

# Relationship Mapping

***A powerful tool in acquisition due diligence in China***

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## **Relationship is a key success factor...**

Much has been said about the Chinese practice of “*guanxi*”. The term conjures up shady deals in smoke filled rooms sipping Maotai. *guanxi* implies relationships that help one get “special” treatment, enter through a closed door or lower the cost of entry. The word makes western firms very nervous as they endeavor to stay “clean” in a messy business environment.

In reality, *guanxi* is much more than mere connections. *guanxi* literally means “relationship”. It is conventional wisdom that Asian cultures, especially China, are more “relationship-based” than are many Western cultures.

What sets the Chinese relationships apart from those in the West is the social context in which China is still very much a rule-of-man society with its market economy far from maturity. Foreign companies aiming to explore acquisition or alliance opportunities in the emerging Chinese market need to understand, cultivate, and utilize these relationships. In China, there is a saying: “If you have a relationship, you have a road”. Chinese government and business structures often lack transparency, making it difficult to clearly understand the situation or the players involved. This difficulty is especially true when assessing an alliance or business partnership. Many bad relationships

have been set up in China, in part stemming from ignorance about one’s partner. It is no easy task to fully know potential partners, stakeholder interests, true financial performance, etc., given the opaque nature of the business environment in China. Before one establishes an alliance, a clear understanding of the company’s structure, owners, influencers, etc. is needed.

## **A helpful tool to understand key relationships...**

*Relationship mapping* is a method of visualizing, describing and analyzing all the relationships (individual and organizational) of an existing or prospective Chinese business partner by establishing a dynamic “map”. This “map” provides a background setting to the target company by exposing its direct and indirect, business and social, individual and organizational, “relations”.

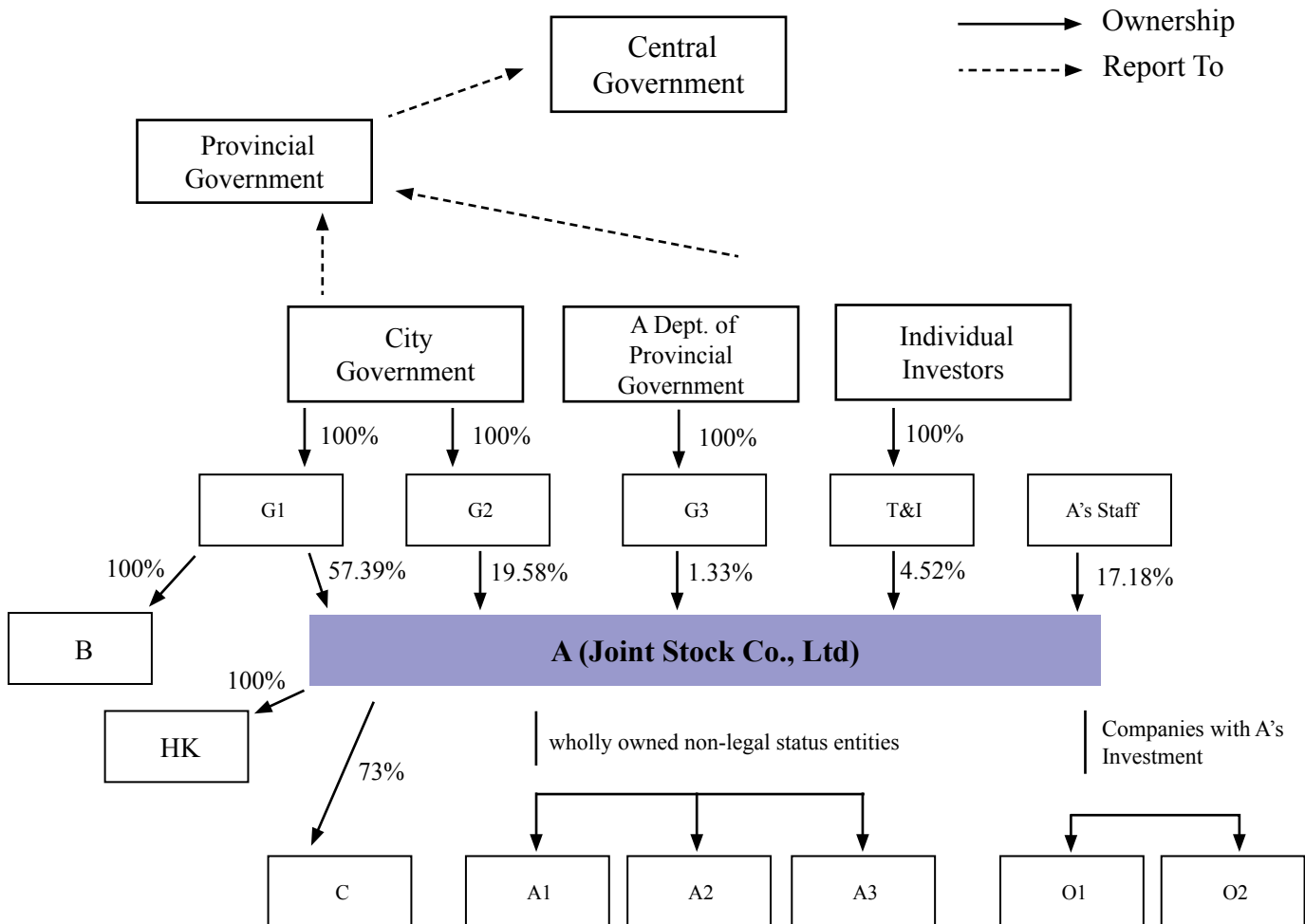
As indicated before, lack of transparency is always a concern of Westerners doing business in China. Oftentimes, lack of accurate documentation, the inaccessibility to information in the public domain, and questionable accounting practices make it difficult to understand a candidate’s operations. Many companies have experienced the phenomenon of having various executives of a potential partner

unequivocally state, “I’m the one you need to talk with to make this deal.” Relationship mapping provides a means in the due diligence process to go beyond financial statements and the contradictory bravado of many of the stakeholders, to assess the real story behind the scenes and to better measure off balance sheet risks as well as the benefits of a business arrangement. This knowledge helps to qualify an alliance as well as outline the best way to manage the ongoing relationship. And it will certainly minimize the surprises experienced by many western firms who made deals in the 1990s.

Specifically, the relationship mapping process helps:

- Expose and clarify the candidate’s inter/intra “relations”;
- Identify where the “power” and “influencers” are and the nature of the relationships between them;
- Understand the real objectives of all of the players in the map;
- Uncover structural problems or “hidden liabilities”
- Provide a “roadmap” to construct a win-win deal

By analyzing and utilizing the dynamics on the map, the due diligence process will be more productive. For example, a simplified “map” of A, a target in a recent acquisition case, looked like the picture below:



Through the relationship mapping process, we are able to construct this map, which gives us an initial definition of the playing field and the key players on it. In constructing and analyzing this map, we were able to discover:

- G1 and G2 are the corporate arms of the city government and, between them, are the majority owners of A, the target company.
- In a bid to restructure A for IPO in the early years (which failed), G1 created a separate corporate group or “waste basket”, B, to hold A’s poor and non-performing assets (historical baggage) to make A look attractive. B is owned by G1 and still managed by the team of A.
- Under the urgency of “ownership transformation”, or privatization, G1 and G2 would like to sell off their stakes in A but G1 and G2, representing government interests, are concerned to defuse social tension by protecting individual shareholders’ interests.
- G3, initially intended to add “fancy” in the stock market because of its links with the provincial science and technology department, wishes to cash out on its 1.33% share in A because of dashed hopes to exit through IPO.
- T&I is merely a company on paper to represent individual investors holding a portion of A’s shares which can only be subscribed by legal entities. Now those individual investors along with A’s staff shareholders, worried about the poor operating results of A and no immediate opportunities through the stock market, are desperate to seek liquidity.

- HK is an offshore subsidiary, 100% owned by A. A has used HK to “round trip” money to launch C, a joint venture, to take advantages of preferential treatments (tax, etc.) accorded to “foreign” invested companies.

- C is a major supplier to A and “transfer pricing” helps A to “optimize” profit structure and tax obligations. A1, A2, A3 are A’s divisions contracted out in terms of operational management with A1 being A’s core business/cash cow and A2 and A3 suppliers to A1.

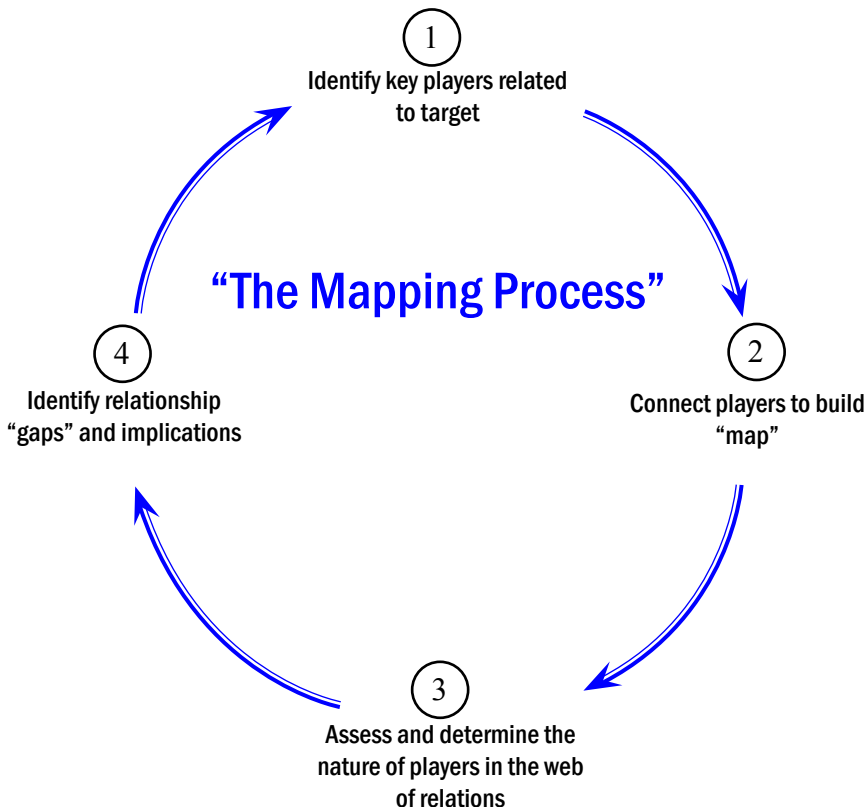
Admittedly, the above description conjures up one of Harry Belafonte’s Jamaican lyrics, “*It’s clear as mud, but it covers de ground*”. However, these revelations were critical to the acquiring company in order to qualify the deal’s attractiveness as well as develop a game plan to negotiate it. In the above case, the first inter/intra organizational relationship map provided a “platform” on which we were able to further construct an inter-personal relationship map of all the stakeholders as individuals, yet another facet of the relationships. The mapping process revealed that the real power and decision maker for a deal is the chairman of A backed by a power camp in the city government instead of A’s majority owners: G1 and G2. Having identified the real power as well as an understanding of the objectives and concerns of the powers and influencers, our client devised a package of deals which took care of the government guys’ interests of “ownership transformation” by foreign investment, ensuring stable employment and tax revenue,...of the chairman’s objective of exiting the business (considering his age) with proper compensation... and the younger generation of management’s hopes for a bright future and improved career opportunities with a multinational.

It should also be noted that the above is a basic “partnership relationship map”. To be able to fully understand the situation and optimize an approach to a deal, other “maps” may also be required such as: “relationship map of stakeholders as individuals”, “approval path relationship map”, “regulatory relationship map”, etc.

## The relationship mapping process...

We recommend a purposeful and cyclical process (described below) to evaluate a target company’s relationships, which are often:

- Very dynamic
- Multiple layered
- Opaque...lacking transparency
- Very personal ...in some cases inter-organizational as well
- Context dependent



Relationships should not be viewed and tackled as discrete. They are networked and often inter-dependent. In the case of company A, the chairman and his gang in the city government, the ultimate decision maker, still have to balance the various interests of other stakeholders concerned before finalizing a decision. A powerful aspect of the relationship map is to enable the foreign company to successfully find the ideal compromise that will make the relationship work for all parties.

Western companies often do not take a rigorous approach to understand, cultivate, and utilize relationships in China and hence can make key mistakes and miss opportunities. Relationship mapping serves to enhance understanding of a prospective Chinese partner in the due diligence process, or even after a deal is done. It helps companies to discover off balance sheet risks and benefits in a business arrangement and thereby avoids costly mistakes. In addition, a relationship map can be used as a directive for relationship management at a later stage.

Remember: “If you have a relationship, you have a road” in China.

*This article was written by Technomic Asia, a Shanghai based market strategy firm. Technomic Asia has assisted over 140 multinational firms with their China growth strategies across a wide range of industries. This article is one in a series on myths about China business. For further information, please contact Technomic Asia at [info@technomicasia.com](mailto:info@technomicasia.com). You can also visit our web-site at [www.technomicasia.com](http://www.technomicasia.com)*