

2008

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### Recommended Citation

Catherine Zhang, *Business Negotiation between Westerners and Chinese State-Owned Enterprise*, 42 INT'L L. 1303 (2008)

<https://scholar.smu.edu/til/vol42/iss4/6>

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# Business Negotiation Between Westerners and Chinese State-Owned Enterprises

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## Abstract

*Based on the existing literature covering Sino-Western business negotiations, this paper is an effort to distinguish Chinese entities' negotiation styles based upon their ownership structure. Particularly, this paper reviews the specific issues that exist in business negotiations between Western firms and Chinese State-owned enterprises (SOEs). Such issues involving Chinese SOEs' unique motivations, communication patterns, and decision-making processes arise from the significant role the Chinese government plays with respect to its SOEs, and also the complex transition period in which the SOEs are operating and the various reforms they are carrying out. In response to the unique issues presented by Chinese SOEs, this paper attempts to explore possible solutions available to Western firms before, during, and after their business negotiations with Chinese SOEs.*

## I. Introduction

Since the People's Republic of China (PRC or China) adopted its "reform and open-up" policy in late 1978, "Western business communities have been enthusiastic about China—the world's largest emerging market with more than one billion consumers."<sup>1</sup> According to the World Trade Organization, "China surpassed the United States as the world's second-largest exporter in the middle of [2006]."<sup>2</sup> In 2006, China approved 41,485 foreign-invested enterprises and attracted foreign investment totaling 69.468 billion US dollars.<sup>3</sup> Negotiations with the Chinese, however, have frequently been described

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1. Pervez Ghauri & Tony Fang, *Negotiating with the Chinese: A Socio-Cultural Analysis*, 36 J. WORLD BUS. 303, 303 (2001).

2. Ministry of Comm. (PRC), *WTO: China Overtakes US as Second Biggest Exporter*, Apr. 12, 2007, available at <http://english.mofcom.gov.cn/aarticle/subject/cief/lanmua/200704/20070404566956.html>.

3. Ministry of Comm. (PRC), *National Update of Foreign Investment from January to December 2006*, Jan. 16, 2007, available at <http://www.mofcom.gov.cn/aarticle/tongjiziliao/v/200701/20070104307380.html>.

as particularly difficult for Westerners, given the unique features China possesses and the special challenges it offers.

#### A. LITERATURE REVIEW

In response to the increase in Sino-Western business transactions, as well as Westerners' surprise and confusion regarding the Chinese negotiation style, a special area of literature has gradually developed since the 1980s concerning international business negotiation between the Chinese and Westerners—authors include Pye, Macleod, Blackman, Goh, Lam, Ghauri and Fang, Lee, and Lam and Graham.<sup>4</sup> The majority of these authors' works take a socio-cultural approach to facilitate better understanding of the Chinese business negotiation style.

Pye lays a foundation by identifying the three major sources of difficulty in Sino-Western business negotiations.<sup>5</sup> Goh states that the major divergence between the Chinese and Western negotiation styles is that "the former tend[s] towards a relational approach, and the latter adopt[s] a transactional approach" and further points out that the "main cultural reasons behind such a divergence [are] collectivism/individualism, and high-context/low-context communication patterns".<sup>6</sup> Blackman provides insightful case studies of Westerners' business negotiations with Chinese.<sup>7</sup> Fang establishes that the Chinese business culture framework consists of three distinctive and interrelated components: the PRC condition,<sup>8</sup> Confucianism, and Chinese stratagems.<sup>9</sup> Ghauri and Usunier nicely re-captured Fang's model as follows:

[The] Chinese business culture framework suggests that the Chinese negotiators have a "three-in-one" negotiation style; they negotiate like "bureaucrats," "gentlemen," and "strategists." Trust is a prime indicator showing which role the Chinese are going to play. When mutual trust between the business partners is high, the Chinese will negotiate as "gentlemen;" when it is low, they will negotiate as strategists! The

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4. See generally RODERICK MACLEOD, CHINA, INC.: HOW TO DO BUSINESS WITH THE CHINESE (Bantan Books 1988); CAROLYN BLACKMAN, NEGOTIATING CHINA: CASE STUDIES AND STRATEGIES (St. Leonards, NSW, Australia 1997); Bee Chen Goh, *Sino-Western Negotiating Styles*, 7 CANTERBURY L. REV. 82 (1998); MARIA LAI-LING LAM, WORKING WITH CHINESE EXPATRIATES IN BUSINESS NEGOTIATIONS: PORTRAITS, ISSUES, AND APPLICATIONS (Quorum 2000); Ghauri & Fang, *supra* note 1; CHARLES LEE, COWBOYS AND DRAGONS: SHATTERING CULTURAL MYTHS TO ADVANCE CHINESE-AMERICAN BUSINESS (Dearborn Trade Pub. 2003); N. MARK LAM & JOHN L. GRAHAM, CHINA NOW: DOING BUSINESS IN THE WORLD'S MOST DYNAMIC MARKET (McGraw-Hill 2007).

5. PERVEZ N. GHAURI & JEAN-CLAUDE USUNIER, INTERNATIONAL BUSINESS NEGOTIATIONS 413 (2nd ed. 2003). According to Pye, the "three major sources of difficulty in Sino-Western business negotiations are . . . [1] problems that arise from the newness of the relations and the lack of experience on both sides, [2] problems inherent in capitalist enterprises seeking to do business [within a] socialist economy [experiencing] uncertain transition and reform, and [3] problems that arise from the differences between the Chinese and Western cultures." *Id.*

6. Goh, *supra* note 4 at 82.

7. BLACKMAN, *supra* note 4.

8. Under Fang's model, the "PRC condition" is comprised of eight variables: politics, economic planning, legal framework, technology, great size, backwardness, rapid change, and Chinese bureaucracy. See GHAURI & USUNIER, *supra* note 5, at 416.

9. Under Fang's model, the term "Chinese stratagems" refers to a long-lasting Chinese cultural tradition that shapes the strategic Chinese business behavior, deriving from its world's earliest treaties on military strategy—ART OF WAR by Sun Tzu.

PRC negotiators also negotiate as “bureaucrats,” particularly so when the political wind blows.<sup>10</sup>

## B. LIMITATION OF EXISTING LITERATURE

Although the rich existing literature on Sino-Western business negotiation has offered a useful framework and tool-sets to facilitate cross-cultural understanding, there is a shared temptation to over-generalize Chinese negotiation styles, or to only limitedly distinguish them by geography.<sup>11</sup> There is a lack of literature that attempts to distinguish the negotiation styles of Chinese entities by their ownership structure.

In fact, Chinese enterprises can generally be categorized into three sub-groups based on the nature of their controlling shareholders: (1) SOEs, (2) privately-owned enterprises (POEs), and (3) foreign-invested enterprises (FIEs). These three types of Chinese entities can be dramatically distinct from each other in terms of organizational culture, management motivations, and control systems, and these distinctions can lead to different features in their negotiations with Western firms.

## C. WHY CHINESE SOES?

Under the PRC law, the term Chinese SOEs refers to Chinese companies whose assets are owned by the state, in which the State Council and the local people’s governments perform, on behalf of the state, the contributor’s duties and enjoy the owner’s rights and interests.<sup>12</sup> This paper is focused on further analyzing business negotiations between Westerners and Chinese SOEs (as opposed to the other two entity types) due to the following two major reasons.

First, as compared to Chinese POEs (which are primarily run by private entrepreneurs and accordingly more market-driven) and FIEs (which are primarily controlled by foreign investors and therefore more westernized), the gap between Chinese SOEs and Western firms seems larger, especially given the unique issues Chinese SOEs face due to their complicated reform histories, ownership structures, organizational culture, and incentive systems. All of these issues provide particular challenges with respect to achieving effective communication between Western firms and Chinese SOEs.

Second, Chinese SOEs are the major players in China’s increasing outbound investment activities, which are “intended to improve their competitiveness both globally and at home, seeking to acquire brand names, technology, distribution networks and even human resources.”<sup>13</sup> According to statistics published by China’s central government, the aggregate amount of outbound direct investment by Chinese companies grew to \$21.16 billion

10. GHAURI & USUNIER, *supra* note 5, at 421-22.

11. LAM & GRAHAM, *supra* note 4.

12. See Article 2, Qi ye guo you zi chan jian du guan li zan xin tiao li [Provisional Measures for the Supervision and Administration over the State-Owned Assets of Enterprises] (promulgated by the State Council, May 27, 2003, effective May 27, 2003).

13. Aihong Yu, Howard Chao & Michael Dorf, *Outbound Investment by Chinese Companies: The Chinese Government Approval Regime*, TOPICS IN CHINESE LAW, O’MELVENY & MYERS, LLP (2005).

in 2006, 26 percent of which was carried out by Chinese SOEs.<sup>14</sup> This trend obviously anticipates more encounters between Chinese SOEs and Western firms.

As stated, the goal of this paper is to analyze the specific issues surrounding business transactions between Western firms and Chinese SOEs and then suggest possible solutions to facilitate effective communication and business transactions between the two entities. To achieve this purpose, this paper draws on the empirical experiences of intermediary professionals and in-house councils of several Chinese SOEs in business negotiations representing Chinese SOEs and Western clients.<sup>15</sup>

## II. Backgrounds of Chinese SOEs

In order to better understand the specific issues that may exist in business negotiations between Chinese SOEs and Western firms, it is helpful to have some background on Chinese SOEs.

### A. THE GOVERNMENT'S ROLE IN CHINESE SOES

First, because the central or local government “perform[s] contributor’s duties, and enjoy[s] the owner’s rights and interests” in Chinese SOEs, the government’s role should never be neglected or underestimated.<sup>16</sup> As noted above, the PRC condition is an important component of Fang’s Chinese business-culture framework. This is particularly true for Chinese SOEs. As one scholar noted:

At the centre of the PRC condition lies the theme of Chinese bureaucracy which features red tape [more often, decision making requires consensus at various levels crossing various departments] as well as quick buying (e.g., [when politics require a quick deal and] when your products fit in with the government’s priority categories).<sup>17</sup>

As compared with POEs and FIEs, Chinese SOEs are more obliged or expected to follow the Chinese government’s policies and plans to do business. As one of the interviewees indicated, “the reason why it is so emphasized in China to separate the functions of government and enterprises for SOEs is precisely because these two are severely commingled in practice.”<sup>18</sup>

### B. CHINESE SOES IN TRANSITION

Historically, China’s SOEs were wholly owned by the government. Starting from the early 1990s, the central government began to reform its SOEs by listing some large ones

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14. Ministry of Comm., State Admin. of Foreign Exchange, & National Bureau of Statistics (P.R.C.), 2006 nian du zhongguo dui wai zhi jie tou zi tong ji gong bao [2006 Statistical Bulletin of China’s Outward Foreign Direct Investment] (2007), available at <http://hzs.mofcom.gov.cn/accessory/200709/1190343657984.pdf>.

15. Identities of these interviewees cannot be disclosed due to confidentiality arrangement with the interviewees.

16. See Provisional Measures for the Supervision and Administration over the State-Owned Assets of Enterprises art. 2.

17. GHOURI & USUNIER, *supra* note 5, at 417.

18. See disclaimer, *supra* note 15.

and selling off certain smaller ones.<sup>19</sup> The remaining SOEs are mainly mega-firms in strategically significant sectors, such as financial institutions, automobile industries, telecommunications, and petrochemicals. Such Chinese SOEs, however, have been faced with drastic internal and external changes.

Internally, management of Chinese SOEs was recently “given [relative] autonomy over pricing, investment, accounting, human resources, material supply and acquisition, and other decisions related to [their] operations, [all of] which were absent under the former planned economy in China.”<sup>20</sup> Externally, since the 1980s when China began to convert itself into a market economy, Chinese SOEs have been exposed to a much more competitive market with pressure from both domestic private sector and foreign direct investment in China. As one author noted, “[t]he emergence of the domestic private sector [which increased the number of more market-driven POEs], as well as the growth of [more westernized FIEs], has brought unprecedented challenges” to Chinese SOEs.<sup>21</sup> Furthermore, China’s accession to the World Trade Organization in 2002 has invited more foreign direct competition within formerly protected sectors such as financial institutions, automobile industries, and pharmaceuticals, which are the major sectors in which Chinese SOEs participate.<sup>22</sup>

Facing such challenges, Chinese SOEs have been under a series of reforms since the 1980s (including the introduction of foreign strategic investment in Chinese SOEs to increase their efficiency and the establishment of Western corporate governance systems within Chinese SOEs, among other reforms). Such reforms can be bottom-up or top-down, market-driven or government-mandated, but, all in all, they have to go through the process by trial and error. Therefore, Chinese SOEs are in transition.

During this transition period, it is inevitable that the pre-reform planned economy under which Chinese SOEs had been operating for decades and the market-oriented practices that Chinese SOEs desired to develop in the face of the above-mentioned challenges will intersect. What further complicates the situation is that different Chinese SOEs may have adopted various means of reform, with the same type of reform being carried out to different degrees and having distinct impacts in various specific cases. As one of the interviewees commented, “Chinese SOEs can be very different from each other, depending on various factors, such as whether it is a public company, which industry it operates in, and how such industry is regulated by the government, and whether it has foreign strategic investor at the corporate level.”<sup>23</sup>

### III. Specific Issues with Chinese SOEs

Apart from the widely-recognized issues effecting Sino-Western business negotiations (such as the relational/transactional approach, collectivism/individualism, and the high-context/low-context communication patterns as described by Goh), the interactions be-

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19. David A. Ralston et al., *Today's State-Owned Enterprises of China: Are They Dying Dinosaurs or Dynamic Dynamos?*, 27 STRATEGIC MGMT. J. 825, 827 (2006).

20. *Id.* at 827-28.

21. *Id.*

22. *Id.*

23. See disclaimer, *supra* note 15.

tween Chinese SOEs and Western firms present specific issues, particularly in terms of the different motivations, communication styles, and decision making processes of each entity.

#### A. MOTIVATIONS

From a Western perspective, the goal of a business organization is to create economic wealth and maximize the benefits to shareholders. Therefore, Western firms are primarily profit-driven, and executive compensation, being comprised of performance-based bonuses and equity-based option plans, is primarily linked with the companies' performance.<sup>24</sup>

By contrast, Chinese SOEs have much more complicated incentive systems, combined with the government's significant role in Chinese SOEs, as mentioned above. The motivations of Chinese SOEs' executives in business negotiations are far greater than merely profit-making. Other factors, such as the overall political environment, compliance with policy guidelines, and even the deal's impact on the executive's personal political career path, will have an inevitable impact on the Chinese SOEs' business negotiations with Western firms. Furthermore, these various motivations are generally interlinked. Whether signing the deal has a positive or negative effect on the political career of Chinese SOEs' representatives is closely related to the then-applicable PRC condition (particularly the overall political environment) and whether the deal is in line with the policy guidelines issued, publicly and/or internally, by central and/or local governments.

Due to the complicated motivations of Chinese SOEs' executives, they tend to be more risk-averse because they have too much at stake, and without a high level of precaution, they cannot manage all of the interlinked motivational factors correctly. As one of the interviewees who had been working with a large Chinese SOE commented, "executives in Chinese SOEs tend to be 'risk avoiders', and they would rather do nothing than make a mistake as too much is at the stake for them."<sup>25</sup>

#### B. COMMUNICATIONS

Lee illustrates how serious the miscommunication can become between Western and Chinese negotiators merely due to eye contact. The deal can "go south" because an American's attempt to "show great interest [and] be earnest" by using firm eye contact may be misinterpreted by the Chinese, whose custom is to "show respect . . . by avoiding direct eye contact."<sup>26</sup> Apart from such cultural differences between Westerners and Chinese, it should be noted that Chinese SOEs have their own language system and behavioral customs, which may not be well understood by outsiders (even Chinese who lack previous experience in government authorities or SOEs may be unfamiliar with this system).

First, such communications can be very vague. For example, after reviewing a project proposal, executives of Chinese SOEs are likely to say something along the lines of: "let's take a look" or "it appears fairly feasible." Such comments do not give a definitive answer,

24. See generally WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION (Aspen Publishers 2007).

25. See disclaimer, *supra* note 15.

26. LEE, *supra* note 4, at 11.

nor do they provide the type of detail a Western firm would expect, such as how long the project will take and whether the project's goals are satisfied or not. As one intermediary service provider mentioned in the interviews, "Western firms may find it very difficult to figure out what such unclear words really mean."<sup>27</sup>

Second, given that executives of Chinese SOEs are driven by a mix of complicated and interlinked motivations, they may create an argument to support their internal decisions if, from their perspective, the real reason behind those decisions cannot be directly stated.<sup>28</sup> This is partly the reason why some Western negotiators complain that their Chinese counterparts resort to "false authority."<sup>29</sup> Such use of "false authority" is also partly due to the two-level game being played by the Chinese SOEs, as further discussed below.

Furthermore, as much literature has highlighted the importance of saving face to the Chinese, this is particularly salient for Chinese SOEs, because executives of Chinese SOEs are usually former governmental officials, and they may have political positions or their equivalents in the bureaucratic system even when they are managing the Chinese SOEs. Thus, they are more sensitive to humiliating acts (which can be deemed quite natural by Westerners, but seem to be insulting from the perspective of Chinese SOEs) and very concerned about losing face, especially to the public.

### C. DECISION-MAKING

In China, government directives and approvals pervade virtually all aspects of societal and economic functioning.<sup>30</sup> This is particularly true for Chinese SOEs because they are under the government's control or supervision to a greater degree, even during this transition period. Therefore, negotiating with Chinese SOEs is more like a two-level game. Though Western negotiators might not realize this situation, any tentative agreement must be ratified or approved by the supervising authority of the Chinese SOE, be it a larger parent SOE controlled by the central government or the central or local government itself.

Similar to the two-level game of international negotiation, at Level I, the Chinese SOE's representatives are bargaining with their Western counterparts with the hope of formulating a business transaction. Afterwards, at Level II (which is usually hidden from outsiders), the executives of the Chinese SOE report the tentative deal to their supervising authority to seek ratification or approval of the transaction.<sup>31</sup> Such ratification or approval can be any decision-making process, formal or informal, to endorse or implement a Level I agreement.

In practice, the two levels of communications are more integrated. As Putnam noted when analyzing international negotiation, "[t]here are likely to be prior consultations and

27. See disclaimer, *supra* note 15.

28. Combined with Chinese SOEs' face-saving culture, some reasons that a Westerner may believe are perfectly fine to discuss may not appear this way to Chinese SOEs.

29. BLACKMAN, *supra* note 4, at 152.

30. Rosalie Tung, *Negotiating with East Asia*, in INTERNATIONAL BUSINESS NEGOTIATIONS 369, 375 (Pervez N. Ghauri & Jean-Claude Usunier eds., Pergamon 1996).

31. Robert D. Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games*, 42 INT'L ORG. 427, 436 (1998).

bargaining at Level II to hammer out an initial position for the Level I negotiations. Conversely, the need for Level II ratification is certain to affect the Level I bargaining.<sup>32</sup> “[E]xpectations of rejection at Level II may abort negotiations at Level I without” clear reasons being understood by the Western negotiators.<sup>33</sup> After-the-fact objection at Level II may also lead to “involuntary defection” of the Level I agreement.

#### IV. Possible Solutions

With such specific issues weighing on Chinese SOEs, Western firms easily get lost. To facilitate better understanding between the parties, this paper tries to walk through each stage of the negotiation in order to come up with possible solutions.

##### A. BEFORE NEGOTIATION

###### 1. *Avoid Stereotyping Chinese SOEs*

As Goh points out, “relevant cross-cultural knowledge may help one in predicting behaviour, but one has to be constantly prepared for the unexpected.”<sup>34</sup> This statement is particularly true for negotiating with Chinese SOEs. Given that Chinese SOEs are in the midst of transition and reform, which is conducted in different ways and implemented in distinct stages, “Chinese SOEs can be very different” as mentioned by one of the interviewees.<sup>35</sup> Therefore, stereotyping Chinese SOEs entails greater risk. Western negotiators with Chinese SOEs as counterparts have to do their homework sufficiently, and more importantly, they must continually analyze or adjust their assumptions.

###### 2. *Find an Appropriate Middle Man or Intermediary*

An appropriate and effective middle man or intermediary who has an in-depth understanding of the backgrounds and operation of Chinese SOEs or the Chinese government is extremely important for business negotiations between Western firms and Chinese SOEs. As mentioned above, Chinese SOEs have their own language system or style of communication, which can be vague, and may make use of “false authority” at times. In such situations, the middle man or intermediary acts as a cultural interpreter and provides a method of more accurately reading Chinese SOEs. As commented by Graham and Lam, “[o]nly a native Chinese speaker can read and explain the moods, intonations, facial expressions, and body language Chinese negotiators exhibit during a formal negotiation session.”<sup>36</sup> For Chinese SOEs, it is no secret that only those who have extensive experience in dealing with Chinese SOEs or the Chinese government can read between the lines of Chinese SOEs’ vague communications.

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32. *Id.*

33. *Id.*

34. Goh, *supra* note 4, at 83.

35. See disclaimer, *supra* note 15.

36. John L. Graham & N. Mark Lam, *The Chinese Negotiation*, 81 HARV. BUS. REV. 82, 87 (2003).

### 3. *Conduct a Full-fledged Background Check*

Before negotiating with Chinese SOEs, a first priority should be to understand the currently applicable "PRC condition" under the Chinese business culture framework. Given that the Chinese government is the "biggest boss" for SOEs, the SOEs do business according to the government's priorities, policies, and plans. Western firms should be sensitive to the guiding principles of China's social and economic development as set forth by the Chinese Communist Party and the Chinese government. A careful study should be conducted of the relevant Chinese policies, which can take the form of certain general or abstract guidelines or even mere indications in some seemingly insignificant government circulars. All of those resources can provide important indicators of what the Chinese government's priorities or policies are.

Apart from Chinese government policy, various sorts of information about the Chinese SOE (including, without limitation, whether it is a public company, how it has developed to date, what reform is under way, whether it has any foreign strategic investors, and its financial data and competitive information) should be fully researched. Nevertheless, some of the data and information regarding Chinese SOEs can be either unavailable or unreliable.<sup>37</sup> Thus, it is important to gather the critical information from every possible resource. One of the key sources of practical information will be the middle man or intermediary who introduced the representative of the western firm to the Chinese SOE in the first place.<sup>38</sup> It should be noted that knowing who will be bargaining within China, and what their priorities or underlying policies are, is far more important than most Westerners would assume.

## B. DURING NEGOTIATION

### 1. *Keep Patient*

The complicated motivations of Chinese SOEs' executives are foreign to Western negotiators. Their vague and indirect communication style drives Western negotiators crazy. Moreover, the two-level game for decision-making lengthens the whole process and effectively increases the uncertainty of what has been discussed and agreed upon at the negotiation table. With all these factors combined, some Western negotiators cannot help getting angry or yelling at their Chinese counterparts. Experience shows, however, that getting angry ruins relationships, and "loud voices and irritated tones destroy even long-standing interpersonal relationship."<sup>39</sup>

Thus, patience will be the key. Western negotiators should be prepared for the reopening of previous issues (this is also part of the story for the two-level game) and should understand that for Chinese SOEs it is really a package deal based on a long-term relationship; thereby "nothing is settled until everything is settled."<sup>40</sup>

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37. LAM & GRAHAM, *supra* note 4, at 163.

38. *Id.*

39. *Id.* at 184.

40. *Id.* at 164.

## 2. *The Magic "Why"*

Equipped with patience, Western negotiators have to ask as many "why" questions as possible when negotiating with Chinese SOEs. Why did the Chinese SOE change the negotiators today? Is that merely a scheduling conflict, or is there deeper bureaucratic reasons for the change? Why do the Chinese SOE's representatives decline to give a definitive answer? Is this really out of their scope of authority as claimed, or is their behavior due to actual or anticipated difficulties, or even rejection, at Level II?

Seeking to answer these magic "why's" helps Western negotiators foster deeper communications with Chinese SOEs, allowing the Westerners to ascertain numerous unspoken points and reasons. Nevertheless, addressing magic "why" questions is highly context-specific. Some "why's" can be directly posed to the Chinese counterparts at the negotiation table, while others may only be conveyed through a sophisticated middle man or intermediary. Some "why" questions may be resolved through in-house research, while others can only be sorted out by consulting outside professionals.

A wrong choice of channels to convey such "why's" will lead to inferior results, from failing to gain a real answer to offending the Chinese SOEs' representatives, or even destroying the trust or long-term relationship between the parties. The rule of thumb for the Chinese SOEs across the table is to save face. Further, in order to play it safe, it is always a smart idea to consult with a trustworthy intermediary, professional service provider, or personnel who has extensive experience in dealing with Chinese SOEs before posing the magic "why" questions.

## 3. *Channels and Sequencing*

The two-level game of negotiations used by Chinese SOEs presents particular difficulties for Western firms. It is vital to find out the right channels in China and employ the correct sequencing in dealing with different channels. Below are the three major paths available for Western firms' negotiations with Chinese SOEs. Such paths may need to be pursued separately in a certain order or simultaneously, depending on the transactions' contexts.

### a. Path I: General Trust-Building

The importance of trust-building in a business negotiation between Chinese SOEs and Western firms cannot be over-emphasized. As Ghauri and Fang quoted one of their Chinese negotiator interviewees, "They [Western firms] want to come and sign the contract quickly and do not know that [if] we do not understand each other . . . there is no business relationship. First, we have to know and trust each other, then we sign the contract."<sup>41</sup>

Such trust-building can be conducted through certain events (which have no specific transaction-related tasks but are set up only for general trust-building purpose), such as symbolic visits by top executives of Western firms, banquets or informal communications, or Chinese delegations' visits to the Western firm's home country.<sup>42</sup> This kind of general trust-building can take place at different levels, not only with the executives of the Chinese counterparty, but also with its immediate supervisor, or higher central authority.

41. Ghauri & Fang, *supra* note 1, at 314.

42. *Id.*

In such trust-building events, an appropriate middle man or intermediary's function can never be overlooked. An effective middle man or intermediary may have close connections or wide recognition with the Chinese counterparty or even relevant authorities. The middle man, therefore, may be the person who introduces the relationship, builds up the connections, arranges for a proper trust-building event, or serves as a cultural interpreter to facilitate mutual understanding. Furthermore, such general trust-building can also prepare the Western negotiators for in-depth communications through Paths II and III as discussed below.

b. Path II: Chief Negotiator at the Level I

As Putnam points out, "the chief negotiator is the only formal link between Level I and Level II."<sup>43</sup> Thus, the impact of the chief negotiator's preferences regarding Level II decision-making cannot be underestimated. The chief negotiator can be an active lobbyist for the transaction under discussion or a passive servant completely under the control of the Level II decision-makers. Thus, how to effectively mobilize the chief negotiator becomes critical to most transactions between Chinese SOEs and Western firms.

It is critical to link the transaction with the chief negotiator's interests or priorities. This goal may be conceptualized by asking how the transaction might enhance the chief negotiator's "standing in the Level II game by increasing his political resources" or how the transaction might contribute to the implementation of the chief negotiator's own conception of the Chinese SOE and its interplay with the Level II players.<sup>44</sup> In sum, similar to the two-level game of international negotiation, the chief negotiator of a Chinese SOE is more likely to recommend his superiors approve or ratify a deal if he has to invest less of his own political capital to win the Level II-approval while achieving greater political returns for himself in the process.<sup>45</sup>

c. Path III: Constituencies at the Level II

Putnam also mentions that "the preferences of the chief negotiator may well diverge from those of his constituents."<sup>46</sup> Although the chief negotiator sometimes can be mobilized as an active lobbyist for the deal through Path II, he may sometimes also be a major hindrance to the deal if too much of his own political capital is at the stake and he is overcautious, preferring no deal rather than a potentially wrong deal.

In such circumstances, it may be helpful to directly exert influence on the Level II constituencies, align their interests in favor of the deal, and expect a top-down approach by the Level II players to make the deal happen. This path can be difficult and tricky. It is difficult because in most cases, the Level II constituencies or players are not evident to the Western firms or even other Chinese outsiders. It is tricky because if you cannot successfully mobilize the Level II players, such a bypass action itself may sufficiently annoy the Level I players (especially the chief negotiator who may feel humiliated because he is supposed to be the formal link between two levels) and lead to their resisting cooperation in further rounds.

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43. Putnam, *supra* note 31, at 456.

44. *Id.* at 457.

45. *Id.*

46. *Id.* at 436.

Therefore, Path III has to be pursued discreetly. It would be imprudent to go too fast or too far in this kind of persuasion of the Level II constituencies. Which Level II constituent should be approached first, and through what channel? Which core issue should be broached first, in what context, and to what extent? All these delicate factors play important roles in a successful lobbying effort at Level II. Again, a sophisticated insider's view is vital in making such delicate and discreet judgment calls.

### C. AFTER NEGOTIATION

#### 1. *Be Prepared for After-contract Negotiation*

The signing of a contract is never the end of the game in China. As Lee commented, “[a]ll [Chinese] know what social harmony demands. Such knowledge comes from a wide familiarity with custom rather than from formal books of case or statute law as in the West.”<sup>47</sup> Similarly, for Chinese SOEs, their own custom of doing business is much more important than the lifeless terms and conditions of a signed contract.

What further complicates the situation is the two-level game on the Chinese SOEs' side. Sometimes the Level II players later feel unhappy about the deal and argue that they were unaware of such commitments when rectifying or approving the deal. All these factors may lead to a possible reopening of negotiation at Level I or even an “involuntary defection” of the Level I agreement. Thus, for a Western negotiator, the advice is not to be overly exhilarated upon signing but rather to promptly prepare for possible after-contract negotiations.

#### 2. *Long-Term Commitment and Informal Consultation*

For most Chinese SOEs, “trust and harmony are more important than any piece of paper.”<sup>48</sup> As advised by Lee, “[y]our [Westerners'] best legal defense in China is the goodwill that your Chinese business partners possess. This means that building long-term trust relations with your Chinese counterparts becomes even more important.”<sup>49</sup> This advice is particularly true when dealing with Chinese SOEs whose “biggest boss” is the Chinese government. Breaking the trust relations (which are never easy to build up) with the Chinese SOEs is very dangerous and could potentially close off opportunities with the particular Chinese SOE or other Chinese SOEs within the sector or community or other involved parties, be they a superior and larger Chinese SOE or the relevant government authorities. Therefore, ahead of any proposed reopening of negotiations after signing a contract, the more strategic path is to continue to show long-term commitment, reinforce the trust relations between the parties, and cooperate on mutually-acceptable solutions.

Although an international arbitration clause is usually included in contracts between Western firms and Chinese SOEs, a Chinese approach to conflict resolution may still be more effective. This path involves approaching the dispute from a cooperative standpoint and communicating with the Chinese counterpart. If one has maintained the harmony and trust and one has an honest mutual interest in the deal, problems can usually be

47. LEE, *supra* note 4, at 133.

48. LAM & GRAHAM, *supra* note 4, at 194.

49. LEE, *supra* note 4, at 138.

resolved through simple conferral.<sup>50</sup> If the tension between the parties is so intense that face-to-face renegotiation would be difficult, it is advisable to have the middle man or intermediary mediate the problem by addressing both parties' concerns and helping them determine possible solutions.

### 3. *Choice of Forum and Dispute Resolution*

In case the after-contract issue is so severe or the disparity between the parties' interests is so material that informal consultation (either directly or through middle man) is not feasible, it is critical to have effective choice of forum and dispute resolution clauses in the contract as a last resort. It should be noted that a formal dispute resolution mechanism is always the last resort, as illustrated by the U.S. Department of Commerce advising its companies that:

[W]hen a U.S. firm has a dispute with the Chinese [SOE] . . . the most effective initial step is to quietly raise the issue with the entities involved, citing the importance of foreign companies' investment in China. The firm should explain its situation to the Chinese entity, and offer to work with it to resolve the problem amicably. This allows for a more aggressive approach at a later date, if necessary.<sup>51</sup>

## V. Conclusion

As compared with other Chinese entities of different ownership structure (i.e., POEs and FIEs), Chinese SOEs present specific issues, including (1) complicated and interlinked motivations, (2) vague and indirect communication patterns, and (3) a two-level game decision-making process. These issues derive from the significant role the government plays in Chinese SOEs and from the complex transition period the SOEs are operating in and the various reforms they are carrying out. To address such issues, Western negotiators need to be fully prepared and equipped with relevant strategies at different stages of the entire process of negotiations.

Before the negotiation, it is vital to avoid stereotyping Chinese SOEs, to conduct a full-fledged background check of relevant Chinese SOEs and the current PRC condition, and to locate a trustworthy and sophisticated middle man or intermediary (whose functions can be very important in various stages of the negotiation). During the negotiation, Western negotiators need to remain patient and equip themselves with the magic "why" questions, while attempting to win the two-level game through various channels or paths, which can be pursued either separately or simultaneously as the context requires. After the contract is signed (usually following lengthy negotiations between the Chinese SOE and the Western firm), it is still too early to feel great relief. Western firms should be prepared for any after-contract renegotiation, and they should be prepared to resolve any conflicts using a Chinese approach, which is generally more effective, although a valid formal dispute resolution clause must be included in the contract as a possible last resort.

50. LAM & GRAHAM, *supra* note 4, at 197.

51. U.S. DEP'T OF COMMERCE, U.S. COMMERCIAL SERV., DISPUTE AVOIDANCE AND DISPUTE RESOLUTION IN CHINA 7 (2003), available at [http://www.export.gov/china/exporting\\_to\\_china/disputeavoidanceandresolution.pdf](http://www.export.gov/china/exporting_to_china/disputeavoidanceandresolution.pdf).

This paper serves as an initial effort to distinguish Chinese entities' negotiation styles by their ownership structure. Business negotiations between Chinese SOEs and Western firms were specifically analyzed due to the greater difference between these two entities (as compared with the difference between the other two types of Chinese entities—POEs and FIEs—and Western firms) and the fact that more business encounters between these two entities can be envisaged, given the Chinese SOEs' strength and ambition within the global economy. Given the limited scope of this paper, large-scale empirical research was not included. Rather, the paper's findings are based on interviews with several professional practitioners and business insiders.

With more empirical research in this sector, more in-depth and insightful findings can be drawn, which can hopefully contribute to increasing the understanding between Chinese SOEs and Western firms. In addition, further research into the specific negotiation styles of the other two types of Chinese entities (i.e., POEs and FIEs) will also help to generate a full picture of the Chinese entities' different negotiation styles based on ownership structure. Such continuing and deeper efforts in the area of Sino-Western business negotiation will facilitate the increasing of business transactions between Chinese and Westerners.

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