Making It in China
For U.S. companies working with Chinese partners, here's a crucial bit of advice: Don't let expectations get lost in translation

By ANDREW R. THOMAS, TIMOTHY J. WILKINSON and JON M. HAWES
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Any business relationship works best when both sides understand what the other expects. For U.S. companies working with Chinese business partners, that understanding can be particularly difficult.

The problem is that each side comes to the partnership with very different cultural and economic perspectives. Americans tend to view a business relationship as a win/win proposition -- a contract between two corporate entities designed for their mutual benefit in long-term profitability and growth.

In China, personal relationships among business partners are far more important, and the benefits foreseen in entering a partnership often are broader and focused more on the near term -- and not necessarily evenly balanced.

Any U.S. company that joins a Chinese partner without understanding these differences risks failure. The key to success is paying close attention to the relationship, both on a personal level and by implementing procedures to monitor the progress of the venture.

Several years ago, one of the authors of this article worked with a U.S. company in a nonexclusive partnership with a Chinese motorcycle manufacturer. That venture is a case study in the difficulties of a Chinese-American business relationship, and the importance of understanding and overcoming those difficulties.

Different Priorities
In the mid-1990s, a U.S. export-management firm established an alliance to purchase small motorcycles made in China, for sale to consumer markets in Latin America and Africa. The Chinese manufacturer agreed to produce motorcycles at its facility for export, while the U.S. company took charge of quality control, sales, distribution and after-sale service.
## FOR FURTHER READING

The related articles from MIT Sloan Management Review.

- **The Seven Disciplines for Venturing in China**  
  **By Ajit Kambil, Victor Wei-Teh Long and Clarence Kwan (Winter 2006)**  
  The authors identify seven disciplines critical to successful investment in China.  

- **Strategies for Competing in a Changed China**  
  **By Peter Williamson and Ming Zeng (Summer 2004)**  
  Multinationals must face the fact that the competitive edge that is potentially available to them from superior technologies, products and systems will be blunted unless they build stronger local competencies.  

- **What Quality Means Today**  
  **By Armand V. Feigenbaum and Donald S. Feigenbaum (Winter 2005)**  
  The continuous product and service innovation that is required to meet such heightened customer value expectations must stem from a culture of systematic management innovation, which in turn requires systematic leadership innovation.  

- **The Challenge for Multinational Corporations in China: Think Local, Act Global**  
  **By Seung Ho Park and Wilfried R. Vanhonacker (Summer 2007)**  
  Recent high-profile mistakes have shown that multinationals are not entirely up to the task in China.  

- **Blending Cultural Business Styles**  
  **By Larry Yu (Fall 2002)**

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### HOW TO KEEP A PARTNERSHIP ON TRACK

To keep a relationship with a Chinese business from drifting off course, U.S. companies need to implement procedures for closely monitoring the progress of a venture.

Two kinds of controls should be put in place: external controls, set up and executed with the cooperation of both parties, and internal controls, undertaken by the U.S. company without the explicit knowledge of the Chinese partner.

External controls include the following:

1. **SPECIFY PERFORMANCE STANDARDS.** Standards should exist for every objective that is critical to the success of the venture. For example, if the basis of the relationship seemed clear enough, but from the beginning there were unstated differences in what the two sides hoped to accomplish.

The U.S. executives assumed that their Chinese partners shared their focus on ensuring long-term profitability by pleasing the venture's distributors and customers with quality motorcycles. But from the Chinese perspective, the relationship with the U.S. firm provided multiple opportunities, some of which had nothing to do with the venture's long-term profitability.

Think back to the mid-1990s. China was desperately short of foreign currency. So, first and foremost the Chinese saw the relationship as a source of regular inflows of U.S. dollars. In addition, the Chinese executives were more interested in the venture for what they could learn than for what they could earn -- they saw the Americans primarily as teachers. The Chinese managers knew nothing about selling their motorcycles outside of China. Through their affiliation, the Americans provided the Chinese with market insights and knowledge the Chinese would never have been able to acquire on their own.

These differences in focus between the American and Chinese sides would emerge later, much to the detriment of the venture.

Since the mid-1980s, the Chinese manufacturer had been producing about 450,000 motorcycles per year, all for its domestic market, under a licensing agreement with a Japanese auto company. But the performance of the motorcycles was poor. To ensure higher quality for this new partnership's motorcycles, the U.S. partner insisted on the use...
When companies from the industrialized West conduct business in China, they often experience a clash in business cultures that may appear to force them to choose between the different styles of doing business, but new research shows this is not the case.

An important goal is to supply fast delivery of goods to distributors, a reasonable standard might be: "Manufacturer will deliver to customers within X business days of the receipt of a purchase order." Every standard should be measurable.

An aggregate measure of performance also helps keep a venture on track. This should incorporate several performance standards, each weighted according to both partners' opinions about the importance of the individual criterion.

• **CONDUCT PERFORMANCE AUDITS.** A mistake most companies make in a new business relationship is that they conduct performance audits only after problems arise. It is much better to conduct these audits regularly -- perhaps quarterly or annually, depending on the stage of the venture's development -- even when the relationship is going well.

Steps should be taken to avoid alienating the other party when conducting an audit. Hiring a mutually agreed upon and neutral third party to conduct the assessment can help. Managers should stress the fact that the purpose of the audit is to uncover mutual problems and to find solutions. Neither party should take on the role of a police officer who is attempting to identify transgressions and impose punishment.

• **ARTICULATE THE CONSEQUENCES OF UNACCEPTABLE PERFORMANCE.** It is critical to be specific in defining the consequences of unacceptable performance. Consider the benefits of the following contract language: "Upon failure to reach the agreed upon performance standards, Party X will transfer to Party Y all related and legitimate property, including trademarks, patents, company name, and lists of all other Japanese imports for key engine components, in place of the inferior Chinese-made parts the manufacturer had been using. Both parties agreed that the U.S. partner would send an observer for the purpose of quality control, including confirmation that the Japanese components were being installed in the bikes.

The observer was a Chinese-American who had returned to China to explore newly available business opportunities. He was retained for one week each month by the U.S. company. Every time a monthly production run was scheduled, the observer would make sure that the Japanese engine parts were used on the motorcycles to be exported.

This system worked well for five years. Nearly 250,000 high-quality motorcycles were profitably produced and sold. Customers were pleased with the...
customers and contacts."

OUTLINE

- DISPUTE-ADJUDICATION PROCEDURES. Any agreement must articulate what laws and procedures will govern the resolution of any disputes.

Internal controls include the following:

- PROTECT COMMUNICATIONS. Regular, clear communication between business partners is important, but sensitive information must be protected. It can be a grave mistake for companies to assume that their communications with partners in China are kept confidential.

- ENLIST DOUBLE-CHECKERS. Double-checkers are individuals who can check on a business partner's activities, like the observer who monitored the production of motorcycles in the case outlined in the accompanying article. This personal contact is of great value in China.

- BE PREPARED TO ANNUL THE RELATIONSHIP. There must always be, outside of the sight of the Chinese partner, a constant review of annulment contingencies and risks. Any partner that is unwilling or unprepared to walk away from a deal is highly vulnerable should the relationship turn sour.


A Rift Opens

At the beginning of the sixth year, the observer representing the U.S. partner quit. The American executives chose not to replace him, assuming that after five years of high-quality production, the Chinese would continue using the Japanese parts for the export motorcycles. This decision was made without consulting the Chinese.

A few months later, the U.S. company began to receive complaints from customers about the quality of the motorcycles. The problem was the same everywhere: The engine would run well for the first 200 miles or so, then it would begin to smoke and eventually the engine would seize up, rendering the bike inoperable. It was quickly determined that the Chinese manufacturer had substituted poorly made Chinese parts for the specified higher-quality Japanese-made components.

From the American perspective, this is where the relationship went bad -- when the Chinese began using inferior parts. From the Chinese perspective, however, the removal of the observer was where the problems started, because it signaled a major change in the relationship between the two companies. While the Americans had viewed this person simply as a quality-control monitor in an overseas factory, the Chinese looked upon him as the personal representative of the U.S. company within the Chinese operation. The disappearance of this person, with no explanation and no replacement, was seen as a breach in the relationship. No longer strictly bound by the terms of that relationship in their minds, the Chinese partners acted in their own self-interest, cutting costs to maximize their profits.

Frictions Worsen

Efforts to resolve the problem caused greater friction.

Confronted with several thousand motorcycles that would require replacement parts as well as major servicing in 15 countries, the U.S. partner calculated that $400,000 would be needed just to begin to deal with the problem. The Chinese manufacturer was consulted, and it was decided that customer credits should be issued to maintain the integrity of the brand. Because of stringent foreign-exchange controls in China, the U.S. partner issued the customer credits. Both parties then agreed that they would meet in Shanghai later that year to negotiate how to share these costs.

Prior to the meeting in Shanghai, the Chinese sent a fax demanding that the Americans provide comprehensive documentation for every customer complaint. The Americans objected, but the Chinese wouldn't budge. This angered the Americans, who felt that both sides understood that the Chinese were to
The Americans were further distressed to learn that before any negotiations could occur, they would have to verbally present their findings on each motorcycle. The presentations were scheduled over a four-day period. On the second day, after presentations had been made for only about 200 of the motorcycles, the U.S. side decided that they had had all they could take. The two Americans stormed out of the room.

As the Americans were walking out of the building, one of the Chinese managers tracked them down. The Americans told him that if this continued, they would never buy another motorcycle from the Chinese. The ultimatum worked, at least in one sense -- the Chinese executives agreed to at last begin discussing how to cover the $400,000 of customer credits.

After more than six hours of further talks, the Chinese executives offered to pay half of the $400,000. Incredulous, the Americans again staged an angry walkout. In a repeat of the day before, the English-speaking member of the Chinese team caught up with the Americans. He explained the Chinese position, saying that the Americans were one-half responsible for the defective motorcycles because they had allowed their Chinese partner to violate the arrangement by using Chinese parts.

Eventually the U.S. side agreed to split the costs evenly, but bad feelings remained on both sides. Again, the Americans had failed to appreciate the importance of personal relationships to the Chinese. Rudeness and anger are out of place in China and are considered embarrassing. By having a public tantrum, the Americans looked like barbarians in the eyes of the Chinese. In addition, the Chinese viewed the American demands as unreasonable because in their minds it was the Americans who devalued the relationship in the first place.

The problems between the U.S. and Chinese partners ultimately were resolved.

Mark Twain is quoted as having once said that "Nothing is as weak as a relationship that has not been tested under fire." With a better understanding of Chinese thinking and with close monitoring, American companies in ventures with Chinese suppliers can keep those inevitable fires from spreading out of control.

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Dr. Thomas is an assistant professor of marketing and the associate director of the Taylor Institute for Direct Marketing at the University of Akron's College of Business Administration, in Akron, Ohio. Dr. Wilkinson is an associate professor at the College of Business at Montana State University, Billings. Dr. Hawes is a distinguished professor of marketing and the director of the Fisher Institute for Professional Selling at the University of Akron's College of Business Administration. They can be reached at reports@wsj.com.

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