here?” Then I realised that they obviously wouldn’t be saying half the stuff they were saying if I had a translator with me.

Then an interesting idea came to mind. While they were having a chat and a giggle, I pulled my phone out of my pocket and switched on the voice recorder. I then casually put the phone down on the table and recorded the whole meeting.

As soon as I got back to my hotel room, I uploaded the audio file and then posted a translator job on a few online job boards. Within a few hours, I had received full transcripts of the entire meeting – including their "private" discussions. I now knew all their pricing, the strategy they were using against me and more importantly, what the lowest price they were willing to deal at was. With some quick lateral thinking, I had gained a significant advantage in the negotiation.

Time Is the Best Negotiation Tool

In China, nothing has a fixed price and there is no better negotiation tool than time. The moment the Chinese smell desperation, they will pounce on it. You can never reveal that you really need something or that your deadlines are tight.

We always try to lock in deals and production runs as early as possible so that we are not at the mercy of the Chinese during a negotiation. For example, the Olympic Games in July will cause a huge global spike in Big Screen TV sales. We started negotiating our Olympic Games production runs in January. We reached some very good prices by the end of January but then we stayed silent throughout February. The factory owner could see there was no desperation from us and wasn't sure why we were not locking it in. We told him we had a better price and virtually stopped responding – when we did, it was only with one-liners. He lowered his price in February by more than 10 per cent.

In March, we kept telling him we had an even better price. We asked for a certain price that was slightly below his last offer. He told us he could not match that price, so we put our communications on ice. After a couple of weeks of silence, we realised that the factory could simply not transact at that price. In late March, we offered slightly more and struck a deal. The price was about 30 per cent better than the initial pricing in early January.

The key to negotiation is to not show desperation, and use time to find a price at which the vendor is not willing to transact. Then slowly creep your offer up from that point and it will ensure you get a great deal.

Never Reveal a Target Price

Often, the Chinese will ask: "What is your target price?" I always say "$0", or "Don't worry about my target price – just give me your best price. When you walk into a supermarket, do they ask you for your target price for bread?" This usually gets a bit of a giggle but it is very true.

The Chinese negotiators are very clever. They will try and get as much commercial information out of you as possible. They will use this to determine what price to offer you. Your goal is to give out as little information as possible. For instance, if they know that you have a customer that you are selling your product to, and you are going to charge $50, they may assume that you are happy with a 30 per cent margin and will quote you $35, whereas in reality they could be willing to sell the product for $10. Ensure that you reveal as little as possible and make them aware that you are getting many factories to bid on your order. Explain that the factory with the best price, which can most adequately meet your specifications, will win the order.

The Landscape

Shelve the Chinese Culture Books

I have never read a book about Chinese culture and how to do business there. Hundreds of these books exist. Some of my western associates have read them and it's amazing how farfetched they are from reality.

No matter what the books say, transactions get conducted using the terms of the person paying the bills. Therefore, if you are the customer buying hundreds of millions of dollars of product every year, the factory will speak to you in whatever language you wish. Furthermore, they will not mind in the least if you choose to eat your meal with chopsticks, a fork or with your hands.
I'm told a lot of books say that in China, business is just as much about the relationship as it is about the commercial arrangement. The bottom line is, even if you have the best relationship in the world with someone at a Chinese factory, they will never dispatch your goods unless you pay your bill first. Don't get me wrong, it's important to maintain good relationships with your key vendors, but don't let it cloud your commercial judgment.

One of my business partners told me that he read a chapter about "toughness" and it said that when you get taken out to meals, they will try and serve you all sorts of weird types of food to see how tough you are. If you don't eat something and the other person does, it means they are a tougher negotiator than you. Rubbish.

We were once at a dinner with a supplier. There were some incredibly bizarre dishes on the table. We were served a whole chicken that looked raw and still had the head attached; there were monkey brains and many other repulsive-looking dishes that I had no idea about. I picked at a few things and then went to McDonalds afterwards. My business partner tried his best to appear "tough" and proceeded to eat everything. Watching his face was hilarious. He later realised that the book was meaningless and our supplier would still be nice to us as long as we paid on time and kept ordering massive volumes. He learnt the hard way. We still have dinner with that supplier every few months, but these days we take him to a restaurant at our hotel.

Round, Round, Get around!

Ensure all your factories know that you get around. They should never feel like your business is exclusively with them – this will make them become complacent.

I don't like trade fairs very much – I think they are out-dated and brimming with old technology. However, I do still go to them every now and then, and I send our products team to them as often as possible. We visit the booths of many of our factories/suppliers. Not only is this a way to see them all under the one roof and save a lot of time, it also sends a message to the factory owners that you are looking around and they must keep bringing their A-game! Other than the trade fairs, whenever I meet with one of our suppliers, I always tell them that I just came from a meeting. At the conclusion of the meeting, I make sure to let them know I am heading to another meeting.

The bottom line is, we will never hesitate to cease a relationship if the other party is not meeting their end of the deal. At all times, we have a plan B and C for all product lines, and we ensure our existing partners are well aware of it. Vendors get complacent when they think you do not have other relationships, or a plan B and C. It is important suppliers always know we are looking around so that they always feel pressure to offer awesome prices and service – which we can then pass onto our customers.

Go Direct

In China, every man and his dog will claim to own a factory. For any given product, there may be 20 or so large factories in China that produce it. Then there will be about 200 trading companies selling the products from the factory. For each of these trading companies, there will be roughly another 25 agents – that's another 5000 or so eager "middle-men" to contend with. The only way to get the absolute best prices is to produce products in mass volumes and deal with the factories direct. Each extra party you involve will cost you about 10 per cent.

The biggest problem is, nobody will ever admit to being a "middle-man". They will all claim to be "from the factory". While uncovering the truth is critical, it can be extremely difficult. But there are few methods that can help:

- Check out their email address – This doesn't always work as some huge factories still have their staff on generic email accounts like Hotmail.com. It may seem obvious, but it's something I see many people overlook.
- Visit the factory – Check that the Chinese symbols on the business card of the person you are dealing with match up to the characters on the building. Check the uniforms of the staff – is there any branding?
- Ask the production staff if they have ever seen the person who is showing you around.
- Over and above all these easy checks, there is one that is yet to fail me. I ask the person I am dealing with to open a random door at the factory. If they take a long time to organise for it to be opened, I know that they aren't as intimately involved with the factory as they claim.

Compare Pink Lady Apples with Pink Lady Apples

Most factories in China are just assembly lines. This means they get all the components you need to make a great product and then put it together. Very often, the same product from differing factories will look identical, because the same casing is being used. Don't be fooled by this – the internal componentry can be very different. It would be the same as assuming that two desktop computers that use the same case are identical. Ensure you properly test all products and scrutinize the components inside. This is particularly important when you are comparing prices. Whenever you are getting factories to tender for large work, ensure there is no ambiguity about your product and everything is explicitly stated. Then triple-confirm it with them.

Money in the bank is the best contract
Many westerners waste time trying to draft contracts with Chinese factories. This is a huge waste of time because the contract is not worth the paper it's written on. These sorts of contracts are near impossible to enforce and would require the involvements of embassies and lots of bureaucrats.

From my experience, the Chinese will always hold their side of the deal. Just ensure everything is communicated properly. Ensure that there is a clear understanding of the expectations of both parties. This can be easily achieved by emailing and asking them to confirm that they understand. To keep transactions running smoothly, only pay once you see the goods have been produced. This should give you enough protection without the need for litigation.

Birds of a feather
China has over 1 billion people: millions of sales agents; hundreds of thousands of trading companies; thousands of factories. Finding the right partner for each product you deal with isn't easy. A good trick is to use the networks of factories you cooperate with and get referrals from them. For instance, chances are that a top-tier LED TV factory knows a top-tier Blu-Ray player factory and a top-tier HDMI cable manufacturing facility. They will not want to screw you over, because you already do business with them. But even though they won't recommend duds, be sure to still conduct your usual due diligence. In China, you can't be too careful.

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