

# Doing business in China: A primer for the daring, shrewd, and determined

## Practice Matters

By Tom Larsen, AIA

If you're an architect bound for China, here's some advice from veterans: Be as good at negotiations as you are at winning competitions; do not underestimate the competitive drive and business savvy of owners, developers, government officials here; do believe people when they say that Chinese clients and design professionals are quickly becoming sophisticated; they are rapidly gaining technical knowledge, and they demand excellence. One more thing—think about packing an extra bag; those who venture out for the long haul stand to make the most of what it takes to get established here.

### Make money and do design, too

The export-fueled growth of the Chinese economy has been in the double-digits for almost 20 years. While officials report the economy grew by only 9.1 percent in 2003, China "honestly may not know how fast it's growing," according to a story in the January 19, 2004, issue of *BusinessWeek*. It notes that Morgan Stanley estimates growth may really be more like 15 percent.

China's transformation into an industrial, high-tech, and services-oriented economy has produced a construction boom. That, in turn, has created the most active market for architectural design services outside the U.S. It's a business opportunity many firms can't afford to ignore.

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There's another equally important hook for American architects. They might get to design world-class buildings that they would never get to do in the U.S., and actually see them built. "The Chinese want international-quality design, and in fact, technologically, they want to surpass things we do in the U.S.," says Gene Schnair, AIA, partner in SOM's San Francisco office.

### Structuring your business

There are three basic ways that firms can do business here. In the first, the U.S. firm contracts with a Chinese client but does not open an office here. The main drawback is that currency restrictions make it hard for Chinese clients to pay for services provided by foreign companies. To get around this, clients usually hire "tendering companies" to make offshore payments on their behalf. These companies must be authorized by the Chinese government.

Those who are ready to open offices here may do it in one of two ways. Opening a "representative office" (RO) allows a firm to have a base from which to do marketing for the main office back in the U.S., and to do things such as market research. But ROs can't engage in contracts for services in China. The second way is to set up as a "wholly foreign owned enterprise," or WFOE. These limited-liability companies can employ Chinese nationals and enter into contracts in local currency. Architecture and engineering offices set up under the Ministry of Construction of the People's Republic of China's Regulations for Foreign-Invested

Construction and Engineering Design Enterprises, Decree No. 114. (See [www.cin.gov.cn/law/department/2002110401e.htm](http://www.cin.gov.cn/law/department/2002110401e.htm).)

For all firms, even those without local offices, working in China is expensive. Professionals who have done a lot of work here say that almost all business is conducted in Chinese, even with Chinese who speak English. They note often younger, less experienced architects who speak Chinese have more influence with clients than experienced American partners. Firms active in China have invested significant sums to hire Mandarin-speaking employees, consultants, and legal counsel to translate codes, regulations, contracts, and negotiations. Travel and housing costs are also not cheap. "You can't imagine the huge human toll on senior management, just in terms of travel. You need really committed people," says Paul F. Jacobs III, AIA, chairman of RTKL, Baltimore.

### Win Competitions ...

Designers need to be aware that, because the state owns the land, almost all work is awarded either by invited or open competitions—with a twist. In invited competitions, architects are asked to participate by a sponsor, the owner or developer commissioning the work, and given a program. Juries comprise members of different governmental agencies, an independent panel of experts, and usually, but not always, the client.

Competitions don't always produce optimal results for the sponsor or designer. The process forces superficial solutions that may not

address the client's fundamental needs. "Competitions make for image-based projects; you have to focus on the big idea to impress the judges," says Schnair.

The risk-reward ratio for architects who participate in competitions can be quite high. Compensation for participants ranges from nonexistent to stipends that may or may not cover the cost of participating. In any case, the cost of doing business here is high, and a few lost competitions can soak a firm's balance sheet with red ink in a hurry. Firms have to be very honest with themselves about whether they can win a competition, and be disciplined about allocating resources to them. Sooner or later, the Chinese will begin making use of qualification-based selection. In fact, Ray Shick of Gensler's San Francisco office notes, "On interiors projects, we are often selected based on our qualifications."

Last but not least, competition winners only take the projects they are selected to do through design development if they can negotiate the contract. After that, most work is handed over to local "design institutes," government-owned architecture firms who handle construction documents and construction administration. Western firms are legally prohibited from participating in these phases and are too expensive to add much value to the process. While U.S. architects continually lobby for more involvement in construction documentation and administration to ensure quality, they face an uphill struggle.

### ... Then, win negotiations

Winning a competition doesn't mean you've got the project. "It only means you have the right to negotiate the commission," says Jacobs. Although modern China only started opening its markets up 25 years ago, people here have been trading with the West since Marco Polo's time, and they know how to drive a hard bargain. Negotiating a job here is like trying to become a supplier to Wal-Mart: The owner may imply that since they will likely be awarding lots of contracts in the future, they should be given a deep discount—for world-class work, of course.

Architects must resist the temptation to lower fees and "buy work" in hopes of raising fees on the next project. Next time the client will start negotiations at an even lower price, if there even is a next time. Clients use local architects' costs as their benchmark, says James F. Porter, AIA, of Altoon + Porter Architects, Los Angeles. "Clients start with the idea that a local firm will cost one-third of what an international firm will, and negotiate from there. You have to convince the client that your expertise is worth more, or you will not get enough fee to do a good job."

Part of being tough means paying close attention to the contract. Contracts are written in Mandarin, so get the best lawyer you can afford. In the U.S., architects usually don't elaborate much beyond what standard AIA contracts describe as the end of each design phase. In China, contracts must state exactly what deliverables the client will receive both at the end of each contract phase and at milestones tied to a payment schedule along the way. Those who don't nail these down may find themselves making endless changes, or simply not getting paid. Some architects insist on a "pay then work" model, where a retainer is

paid, in dollars, every month. Also, firms must give clients exactly what they promise during contract negotiations. If a client has been told a design principal will be leading the team, do not substitute an associate.

The ownership of intellectual property rights (IPRs) is another point for contract negotiations. Clients who

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commission Western architects to design buildings are making a significant investment. They don't want the architect to resell the design to a competitor any more than the architect would want a client to copy a protected design without paying royalties for it. In China, the clients have an upper hand because it is so difficult for foreigners to enforce IPRs here. The most practical advice may be to accept the fact that work can always be copied, negotiate a good fee up front, and call it a day.

Probably the greatest danger is not the misappropriation of a design, but that a client will have a design modified to its detriment yet keep the original design architect's name on it for marketing purposes. Jeff Wolfson, a partner who specializes in IPRs with Winston & Strawn, a law firm, suggests that to protect the integrity of their rights, architects negotiate with their clients either co-ownership of copyrights or mutual consent agreements.

### Commitment begets opportunity

It might appear that because U.S. firms are limited to schematic and design-development services, over the long haul it will be difficult to maintain a competitive advantage. Western firms can't compete on fees profitably, nor are they able to offer the ease and high level of service

that comes with a local architect. But at the moment, the market is robust and growing. Clients not only want their buildings to reflect China's increasing importance in the world; they also want to participate in the design process. "Our Chinese clients understand that the international firms have experience with certain project types that they cannot yet source locally. They acknowledge that they will have to pay a premium, at least in the near term, to import

this expertise," says Jeffrey J.

McCarthy, AIA, a partner in SOM's Chicago office. And now that China has been accepted into the World Trade Organization, Western firms are finding it easier to get work visas for employees and to set up WFOEs, and the protection of IPRs is improving.

Chinese firm structure is starting to change, too, and that will eventually shift the opportunity equation. Those who work at the design institutes are eager to learn and are quickly picking up technical knowledge. "When we interview design institutes and see their work, their imagery is very mature. It is only a matter of time before they start catching up in detail and substance," says Schnair. The government is also starting to privatize some of the institutes, forcing them to change, as well. Now that they're competing for employees and have to pay higher salaries, some of their cost advantages against foreign firms are eroding slightly. Still, these new firms have a way to go before they master the business principles, such as marketing, that Western firms take for granted.

Some believe the larger threat for the U.S. firms will not come from privatized institutes, but from new start-up firms. "We see a lot of U.S.-educated Chinese starting firms that represent both competitive choices

for design services and future competitors to U.S. firms. We have to help them develop their practices while we continue to provide value to our relationships with them," says Bill Doerge, a principal with the Chicago office of Perkins & Will. These firms have advantages over the institutes: They're nimbler and already know how Western firms work. They have command of both English and Mandarin, but may lack the government connections still critical in China.

### What tomorrow will bring

New firms can still succeed in China if they commit to building truly international practices. Firms that are interested in developing business here primarily to offset weakness in the U.S. market are unlikely to make it. "Commitment" means that firms will have to establish not just one office, but several, including some in the interior of the country, where new markets are going to develop. American partners are going to have to relocate from the U.S. to the mainland. To be considered for future work, these firms will have to develop a Chinese "brand," a "face." These offices will be staffed with local talent, some of whom will be put on management tracks.

Firms that succeed in establishing offices here may one day actually export cost-effective, technical services back to their offices in the U.S. That will allow architects in the U.S. offices to focus on work that can only be done locally, rather than producing labor-intensive work such as contract documents, 3D animation, and renderings. Sound far-fetched? Today, much of what we consume in the U.S. comes from China. Why not architectural services, too? As clients worldwide push for "faster, better, and cheaper" design, China is bound to play an important role. Take a page from other industries and look to China as not only a potential market, but a new source of expertise that will make your firm more competitive. ■