THE LENOVO AFFAIR

The Growth of China's Computer Giant and Its Takeover of IBM-PC

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1. Start-up

On October 17, 1984, eleven researchers from China's Computing and Technology Research Institute gathered together to discuss founding a new company. They had no business plan, very limited financial resources of RMB 200,000 (200,000 Yuan using the Renminbi currency, or about US$40,000) and the use of an old ex-guard-post building which had recently being used as a bicycle shed. This building was about twenty square meters divided into two rooms, front and back. This was the beginnings of the Lianxiang Group (in Chinese) or Lenovo as it is called in English.

The driving people behind the formation of this new company were:

■ Wang Shuhe – who would serve as the first general manager of Lianxiang.

■ Liu Chuanzhi – a forty-year-old computer engineer.

■ Zhang Zuxiang – deputy director of the Institute's Number Eight Research Lab and one of China's leading experts on computer sciences.

Although the company would later be renamed the "Lianxiang Group", it was originally called the "Chinese Academy of Sciences Computer Technology Research Institute New Technology Development Company".

"Lianxiang was established during an extraordinary period of impetuous change – this period of casting off the existing system and searching for the future. The early Lianxiang entrepreneurs used 'technology development' to differentiate themselves from mere traders. They relied on chaotic disorder in the system, and the inability of the government to set restrictive policies, to make a profit. They survived considerable hardship at the beginning but their computers eventually became a necessary part of peoples' lives. The 'Lianxiang Spirit' came to be called the 'China Spirit'. The company represented a microcosm of China and Chinese culture. In the past twenty years, Lianxiang has accompanied China as it grew up. It has put its imprint on China and, one could say, it has put the national imprint on itself."

– Ling Zhijun

Despite the fact the new company was a standalone entity, the Institute continued to provide much-needed support during the early days of Lianxiang. Employees of the new company continued to receive salaries from the Ministry of Finance. This meant the new company could in effect second anyone it wanted from the Institute's personnel. Lianxiang was also allowed to use the Institute's offices, telephone, fax and other facilities without any restrictions.

To raise some money to start business, it was decided to try and buy some color TVs at a wholesale price and then resell them at retail. Unfortunately, this was a commercial activity which was rife with cons, and Lianxiang actually lost RMB 140,000 paying for color TVs which did not exist. Considering the fact the company only had RMB 200,000 in capital to start with, this was a major setback. Fortunately, however, the company had been granted some intellectual property rights by the Institute. These proved to be far more worthwhile. The company also picked up some computer service contracts and Lianxiang's chief engineer, Ni Guangnan, had been allowed to bring into the company a Chinese-character system which he had been

working on for ten years. Lianxiang was able to generate some profits by selling these systems to others who were interested.

The fact Lianxiang personnel were allowed to sell technologies they had been working on while at the Institute was particularly important. Ni Guangnan's "Han-card" technology was a good example of this. The card allowed Chinese characters to be entered on keyboards and then used in digital form as readily as English characters. The card also had an early type of predictive technology integrated into its design which sped up the entry of Chinese characters. All of these concepts were fairly revolutionary in 1985 and the new card was dubbed the LX-80 Lianxiang-type Chinese character system.

By the end of its first year in business, Lianxiang had RMB 3.5 million in revenue and RMB 2.5 million in profit, thanks in large part to the fact its costs were artificially low due to the assistance of the Institute. The company's first year revenues came from:

■ Selling research results from the Institute's KT8920 mainframe computer, generating RMB 600,000 in profit.

■ Providing servicing and training for the Institute's purchase of 500 personal computers. This generated RMB 700,000 in service fees for Lianxiang.

■ Providing services for the Beijing Central Agency of IBM, earning the company US$70,000.

■ Selling more than 100 Han-cards Chinese character systems, which brought Lianxiang RMB 400,000 in gross profit.

2. Scrambling for business

The years of 1986 and 1987 saw huge political upheavals in China. As the Chinese government "changed track" and moved away from State-control of industries towards more of a market economy, many tensions arose between government and commerce. The Computer Institute itself was caught in just such a squeeze and it missed out on being given any government engineering or military development projects. With no government funding being made available, nobody was sure what the Computer Institute would do to survive.

Despite all this uncertainty, Liu Chuanzhi and Lianxiang sprung into action. The company now had more than 100 employees, and it was decided one good way to generate revenue would be to import personal computers, fit them with a Lianxiang Han-card and then sell the system as a bundle. The only problem with this was Lianxiang lacked a license to import computers. Undeterred by this minor detail, Liu Chuanzhi found out the Hong Kong branch of the Bank of China Group was an IBM computer customer and had a license to import personal computers. Liu Chuanzhi approached them and asked if they would like to form a partnership. The Bank would provide the import rights while Lianxiang would provide a training and repair center. Fortunately, the Bank agreed and after some early hiccups, the arrangement started working very well.

In spite of the fact Lianxiang was earning some good commissions on the sale of personal computers throughout China, Liu Chuanzhi still recognized the limits of this type of business model. He therefore managed to get permission for Lianxiang to set up a trading company outside the borders of China. An advance man was sent to Hong Kong in January 1988 with very specific instructions:

■ A new trading company was to be set up in order to generate capital and business experience for Lianxiang.

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