



This article is an excerpt of the book “**Financial, Administrative and Trade Management in China: A crash course for executives for a successful and compliant business operation**”, available e.g. on [Amazon Kindle](#), [Google Play](#) and [Apple Books](#).

2.3. Group-Benefits vs. Single Entity Optimization

Usually a group with multiple subsidiaries creates incentives for each of the responsible managers, which might lead to typical challenges that are described in the principal agent theory.

In general, employees will act in their jobs according to their personal:

- Ability which depends on their skills;
- Motivation which depends on what goals they want to reach, and
- Authority which depends on what they are allowed to do.

Since most of the staff starts working in one subsidiary of a group and does not rotate within the group, they tend to start improving on their own entity without considering possible effects on the group level; ability and authority are steady but the motivation is only focused on a single company. To gain significant benefits for the group, motivation to increase the group's benefits should be inflicted.

As an example: A production company which sells its products to a sales company in the same group produces two products of which Product A has a gross margin of 25 and Product B has a margin of 5 per piece. Naturally, the production company would try to increase the sales of Product A.

If the market price of Product B is higher, the sales company will prefer to sell Product B, though.

From the group perspective, Product A would be the more beneficial one since the total margin of Product A with

$$25 + 25 = 50$$

than product B with

$$5 + 40 = 45$$

Product	Production Company		Sales Company		Group Margin	
	Product A	Product B	Product A	Product B	Product A	Product B
Turnover	¥ 50	¥ 25	¥ 75	¥ 65	¥ 75	¥ 65
Cost of Goods	¥ -25	¥ -20	¥ -50	¥ -25	¥ -25	¥ -20
= Margin	¥ 25	¥ 5	¥ 25	¥ 40	¥ 50	¥ 45
in %	50%	20%	33%	62%	67%	69%
Total	¥	¥ 30	¥	¥ 65	¥	¥ 95
Margin in %	50%	20%	33%	62%	67%	69%

Figure 1: Example for Group Benefits vs Individual Benefits

In cases like this, where single companies in one group have different interests, sometimes group-wide strategic considerations can be prioritized down due to higher-valued local budget considerations. Prevention of issues like that is possible by a smart setting of targets or by tightly centralized control.

Creating synergies between local companies

If one group has several companies within China, e.g. by separating different strategic business fields or by a separation of production and sales, they often are challenged by similar topics on the administrative and financial side.

If not organized with a shared service center, each company will have similar functions in their own organization leading to unnecessary double work since the respective players do not exchange enough information or do not try to find solutions that can be re-used.

Most of the local groups tend to work independently which often can be attributed to them being independent in their operation and of the key staff not knowing each other very well. Increasing information flow and building trust between the different companies, e.g. by job rotation, can work wonders.

Involve central functions only when required

Central functions in an enterprise mostly have the function to ensure the upholding of a group's standards and to optimize the group benefit. They usually are involved during their regular tasks in which they tend to collect information from you and can help to clarify requirements that you might have towards them.

The downsides are:

- They often do not know the local challenges in detail, and
- For special inquiries, they require time to solve them.

Local entities often prefer to solve issues on their own to reduce the additional overhead, and often central functions are only informed if necessary since they often do not increase the decision quality.

Additionally, your contact partners at headquarters might not be used to the required agility in China and time differences can lead to further delays of important decisions.

Common pitfalls and considerations

- When considering local decisions either as a local company or as two localized companies within the same legal area, you might be too quick to make decisions if you do not involve the central functions of a group. Even while an opportunity might seem positive from your perspective, from a group perspective it can bring disadvantages that you are not able to see at first.
- Making sure that your key staff in different companies know and trust each other can lead to a myriad of synergy.



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- If you work in a central function, trust the management of your local entities and keep your control to a reasonable extent.
- Ensure that your incentives and target setting reflect the group perspective on a reasonable level to produce local decisions that only optimize the benefit of one entity and not of the whole group.

Free Sample

3. Legal Framework and Practical Hints

The legal landscape in China does not have a good reputation—most of the expatriates living here are not even aware of the legal framework around them. From my personal point of view, the legal framework can be summarized as follows:

Laws and Regulations

- Are better formalized than their reputation;
- Are constantly changing and evolving;
- Are not always enforced to the extent they should be, and
- Are often not as unambiguous as you would hope for.

In this chapter we will focus on some very basic laws and legal issues that—according to my experience—you might need to know about with quite a high probability. At the same time, please keep in mind that just knowing the right laws will not necessarily help you in a legal case since interpretation can vary and additional local regulations might be in place next to the national ones. Whenever you run into any legal issues, please be sure that you consult with an expert.