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What's eating away at my profit margins in China?

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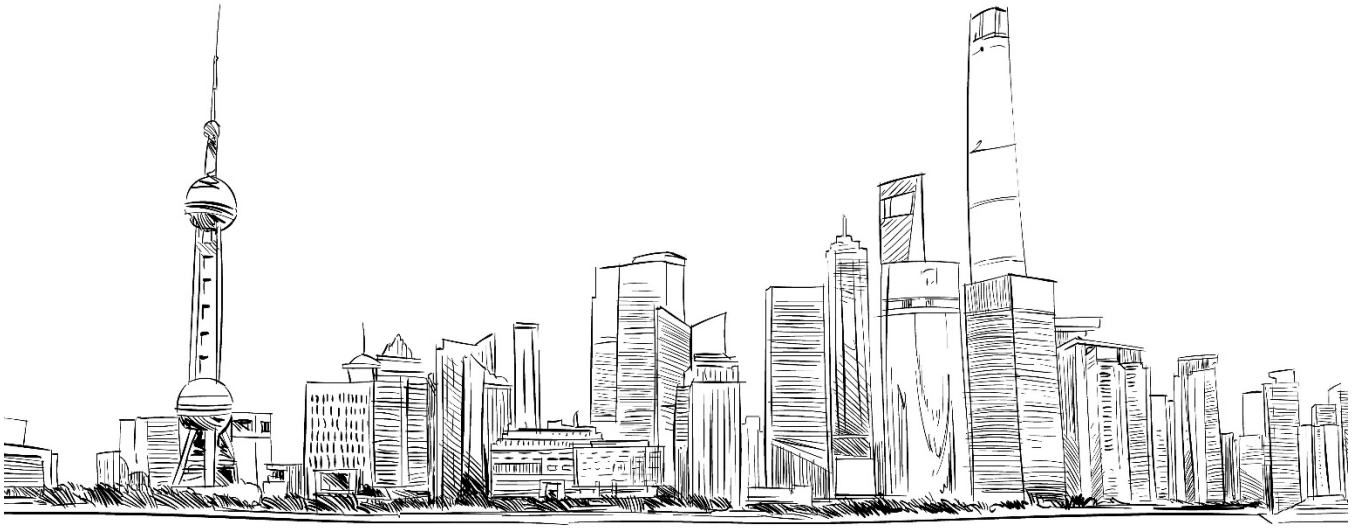

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For Small Medium Sized Enterprises (SMEs) the profit margins are under pressure in China. If you're running a small or medium-sized company and seeing your profit margins erode all round, you are not alone. So where do we go from here? To start, let's examine four areas that are contributing to the SME situation in China, and some solutions to help businesses develop better innovative reflexes, drive change and generate healthier profits.

1. Is the price, right?

Pricing is something that many new and young businesses in China overlook. You have done your research and benchmarking, made your decisions on pricing your products or services and gone into the Chinese market. It doesn't stop there. Even if your initial pricing at launch was based on sound assumptions and rationales, they might not hold true for long. Not until you are amid actual business can you start to really test your assumptions. The fact is that good pricing is hard to do. It isn't something you just pluck out of the air. Nor does it lend itself to extensive trial and error: changing your pricing too much will put customers off or confuse them. One approach is to establish a comprehensive database of intelligence, by whatever means you can. Use resources available to find information on your competitors' pricing. Learn what everyone else is doing and build up a comprehensive picture of the real marketplace in which you operate at this moment in time – it may be quite different to the one you researched before you started. Also, invest strategically in genuine market research. It will take time and resources, but it will be worth it, to help you really understand how pricing works in your sector and what you need to do to price optimally for your own business.

2. Are you overspending?

In a China SME there is no room to overspend. As your business grows, you may feel it's too time-consuming to stay on top of every item spent by every department, every day of the week. But to protect your margins you must stay on top of this. For a start, budget in a detailed and disciplined fashion that you know you can monitor. Be realistic about what you can and can't monitor, but ideally make your budgeting process as granular as possible so you can have visibility over the key trends. Invest in a decent cost control system that's appropriate to the scale of your business. Hiring a financial controller with the right skillset and experience to monitor and control your spend is an option.

Outsourcing your financials to an expert service provider can help you monitor and control the spending as well. Having solid information about where you're spending (and why) is the first step towards keeping it under control and from there trimming back where necessary.

Again, take advice about the systems that are available to help your business. There are lots of them around, and with the advent of intelligent technology they are much more affordable than they were a few years ago. If there's one thing you can do to protect your margins that is within your control, it's this. Cost control may be unglamorous and difficult but it's the one essential day-to-day process which could make the difference to your survival as an SME.

3. Are you finding economies of scale?

Economies of scale don't just happen of their own accord as your business grows. And getting the information on where and how to invest to achieve such savings is tricky. It takes hard work, market intelligence and analysis about your company, your competitors and your customers. Often you won't be able to achieve economies of scale without significant up-front investment, especially if you're in the manufacturing sector, where you may need to invest in plants or machinery to achieve the lower unit costs that come with scale production. You need to plan carefully. Assess the different market scenarios that may arise for your business, and plan in detail for the risks. Look at the things you can control as well as the things you can't. Analyze the market: can it absorb your increase in production at a price that will maintain your margins? What about timescales? Are you prepared to run at a small loss for a period while you build up market share from your increased production? Do you have reserves and funding to help you invest in this kind of business building, reducing short term profits or even running at a loss to benefit from a stronger revenue flow later? Assess the risks. Be disciplined in your thinking regarding this problem. Take advice from experts about what the market can absorb. Then, if the time is right, bite the bullet and invest as much as you can to reduce your eventual marginal costs. It might be the best thing you ever do for your business.

4. Is outsourcing to agencies costing more?

When starting and growing a company in China, many businesses are understandably cautious about taking on too many employees. This may lead an SME to outsource to service providers or agencies. This is countered, however in the Western world and culture, with the conclusion that outsourcing means control of

your company culture is taken out of your hands in some shape or form. Does company culture really impact profits? In fact, research has shown that staff at every level of an organization believes company culture to be the cornerstone to a company's essence and growth. In China it would be our opinion that this is the reverse. Foreign investors entering the Chinese market need to be educated and assisted in learning what the Chinese corporate culture should be in their China organization. The advantage of using a service provider in China is that they can aid in the education and understanding of creating, developing and implementing the "unique China company culture". Developing and adapting one's corporate culture to a "Chinese corporate culture" is critical for the local employees to assist in the development and growth of the company and ultimately reduce profit margins.

Watching the margins

For any China SME, feeling that your profit margin is under stress is a very uncomfortable place to be – especially when an investment has been made to a new jurisdiction and a new market for growth, such as China. And while there is no magic bullet solution, the four points mentioned above do go some way to changing your thinking about what factors may be influencing shrinking profit margins – particularly in China - and what steps we may take to rectify that situation.

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