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China Buys American

PARTNERSHIPS TRUMP SELLING
IN THE MIDDLE KINGDOM

FAROOQ KATHWARI



Over the last 35 years, I have witnessed extraordinary change and growth in China. I began buying arts and crafts there in the 1970s, and today we are marketing Ethan Allen—a quintessentially American brand—in 53 locations in major cities across China. We ship 60 percent of what we sell there from our well-established U.S. manufacturing base and in turn buy Chinese products to be marketed in Ethan Allen Design Centers in North America.

Growing up in Kashmir, I became quite familiar with Chinese and Central Asian arts and crafts at an early age. For centuries, there has been a link from Kashmir to the ancient Silk Road, and my family had connections to the great trading cities of the day—Tashkent, Samarkand, Kashgar, and many others. My grandfather in Kashmir

was widely known as an art expert and a collector of handcrafted products from Central Asia, China, Tibet, Kashmir, and India. He established an arts emporium and was an advisor to the Maharaja Hari Singh, the last ruler of Kashmir. My other grandfather was an accomplished scholar and member of the maharajah's court, as well as a respected merchant of pashmina, a fine cashmere wool fabric from the coats of pashmina goats, native to the high plateaus of Kashmir, Central Asia, and China.

I left Kashmir for the United States at age 21. I attended night school at New York University while I spent my days working at an envelope printing company in downtown Manhattan. After I had been in the United States for several months, my grandfather shipped me 12 wicker baskets filled with Kashmiri arts and crafts. He told me to sell them and send back only the cost of the products. Ethan Allen was one of my early customers. In 1973, we entered a joint venture to develop and procure handcrafted products from around the globe. It was the very moment of the start of China's opening to the world after the long years of the Cultural Revolution. Richard Nixon and Henry Kissinger had just returned, triumphant, from their first meetings with Mao Zedong and Zhou Enlai, and the business world was electric with the possibility of a billion new customers. I was fascinated with the prospect of a more open China and in 1975 decided to make my first trip to look for unique, handcrafted home décor for my new joint venture with Ethan Allen.

INTO THE MIDDLE KINGDOM

The most direct route into China in those early days was by train from Hong Kong, and that's where I met a businessman from Europe who was paying a return visit to the People's Republic. We were both traveling to Guangzhou, then known as Canton, for the Canton Trade Fair—a major point of entry for outsiders who wanted to explore business opportunities in the mainland. During the Hong Kong leg of our journey, I found the businessman's behavior toward the conductors to be rather abrupt. At the border station where we changed trains we were given a good lunch, an hour-long lecture on the sayings of Chairman Mao, and a copy of Mao's Little Red Book, which I still have today. As we continued on the next train, my European companion became very quiet, even deferential to the train personnel. When I inquired about the change, he responded, "One has to be very careful what one says in the People's Republic, and one must be polite. Otherwise, they can throw you out."

He also warned, curiously, that there was no bargaining over price with the Chinese. I recall thinking that the people on both sides of the border were Chinese, and yet the reality of the lives of those in the People's Republic was a mystery to me.

In 1975, China was quite different from any place I had ever visited. I was struck by the lack of color. Nearly everyone, man, woman, and child, wore either gray or green. There were also large posters everywhere—propaganda for the Cultural Revolution. We stayed in the only

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hotel in Canton that allowed foreigners. The beds were draped in mosquito netting, and there was no air conditioning. Fortunately, it was only a short walk to the Canton fairgrounds. One afternoon, I was taking a stroll when I spotted some men playing badminton and joined them. It was an auspicious decision; some of these players would be among my first business associates on the mainland.

At the time, I was trying to understand the decision-making process in this highly centralized system. As we got to know each other, I asked my badminton companions directly if prices could be negotiated. “It is not possible,” they replied in unison and without hesitation. I insisted that there must be a way; their answer did not change—until it did. I learned that on one level, my European traveling companion was correct. Prices themselves were not negotiable. However, if my company were designated an “agent” of theirs, my commission could be “negotiated.” In fact, designating our company an agent created a special relationship, sometimes even referred to as a “partnership.” Ultimately, we settled on a 7 percent discount.

As I would later discover, creating “partnerships” to do business in China is and has always been an essential component of the business culture. While the concept is to build strong relationships, one should also never become dependent on one potential client or buyer. This was apparent from my first visit in the 1970s and has only been reinforced during my broad exposure to China.

CENTRALIZING BUSINESS

Throughout the 1970s, the Chinese business system was very regimented and centralized—as was the case in all other personal, social, or cultural relations.

To conduct business, my company was required to deal with two government entities—China Arts and Crafts for home accessory products, and China National Native Produce and Animal By-Products for our rugs, which were made of wool. Both agencies were headquartered in Beijing. As I built my business network over the next 10 years, all my Chinese associates worked for one of these two government bodies.

Indeed, at the time of my first visit, the People’s Republic was very much the China of Mao Zedong. It was authoritarian, intolerant of individuality, and regimented. In the aftermath of Mao’s death, one sensed that even as the bureaucracy lingered, chaos lurked just around the corner.

In the early 1980s, China remained trapped in the past. The economy was feeble and the infrastructure poor. During a visit in 1980, I finished my work in Shanghai a day early and decided to travel to Beijing. As in Canton years before, there was only one major hotel for foreigners. I arrived too early for my own reservation and inquired about a room for the extra night. The hotel was fully occupied. I was told the best they could do was let me sleep in the lobby. I declined the offer and finally was put into a car and driven to a hostel about an hour outside Beijing. It was the middle of November and very cold, yet there was no heat. It was government policy that rooms would not be heated until late November.

The next day’s business was to be conducted back in Beijing. I knew that a new hotel was being built next to where we were going to meet. I spoke no Chinese, and my hosts did not speak English. Fortunately, I had with me a China Airlines travel magazine, so I pointed to

the advertisement for the new hotel to indicate where I wanted to go. The car that was supposed to take me there first needed gasoline. This was accomplished by siphoning it from a bus. Finally, we were on the road. I noticed that the drive seemed to be taking longer than the night before, and that we were in the middle of nowhere. I showed the driver the ad once more, pointing at the hotel—the new Great Wall Hotel, pictured in the ad with an image of the Great Wall behind it. Of course my driver had headed straight for the Great Wall—not the hotel. After our car overheated three or four times, we finally turned around. Fortunately, the way back to the hotel was downhill, so we largely coasted to our intended destination. Such was the fragile infrastructure of China in the 1970s and the early 1980s. It wasn't until the mid- to late-1980s, when Deng Xiaoping's economic reforms began to take hold, that the first real changes became apparent.

During the 1970s, a number of furniture factories sprang up in Southeast Asia, and their products began making their way to American markets. In the mid-1980s, I visited plants in Taiwan, Indonesia, the Philippines, Malaysia, and Korea, though at the time none were doing much U.S. business. More than 80 percent of all furniture sold in the United States was still made in America.

GOING MODERN

By the late 1980s, the People's Republic allowed some manufacturers from Taiwan, Hong Kong, and Malaysia to set up modern plants in southern China. The facilities were established either in industrial parks or in large, campus-style operations. The rapid development of manufacturing in China caught many by

surprise. Discipline, an entrepreneurial attitude, and the willingness to invest in modern technology combined with a large labor force and low wages, resulted in China's major competitive advantage.

It certainly wasn't their innovation that gave them an edge. At first, China focused solely on duplicating, and their determination to copy products at very competitive prices enabled them to build their enterprises. They never hesitated to bring in outside talent, especially Americans, to help them reproduce products at lower costs.

The era of globalization and commoditization hit the American furniture industry like a tsunami—not dissimilar to the experience of many other industries like textiles, shoes, electronics, housewares, and hardware—and U.S. furniture stores started closing. In the course of a decade, thousands of retailers—many small and family operated—went out of business, replaced by larger, big-box retail outlets. We, too, had to address the pressures that Chinese manufacturing posed to the future of our operations. The easy option was to join the crowd and give up our manufacturing in the United States. That was the easy way out. We had an 80-year history of manufacturing, proximity to Appalachian hardwoods, and a skilled labor force. So we chose to consolidate our 31 manufacturing locations into six of the best sites in the United States, invested in technology, and started converting to custom, or “just-in-time” manufacturing. As part of this decision-making process, we also recognized that the affluent Chinese consumer would prefer European- or American-made products, and we had an iconic American brand. Still, to take advantage of our brand in China, it had to be available. It was essential to extend our presence in China itself.

That opportunity came in 2000 when the chairman of a medium-sized China-based furniture manufacturer called Markor approached us. He said his research had led him to Ethan Allen, and that he had two objectives—to establish a retail network in China and to enter a relationship that enabled them to sell the furniture they were making in China in the United States. I was impressed with the chairman, Richard Feng, and the associates he brought along. He was disciplined, entrepreneurial, and driven. Born and brought up in Mao's China, Feng is Han Chinese—the race that forms the nation's core and much of the ruling elite. Some three decades ago, the family moved hundreds of miles into China's far west—to Urumqi, where the Hans were a minority to the Uyghurs, and tensions were high. Still, the Fengs quickly sought an accommodation with their neighbors, and began calling Urumqi their home. With access to forests in the area, the Fengs opened a saw-mill and furniture factory.

Eventually, with the spread of furniture manufacturing to China in the mid-1990s, factories began opening on the nation's east coast, with major plants established, largely in modern industrial parks like Tianjin, where Markor launched several production facilities. Using the latest technology, these new plants had been mostly set up with American managerial and technical expertise.

MAKING A CHINESE ENTREPRENEUR

Richard, above all, is an entrepreneur, and working with him is far from the early days of badminton diplomacy. By 2000, the Fengs had resources, and with resources came confidence. No longer did a simple decision require a trip or a telephone call to Beijing. He was and is the

face of the new China. I visited Markor at their headquarters in Urumqi, the capital of Xinjiang Uyghur Autonomous Region.

My earlier interactions in China played an important role. We discussed the need for a “strategic alliance”—a partnership. Richard Feng impressed me once again with his desire to become a leading and respected home furnishings retailer. His goal was to create a retail network in China modeled on Ethan Allen. Markor was not involved in retail at

any level, and it seemed to me they didn't have the know-how to make a go of such a large project. When I asked Feng how he would do it, he simply said, “Show us what needs to be done, and we will do it.”

Over the next two days, I personally drafted the agreement that we both signed. That's the working document we still have.

Feng's strategy of simultaneous learning and development reflects China's drive to become commercially independent and to assume a leading role in business in the future. Even though I suggested strongly that they focus exclusively on the Ethan Allen brand, our agreement included Markor's development of a parallel label. We agreed to leave Ethan Allen as traditionally American while Markor would develop more modern, more Chinese designs. But they weren't ready to leap into any sort of truly innovative products yet, preferring to sell designs they were selling to other American distributors for sale in the United States under their own brand in China. Partnership in no sense meant exclusivity.

**OUR LABOR
COSTS... ARE
ABOUT \$23,000
HIGHER PER
PERSON ANNUALLY
IN THE U.S.**

While in Urumqi, I visited the old city with its lively marketplace and reflected on the early history of my family in cities like Kashgar, some 900 miles from Urumqi. I often turn nostalgic when I visit Urumqi—or anywhere in Xinjiang—probably because of its proximity, culturally if not physically, to Kashmir. Feng and our Markor associates understand this connection, which has helped us forge closer relationships. In China especially, personal identification is often as important as any business relationship.

Of course, competing with China and other emerging countries has come with challenges. For example, our labor costs, including health and other worker-related expenses, are about \$23,000 higher per person annually in the United States than in China. Our American tax rates are much higher. In the United States, the annual wage of an average production worker in the furniture industry is \$25,000 to \$30,000 with another 40 percent in health insurance and other benefits—a total of \$35,000 to \$42,000. This compares with \$3,000 in China. Moreover, in China, the state and enterprises work very closely together—the government’s investments in infrastructure, low-cost energy, and especially its consolidated and simplified tax structure are all designed to make their businesses more competitive, and certainly more profitable, than any American company.

Regardless, we are determined to maintain a strong manufacturing presence in the United States, which has led to shrinking profit margins. We still produce more than 70 percent of our products in the United States, assisted by a cut-and-sew plant in Mexico. Furthermore,

60 percent of the Ethan Allen products being sold in China are imported from the United States. While the cost differentials remain, they are starting to narrow. Wages, raw material, and transportation costs are rising in China.

BUILDING STRUCTURES

In the course of our partnership, Markor built a business structure modeled on ours. They have developed a training institute, a research center, a strong technological, and logistics network, and have established 53 locations in China that market the two brands. Four are in Shanghai, a city of 23 million people, according to China’s 2010 census. For context, one would have to combine the populations of Connecticut, Rhode Island, Massachusetts, New Hampshire, Vermont, Maine, and New Jersey before reaching 23 million. Yet the sales region our Shanghai stores share is less than half the size of Connecticut. The market is immense; China has the resources to be no longer just a maker but a significant taker as well.

Next year marks the 10th anniversary of the opening of our first design center in China. Today, we have a presence in most major cities, including Beijing, Dalian, Chongqing, Chengdu, Urumqi, Shanghai, and Guangzhou. As an economy develops, competition increases, and a recognized brand has an advantage. Whether the label embodies excellence, personal aspiration, wealth, or all of those traits, a brand stands for something. In China, our American roots work to our advantage. Chinese consumers of luxury goods prefer foreign—especially American—goods to those made in China. They have more confidence in the

quality and durability of foreign products. There is also the element of status. For most buyers, foreign brands are a mark of personal success, and something to show off to one's friends and neighbors. Indeed, what we see when we look at China is that, among certain consumers, the brand means everything.

It has been interesting to observe the changes and growth in our Chinese customers' expectations and behavior. Initially, customers lacked the confidence to make choices, often buying exactly what they would see in the store, just as it was displayed. Today, they do their homework. They are willing to purchase items from multiple sources. They buy online. Increased confidence in their purchasing decisions has led quickly to higher expectations. Moreover, consumers want more for their yuan than just merchandise. They also want to be treated well.

The Chinese appetite for fashion has become voracious. The observation that "we first dress ourselves, then we dress our homes" applies equally in China. For years, French, British, Japanese, and American clothing designers have taken China by storm. It was a natural evolution that consumers so immersed in couture and inspired by the biggest names in fashion would turn next to fashion for the home. The demand is there and growing.

In some ways, consumers there are not so different than consumers here. Higher end fashion, be it personal or for the home, has a life outside cultural differences. Home construction in China is increasingly similar to what might be found in any stylish new residential development in the United States. While today's market is global, all customers seek to express

their own personal style. Probably more than anything else, the pursuit of individuality drives Chinese consumers in their purchasing decisions.

In 2009, I found myself again in Guangzhou, this time to celebrate the opening of a flagship Ethan Allen location. With a major skyline, state-of-the-art infrastructure, and people dressed in all styles and colors, the city impressed me. Reflecting back on my first visit to this city some 35 years ago, it's clear that the new China is bold, determined, disciplined, and entrepreneurial. In the West, the entrepreneurial spirit comes to us easily, but maintaining our discipline is sometimes a challenge. In China, discipline is the framework, and the challenge is to innovate. What we can learn from each other will lead to success for us all.

In building their consumer-based environment, the new China gravitated to a Western-style business model—and why not? Who better to learn from than the largest consumer culture in the world? And we have learned from the new China. We know that competition requires bold, aggressive change. We need to rebuild many elements of our infrastructure. We need to educate our children in engineering and technology. We need a new generation of business leaders focused beyond financial maneuvering, while understanding competition in the global market. We need the U.S. government to become a partner in development, learning from China as well as buying from it. And we must develop strategic alliances—partnerships—with China for our mutual benefit. ●