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**Trade With China:  
A Lesson for American Companies**

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**Presented in partial fulfillment of the requirements for  
the degree of**

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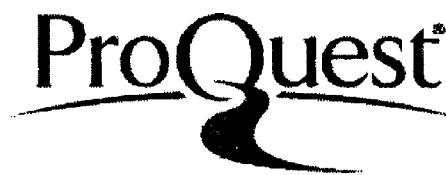


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# Trade With China - A Lesson For American Companies

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## Chapter I. Introduction.

### The Purpose of Study

For all corporations which may be considering doing business with a host country, especially with a developing country, a deep understanding of its economic and political system, that government's goals, priorities and trade policies, and the business cultural environment of the host country is very important.

The major purpose of this paper is to offer to American companies which would like to enter into and trade with China a better understanding of the cultural differences and the current economic condition between the U.S. and China. These include the background of China's "open-door" and "economic reform" policies, achievement, and the problems encountered in its recent economic development. This purpose can best be accomplished by reviewing the trade relationship between the U.S. and China in recent years, and in examining China's foreign trade policy, priorities, and particularly, the obstacles which some American companies in China have already experienced. The author intends to offer useful references to American companies to assist them in their decision-making process of potentially entering into and trading with China. Once American firms have decided to enter into trade with

China the process of negotiating with the Chinese, will most likely be the first and the most difficult step for them. Through identifying some particular cultural traits in the Chinese culture, which might reflect upon and influence any negotiation with the Chinese, this paper will also discuss some necessary adjustments which may prove helpful to American companies in negotiating tactics so as to enable them to gain the permission required to enter into trade with China and to ultimately reach contractual agreement.

There is a saying in The Art of War, an ancient Chinese military book which was written by Sun Tzu 2300 years ago, "Knowing one's own position and that of enemy guarantees victory in every battle."

Since the launching of its four modernization drives at the end of 1978, China has abandoned its self-reliance policy which had been observed during Mao's era and made a 180-degree turn toward becoming an important member of the international trading community. Since 1979, the value of China's trade with the rest of the world has grown substantially. By 1985, according to the statistics of IMF from a report dated June 1986, China's imports exceeded \$42.5 billion while exports exceeded \$27.3 billion,<sup>1</sup> almost six times the 1975 figure, making China one of the world's biggest developing-country markets. However, since the

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<sup>1</sup>G.A. Thoma, "The Structure of Trade Between the U.S. and China," Business Economics (October 1986):32.



policy of opening trade to the outside world, which was announced in 1978, China has become a major purchaser of grain, cotton, chemical fertilizers, metals, machinery, and equipment. With the opening of this new and huge 1.05-billion population market, and its continuous "Five-Year Plans," which have been set up by the Chinese government, many new business prospects have been opened up to the western world.

Since the normalization of relations and the establishment of formal diplomatic ties with the United States in January of 1979, more and more American companies rush to knock on the door of this vast attractive market. Some succeed but many succumb to disappointment. One of the major reasons for such frustration is that most American companies don't understand the characteristics and the problems of the Chinese economy and market. Factors such as the Chinese government giving the highest priority for high-tech products over consumer or low-tech products, the inability of American companies to exchange Chinese currency for hard currency, and the lack of experience in negotiating with the Chinese, particularly in regard to the impacts of Chinese cultural characteristics in the negotiating process, have proven to be difficult hurdles for American companies to surmount. In addition, the primary goal of American companies in doing business with China is to generate profits from selling in the Chinese market whereas the primary goal

of the Chinese government is to generate foreign exchange by encouraging exports from China. All of these are studied in the following chapters.

## Chapter II

### China's New Economy & Its Foreign Trade

To crack the challenging but lucrative Chinese market, China's new economy and its foreign trade must be understood. In order to adequately understand China's "open-door" policy, its current economic performance, its foreign trade policy, and to identify its current economic problems one must consider China's foreign exchange shortage, poor infrastructure, arbitrary price system, low labor productivity, political risk, and the nature of foreign competition. A thorough understanding of these factors is essential to an American company considering establishing itself in China.

#### **Open-Door Policy.**

To achieve the goals of modernization, and overcome the problem of shortage of capital, technology, and modern management skills, the best and most efficient way for China to grow economically is to open its doors and attract foreign investment, especially from American and Japanese companies. With this purpose in mind, China's "open-door" policy has resulted not only in the promotion of commercial trade but was also embodied the elements of obtaining and utilizing foreign funds and consultant services, training workers in

technical and administrative skills, and in addition, has led to the development of joint ventures, cooperative production, and compensation trade.<sup>2</sup>

Due to Mao's adoption of Stalin's model of a centrally planned economy, which emphasized the development of capital-intensive heavy industry over agriculture and light industry, many problems arose. These included sluggish agricultural output and low labor productivity, a weak hard currency position, sectoral disproportions, shortages in consumer goods, an inefficient system of planning and management, urban unemployment, and rigid, overcentralized bureaucratic structures and procedures. Mao's adherence to Stalin's model inevitably led to a deterioration of China's economic development.<sup>3</sup>

After Mao's death, China's economic policy has changed dramatically. In 1978, China opened up a large section of its bamboo curtain and an "open to the outside world" policy was declared. Since 1978, in the Chinese Communist Party's Central Committee, the post-Mao leaders have presented a series of economic reforms and readjustment programs, and have announced their desire to catch up with the industrialized countries with the avowed goal of turning

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<sup>2</sup>Jia Shi, "Future Prospects for Broadening U.S.-China Economic and Trade Cooperation," Columbia Journal of World Business Twentieth Anniversary Issue (1966-1986).

<sup>3</sup>Jan S. Prybyla, "China's Economic Experiment from Mao to Market," Problem of Communism (Jan.-Feb. 1986).

China into a major industrial nation by the year 2000. This extremely ambitious plan was going to be implemented through stressing the four modernizations: agriculture, industry, science and technology, and defense.

The essence of these new economic policies, according to Kent M. Wiedemann, a counsellor for economic affairs in the U.S. Embassy in Beijing, is aimed at introducing more market elements into the centrally planned economy and giving more autonomy to local governments and enterprises. This will result in the local governments and enterprises taking more responsibility for profits and losses, and taking a greater role in dealing with various economic activities such as recruiting, producing, pricing, and marketing more actively and efficiently. These new economic policies call for the application of market-determined pricing, differentiating wages, efficiency-oriented recruiting, and the encouragement of a free market, coupled with the attraction of foreign funds, technology, and management in order to promote greater productivity and efficiency. The goal then is to strengthen China's competitive position in the international markets in order to boost exports and earn necessary hard currency needed to pay for imports and finally to achieve the ultimate goal of modernization.<sup>4</sup>

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<sup>4</sup>Kent M. Wiedemann, "China in the Vanguard of a New Socialism," Asian Survey, Vol. XXVI No. 7 (July 1986):775-76.

### Current Economic Performance:

From the records of recent years, China's economic performance is far ahead of the long-range growth targets it set for itself. In the last five year plan (1981-1985), the actual annual growth in the gross value of industrial and agricultural output was 11 percent while the target annual growth rate was 4 percent. The data in table II-1 reveal additional details about Chinese economic performance relative to the last five year economic plan.

Table II-1

	Actual annual growth 1981-1985 (%)	Target annual growth 1981-1985 (%)
Gross value of industrial and agriculture output	11	4
Gross value of industrial output	12	4
Gross value of agriculture output	8	4
Gross national output	10	-
National Income	-	4

Source: Xinhua newsagency. (See Far Eastern Economic Review April 10, 1986)

By vastly exceeding its planned economic growth rate, the living standards in China (i.e., the consumption of

grain, edible-oil, pork, living space and the number of bicycles and TVs) have improved dramatically.<sup>5</sup>

#### **Current Economic Problems.**

There is no question, in the period of the last decade, China has become one of the fastest growing economies in the world. These achievements, according to premier Zhao Ziyang, are a result of reform, readjustment and open-door policies. However, this "open to the outside world" policy has revealed some economic problems which may seriously impede China's continued economic development and cool the investment enthusiasm of foreign companies. From the viewpoint of foreign companies which would like to enter the Chinese market, an ignorance of China's current economic problems might result in their investments proving unprofitable in the future.

#### **1. Shortage of Foreign Exchange:**

Due to the economic reform and the open-door policy, which gave greater control over economic decision making to local authorities and enterprises, and allowed them to retain a part of earned foreign exchange, the Beijing authorities' control over the expenditure of foreign exchange has been weakened. The large increase in imports in both industrial and consumer products by various local authorities and entities in recent years, has generated large deficits in

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<sup>5</sup>Far Eastern Economic Review (March 20, 1986):78.

China's foreign trade, and has led to a rapid reduction in its foreign exchange reserves.<sup>6</sup>

(US \$ Million)

	<u>1984</u>	<u>1985</u>	<u>1986</u>
<u>Trade deficits</u>	\$ 1,119	\$15,199	\$13,000*
Foreign Exchange Reserves:	16,800	11,900	10,500*

Source: IMF, International Financial Statistics (June 1986) SSB year book.

\*: Beijing Review figure.

Facing the continuing trade deficits and the decline in foreign exchange reserves, the central government has adopted more restrictive policies to control foreign exchange and import.<sup>7</sup> To reduce the trade deficit and the drain on foreign exchange reserves, China has recently adopted a two-year "ban" on "luxury" imports such as cars, color TVs, refrigerators and stereo cassette recorders, and has devalued its currency--Remminbi sharply against the U.S. dollar and Japanese yen to boost its exports.

Although China has undertaken stringent measures to reduce the loss of its foreign exchange reserves, according

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<sup>6</sup>"China's Open to the World," Problems of Communism (Nov.-Dec. 1986).

<sup>7</sup>Nanfang Ribao (Guanghou) (June 9, 1985):1; and Shijie Daobao (March 24, 1986):3. (See Problems of Communism (Nov.-Dec. 1896):64)



to Premier Zhao Ziyang, the shortage of foreign exchange will remain a major problem for a long time.<sup>8</sup>

## 2. Shortage of Raw Material, Energy, and Infrastructure.

Under the reform program, local governments and enterprises were given greater decision-making autonomy to initiate new investments and allocate the funds which they needed. In exercising this newly acquired right, although many positive results were created in many cases, a significant new headache which resulted from the local authorities' failure to adhere closely to the Central Government's guidelines was generated. The allocation of resources such as raw materials and electric power required by various newly constructed small and inefficient plants has unavoidably cut into the supply of resources needed to operate the existing more economical ones. This has resulted in many big and modern plants running below capacity. Due to the consideration of profitability and quicker returns, most local investments were concentrated on manufacturing and processing projects. Those projects, from a viewpoint of macroeconomics, became redundant and thus wasteful in resource allocation.<sup>9</sup>

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<sup>8</sup>Zhao Ziyang's reports to the National People's Congress delegates in March 1986.

<sup>9</sup>Nai-Ruem Chen, "Readjustment Remains Goal of China's Economic Policy," Business America (May 31, 1982):19. Also see "China's Economy," The Economist (August 1, 1987):3-22.

Energy and transport bottlenecks are another serious problem in the process of recent economic development. In 1985, due to the rapid growth in power demand and inefficient energy distribution, power shortfalls reached 50 billion Kilowatt hours (KWH). This shortage is nearly 10 percent below China's overall industrial growth. Although this situation has improved since early 1986, energy shortfalls will still plague the economy. In addition to the shortage of electric power, in 1986 raw coal output rose only 1.1 percent and oil production grew only 2 percent. This production level still lags far behind the 1986 economic plan target. Raw coal output was expected to rise 3.5 percent, and oil production to increase 4 percent.<sup>10</sup>

China's transportation and communication network needs to be expanded and simultaneously overhauled. So far, China still relies heavily on its vastly overburdened railway transportation system. In spite of efforts to improve the railway system by double-tracking, electrification, and dispatching most of the major rail upgrading projects are not scheduled for completion until 1990.<sup>11</sup> This will undoubtedly impede the economic growth of China.

As one of the important factors of the investment environment, the basic hardware infrastructures of energy,

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<sup>10</sup>"Foreign Economic Trends and Their Implications for the United States," American Embassy Beijing (October 1986):5-6.

<sup>11</sup>Business America (Nov. 26, 1984) p. 7.

transportation and communication, might necessarily be the first and most important considerations of foreign investors thinking of stepping into China's market. Just like Deng Xiaoping said, "For a number of years, the factors in our economy have been in imbalance," he said

We don't have enough electric power, for example, if you want to build more factories, how are you going to operate them without power? If we don't improve our transportation, how can we expand?<sup>12</sup>

### 3. Arbitrary Pricing-System & Low Labor Productivity.

Other serious problems which were exposed in the process of implementing China's economic reforms were its arbitrary pricing system and the low productivity behind its cheap labor. Both of them could have the effect of impeding one of the most important goals of China's open-door policy, the attraction of foreign investments. Unlike free market economies in which commodity prices are largely dependent upon the law of supply and demand China's central planned economy results in the arbitrary pricing of most commodities.

The shortcoming of this irrational pricing system has resulted in China's economy being divorced from productivity development and unrelated to international prices. Such a pricing system has certainly made it difficult for both foreign investors and Chinese enterprises to meet their cost control, production and marketing schedules. Thus, it is

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<sup>12</sup>Daniel L. Board and Herbert S. Levine, "China's Long Road to Large-Scale Trade," Business Week (May 28, 1979).

very difficult to set prices and forecast profits for their products or to make their long-term plans.

In fact, a new price reform was undertaken in the Seventh Five-Year Plan (1986-1990). To reflect the production costs and take into account the supply and demand forces in the economy, selective price increases have been allowed for commodities that are in short supply or whose production costs have risen sharply. Likewise, prices for certain materials and goods have been reduced to help producers reduce their inventories accordingly. In general, the scope of the state-controlled pricing structure has been reduced, and a more competitive pricing environment between buyers and sellers has resulted.

Obviously, price reform is very important and valuable in China's whole economic reform movement. However, so far, these more flexible pricing practices have been largely restricted to the overstocked and lesser important commodities. The government in many cases still plays a key role not only in the allocation of financial and human resources but also in intervening in the prices of essential industrial raw materials especially when the prices fluctuate too sharply.<sup>13</sup> Obviously, China has a long way to go to achieve a market economy through pricing reform since any

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<sup>13</sup>Luc De Wulf, "Economic Reform in China," Finance & Development, (March 1985):10.

such reform will necessarily have to be introduced cautiously and gradually.

The term "iron-rice bowl" is a traditional Chinese concept which refers to the job security of a worker hired by the government. Once hired the worker's job is secure and not dependent upon job performance. As an iron rice bowl is not subject to breakage neither is the Chinese government worker subject to termination of his employment. This term as used in China represents another socialistic policy which has led to low labor productivity nationwide.

As the birthplace of Confucianism, strictly speaking, China has gone even further than Japan in enmeshing family life with the workplace. In China,

The family whose head works for a large-scale state-owned enterprise will most likely live in enterprise housing, attend movies in enterprise auditoriums, send the children to enterprise schools, utilize enterprise health facilities, and expect at least one of the children to replace his or her parent upon the latter's retirement.<sup>14</sup>

Under this employment policy, an enterprise hires more workers than are needed. Once hired, a person is never fired. This is what the Chinese call the "iron-rice bowl." Undeniably, from a broad social viewpoint, the concept of the "iron-rice bowl" is a humane approach which the Chinese government has been proud of and considers to be superior to the attitude towards labor under capitalism. However, just

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<sup>14</sup>Kenneth Lieberthal, "China: The Politics Behind the New Economics," Fortune (December 31, 1979):49.

like a double-edged sword, this policy fosters inefficiency since firms cannot fire ineffective workers or lay off excess laborers. This results in lowered labor productivity and weakens the China's advantage of cheap labor in terms of attracting foreign investments.

#### 4. Political Risk:

Currently, there is an inherent internal political risk to China's open door policy. The power struggle between the reform group and its conservative opponents in the top levels of the Chinese Communist Party is still ongoing. Besides the difference between reform practice and rigid ideology, the conflicts between different interest groups in the party and government negatively effect the "open-door" policy.

Indisputably, during the past seven years, Deng Xiaoping and his leadership have made remarkable progress in economic growth and in improving the standard of living for the general populous through the open-door policy. Nevertheless, there have been some tradeoffs which in terms of political, economic, social and cultural adjustments which have had a negative impact on the country during the process of changing from a relative closed society to an open one.<sup>15</sup> The conservatives in the party have claimed that Deng has made a mistake in loosening the country's economic controls and

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<sup>15</sup>Huan Guocang, "China's Opening to the World," Problems of Communism (Nov.-Dec. 1986):74.

opening its door to corrupting foreign influences.<sup>16</sup> They have also complained that more and more smuggling, corruption, black marketeering, and many illegal activities which they called "evil winds" have increased significantly following the rapid and extensive foreign involvements in China in recent years.

In addition to these criticisms, the conservatives have also argued that the "open-door" policy has driven socialist China to the "capitalist road" and has resulted in the selling out of the country's sovereignty. So far, the reform group has been unable to fully conquer its opponents in the debate over party ideology, and has not been able to create a new ideology of sufficient strength to justify and legitimize its reform program and the "open-door" policy.<sup>17</sup>

Obviously, this political risk which results from the ideological conflict within the top level of the party might shake the confidence of foreign investors. As a result, they might hesitate while making long-term commitments in China. In fact, the foreign investment in the first two quarters of 1986 had declined 30 percent and there has been no growth in foreign investment or foreign commercial loans in the first quarter of 1987.<sup>18</sup> However, while more and more multi-

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<sup>16</sup>"China-on-a-Fence," The Economist (May 25, 1986):16.

<sup>17</sup>"China's Opening to the World," Problems of Communism (Nov.-Dec. 1986):74.

<sup>18</sup>Chinese Daily News (June 23, 1987):1.

national companies take into account the political environment of the host government as very important considerations in their foreign investment decisions, the continuity of the present policies and internal political stability will be one of the major determinants in the success or failure of China's economic reform and "open-door" policy. This is especially true while China remains so heavily dependent upon the development of foreign trade and capital investment.

#### 5. Foreign Competition:

Besides those domestic economic problems which have been mentioned above, China also faces various external challenges in the areas of exports and foreign investments which could impede its economic development.

To offset the trade deficit and earn more foreign exchange to meet the need of domestic development, more emphasis on expanding its exports is very essential to China's economy. However, despite the increase in exports over the past seven years, China still faces stiff competition from its Pacific neighbors such as Hong Kong, Taiwan, South Korea, and other new developing countries in tapping the international market. Unlike Taiwan and Korea, China may be entering world markets too late to achieve the growth that its rivals experienced in the 1960s and 1970s.<sup>19</sup>

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<sup>19</sup>"China's Push for Exports in Turning into a Long March," Business Week (September 15, 1986):66.



Due to the recession of the world economy global trade isn't growing as fast as in the two previous decades. Moreover, the advent of international protectionism among developed countries has made it more difficult for China to expand its exports.<sup>20</sup> So far oil and textiles accounts for more than 50 percent of China's exports. Unfortunately for China oil prices are falling while textiles face quotas in most major markets. In order to reduce the damage brought on by China's reliance on such a limited export base it is essential that it diversify its exports base through the adoption of various incentive policies aimed at increasing its exports.

With regard to attracting foreign investments, China also faces fierce competition from other developing countries, especially ASEAN<sup>21</sup> and Latin American countries. Based on their free enterprise systems these two geographic areas offer a more advantageous business environment in terms of business negotiation, management, manufacturing, and marketing than China does. In addition to these factors, various tax and incentive programs and business services also have been adopted by these governments to encourage the business climate. All of these have undoubtedly, led to a weakening of China's ability to attract foreign investments.

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<sup>20</sup>Huan Guocang, "China's Opening to the World," Problems of Communism (Nov.-Dec. 1986):60.

<sup>21</sup>Association of South-East Asia Nations includes: Malaysia, Singapore, Thailand, Indonesia, Brunei, and Philippine.

### Foreign Trade & Trade Policy:

Because of the policy of self-sufficiency in Mao's era, China's economy and the standard of living enjoyed by its people are still far behind the developed countries and even poorer than most developing countries. Likewise, its productivity and level of technology are relative low. Under this condition, in order to promote its economic development, foreign trade must be increased if China is going to acquire advanced technology, equipment, and materials for production and consumption.

Since the establishment of the "open-door" policy in 1979, the value of China's trade with the rest of the world has grown rapidly. The following data indicate the level of China's exports, imports and balance of trade in recent years.

Table II-2

China's Exports, Imports and Balance of Trade  
(Million of Dollars)

<u>Year</u>	<u>Exports</u>	<u>Imports</u>	<u>BOT</u>
1979	\$13,614	\$15,621	\$-2,007
1980	18,099	19,941	-1,842
1981	21,456	21,635	-170
1982	21,872	18,900	+2,972
1983	22,177	21,336	+841
1984	24,831	25,950	-1,119
1985	27,327	42,526	-15,199
1986*	30,900	42,900	-12,000

Source: IMF. International Financial Statistics (June 1986).

\*: Chinese custom statistics.

Between 1979 and 1985, the value of China's exports more than doubled and the value of imports increased by 172 percent. This represents a 13 percent average annual growth rate in exports and a 20 percent average annual growth rate in imports while the average annual growth rate of total trade in the period of 1950 to 1978 was 6 percent.<sup>22</sup>

Besides a significant increases in total trade value, over the past thirty-five years the composition of the commodities comprising China's foreign trade have also undergone profound changes. The data in figure II-1, showed the commodity structure of China's exports and imports in 1985.

As figure II-1 shows, the export of foodstuffs accounted for only 15.2 percent of total exports in 1985 while it accounted for 90.2 percent of total value in 1950.<sup>23</sup> Meanwhile, the exports of fuel and industrial products increased from 9.3 percent in 1950<sup>24</sup> to 72 percent 1985. This change in the ratio of foodstuffs to industrial exports reflects the magnitude of China's commitment to industrialization. As far as imports are concerned, the heavy industrial products represent the most important expenditure of foreign exchange, accounting for 62.2 percent of the value of China's imports.

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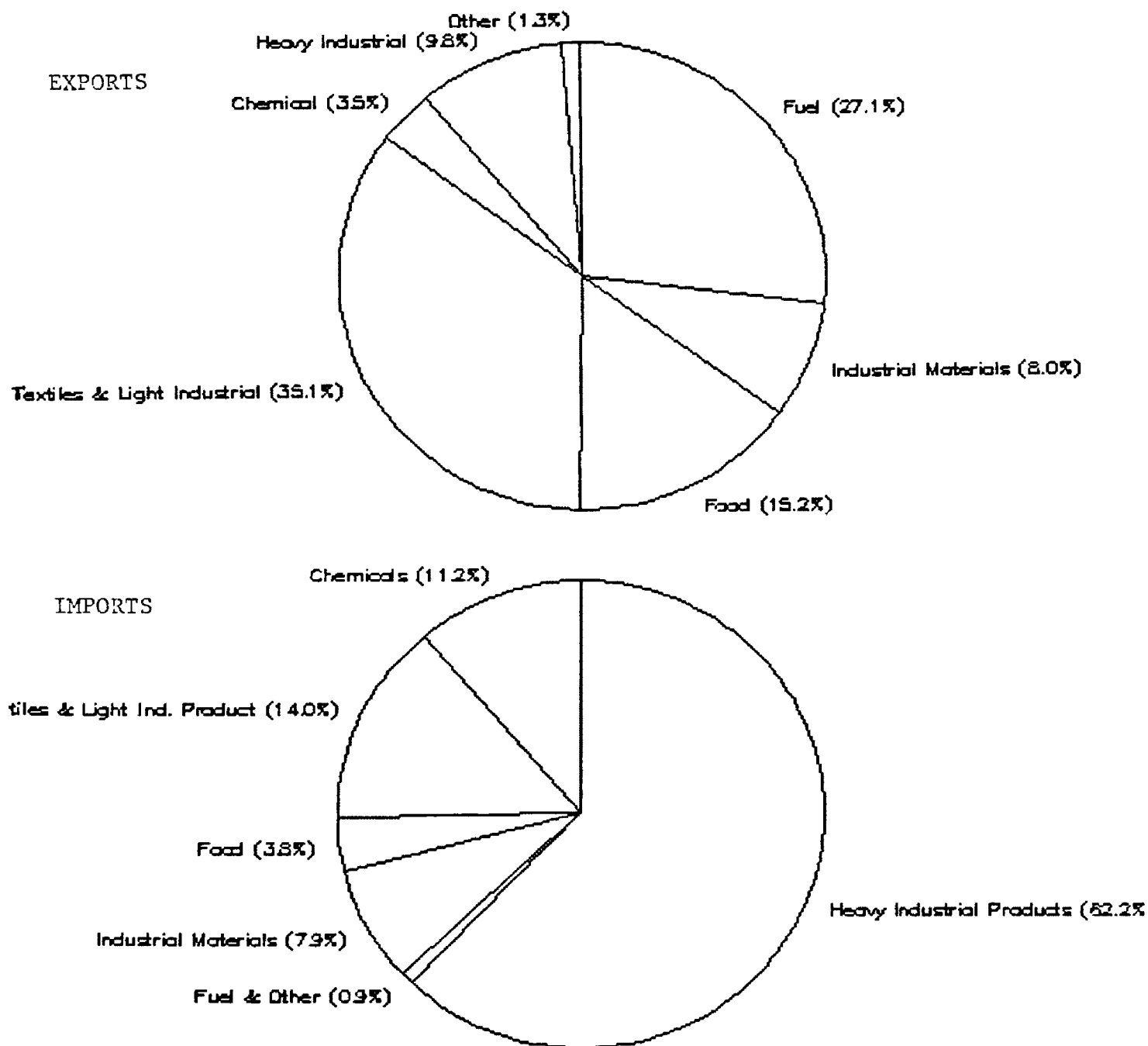
<sup>22</sup>Statistic Yearbook of China (1981):357.

<sup>23</sup>Ibid. p. 358.

<sup>24</sup>Ibid.

**Figure II-1**  
**China's Trade Structure**

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Source: China's Customs Statistics, Based on China's trade I-II Quarter, 1985. (See Business Economics Oct. 1986, p. 33.)

However, for a foreign company which is going to trade with China, understanding the trends in China's trade is not enough. Knowledge of China's foreign trade policy is more important since it reveals the priorities established by China in the area of foreign trade. Thus foreign firms cognizant of these priorities should be able to more effectively meet the demands of the Chinese market.

Briefly, China's foreign trade policy has three main characteristics.

First, imports are controlled by the government so that essential consumer goods and capital goods from abroad can be acquired in the process of modernization. Second, to obtain the foreign exchange to pay for the necessary imports, the Chinese government tries to direct and encourage the expansion of exports. Third, to ensure that the foreign exchange obtained from exports is used to pay for essential imports, the government controls foreign exchange by setting the exchange rate and monopolizing and regulating the trade of foreign exchange.<sup>25</sup>

During the past three years, China has steadily decentralized decision-making for export, while tightening control over imports. The government has encouraged local authorities, enterprises and even private individuals to conduct export business directly with foreign companies.<sup>26</sup> Through promoting exports, China can be expected to generate the foreign exchange earnings needed to satisfy the demand

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<sup>25</sup>George C. Chow, The Chinese Economy, (Harper & Row, Publishers, 1985):289-90.

<sup>26</sup>Liawang (Mar. 10, 1986) p. 12-13.

for the import of materials, equipment and technology required to achieve the goal of modernization.

As to trade priority, according to China's Seventh Five-Year Plan (1986-1990), priority in imports will be given to advanced technologies, key equipment and computer software, while exports will concentrate on textiles, processed foods, petroleum, coal, non-ferrous metals, and farm products. Foreign exchange earnings will be directed to key projects in the areas of energy, transportation, communication, machine building and electronics.

Strictly speaking, the "open-door" and "economic reform" policies during the past several years have proven valuable and successful.

It has brought a large measure of foreign capital, technology, equipment, and management skills to China, thereby speeding up China's transformation into a modern industrial society and narrowing the institutional disparity between the Chinese economy and the industrial market economies. It has, at the same time, strengthened China's position in the international market. In the long run, it will likely have a strong impact on the process of China's development and upon China's relationship with the outside world.<sup>27</sup>

Today, China's economy is facing various challenges from both domestic and international spheres. Continuous economic adjustments must be undertaken by the Chinese government in order to effectively respond to this changing economic environment. In fact, Chinese leaders have repeatedly announced that they would make certain policy adjustments to

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<sup>27</sup>Problems of Communism (Nov.-Dec. 1986):77.

assure that the "open-door" and "economic reform" policies would be kept intact.<sup>28</sup> In April 1986, the passing of the "Law of the People's Republic of China on Enterprises Operated Exclusively with Foreign Capital" revealed a greater concern by the Chinese government for enhancing the legal rights of foreign investors. This legislation specifically gives to fully foreign-owned enterprises the right to hire and fire employees,<sup>29</sup> and demonstrates that China's efforts to maintain its "open-door" and "economic reform" policies are bona fide.

In the long run, it is believed that the future of China's economic reform is bright as long as China continues improving its business environment to attract foreign investors. This end can be accomplished through a further reduction in party and government intervention in the business activities of enterprises. With less intervention foreign investors and local enterprises should be able to maximize the initiative, creativity and flexibility required to respond to the changing economic environment.

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<sup>28</sup> Renmin Ribao, (April 10, 1986):1 and (June 12, 1986):1.

<sup>29</sup> Liaowang (September 1, 1986):5.

## Chapter III

### Chinese-American Trade

By reviewing recent U.S. and China trading practices and identifying current obstacles facing American and Chinese trade in terms of negotiation, profit retention, legal environment, and business costs, it is believed that American companies can further understand the characteristics of the Chinese market, its potential priorities, its possible problems, and future trade prospects. Such a review would be helpful to them in making the decision to trade with China.

#### Review of U.S.- China Trade.

The first trade between China and the United States was started in 1784. The first American vessel to enter the China trade was the Empress of China. It sold American furs, ginseng, and silver dollars in Canton in exchange for tea, silk, and porcelain.<sup>30</sup> From that time on, China has been an important American customer until the outbreak of the Korean War in 1950. In 1972, the United States canceled its embargo against China. Of greater importance than cancelling the embargo, however, was the establishment of diplomatic

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<sup>30</sup>John D. Daniels, Jeffery Knig, and Douglas Nigh, "U.S. Joint Ventures in China," California Management Review (Summer 1985).



relations between the two countries in January 1979. This normalization of relations enabled these two governments to reach various important agreements necessary for normal economic commercial relations. As a result, the U.S.-China trade was rapidly and greatly facilitated. So far, the United States is the third largest trade partner of China while China is the largest communist market for America.<sup>31</sup>

For most American companies, especially those which already have a substantial presence throughout most of the world, the Chinese market represents the greatest potential untapped market remaining for them. After all, it would be imprudent for them to ignore a market which makes up a quarter of the world's population.<sup>32</sup> The management of Nike Corporation, the shoe manufacturer, sums up the feeling of many American firms when considering trade with such a vast, untapped market when it contemplates the potential sale of shoes to one billion pair of feet. Many other American firms have similar "China dreams."<sup>33</sup>

Aside from the size of the Chinese market, from a viewpoint of global competitive strategy, American companies should not wait too long to attempt entry into the Chinese market particularly because Japanese firms have already

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<sup>31</sup>Business America (October 5, 1981):18.

<sup>32</sup>"U.S Joint Ventures in China," California Management Review (Summer 1985).

<sup>33</sup>"Nike in China" case by Harvard Business School (1985).

preempted them to some degree in gaining a market leadership position in China. In addition, it would be worthwhile for American companies to tap China's cheap labor force in order to compete more effectively with Japanese firms in United States and other markets.<sup>34</sup>

On the other hand, because of America's leadership role both on the international political and economic stage, by trading with the United States, China could effectively strengthen its position in the international economic community, and obtain management skill, advanced technology and equipment more easily.

As a result of the "normalization of relations" and the "open-door" policy, during the period 1979-1986, China-U.S. bilateral trade demonstrated extraordinary growth. This growth in trade grew from a level of \$2.3 billion in 1979 to \$8.3 billion in 1986. The data contained in table III-1 shows the amount of imports and exports in U.S-China trade during this period.

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<sup>34</sup>"U.S Joint Ventures in China," California Management Review (Summer 1985).

Table III-1

U.S Trade With China  
(Millions of Dollars)

<u>Year</u>	<u>U.S. Exports</u>	<u>U.S. Imports</u>	<u>BOT</u>
1979	\$1,731	\$ 594	\$1,137
1980	3,821	1,075	2,746
1981	3,624	1,892	1,732
1982	2,920	2,284	636
1983	2,173	2,243	-70
1984	3,016	3,114	-98
1985	3,950	3,821	129
1986	3,106	5,241	-2,135

Source: Survey of Current Business.

During this period (1979-1986), U.S. exports to China have fluctuated year to year but nevertheless are significantly greater than they were in 1979, growing from \$1.7 billion in 1979 to \$3.1 billion in 1986. On the other hand, China's exports to the U.S. have grown steadily with the exception of one year (1983), growing from \$594 million in 1979 to \$5.2 billion in 1986. According to Chinese statistical data, in 1985 the United States supplied 12.2 percent of all Chinese imports, second only to Japan. In that same year the United States purchased 8.3 percent of all Chinese exports, third after Japan and Hong-Kong. In 1986, bilateral trade between the United States and China earned China \$2.13 billion in foreign exchange. In comparison, during the same year Japan experienced a huge trade surplus from its trade with China. As can be seen, the United States

has been an very important trading partner of China from a balance of trade standpoint.

However, in terms of total U.S. trade, China is still a relatively small trading partner. U.S. exports to China in 1985 were only 1.8 percent of the value of total U.S. exports. U.S. imports from China in 1985 accounted for 1.2 percent of all U.S. imports. China was the 16th ranked U.S. trade partner in that year.<sup>35</sup>

Besides the rapid growth in total trade value, the normalization of U.S.-China relations and China's aggressive foreign trade policy has made the commodity composition of bilateral trade change significantly. Data on the composition of U.S.-China trade during 1985 is shown in table III-2.

**Table III-2**  
**U.S.-China Trade, 1985**

<u>Commodity Group</u>	<u>U.S.</u> <u>Imports</u>	<u>Percent</u>	<u>U.S.</u> <u>Exports</u>	<u>Percent</u>
Food & live animals	\$157.17	4.1	\$103.23	2.7
Beverage & tobacco	5.00	0.1	1.24	---
Crude materials	125.81	3.3	567.60	14.9
Mineral, fuel & lubricants	985.99	25.5	2.19	0.1
Oils & fats	1.00	---	0.53	---
Chemicals	162.86	4.2	513.12	13.5
Manufactured goods	656.36	17.0	359.80	9.5
Machinery & transport.	90.97	2.4	1,919.39	50.5
Misc. manufactures	1,633.50	42.3	313.43	8.3
Other	43.00	1.1	16.04	0.4
<b>Total</b>	<b>\$3,861.67</b>	<b>100.0</b>	<b>\$3,800.15</b>	<b>100.00</b>

Source: U.S. Department of Commerce, Import, Export, FT 155.455 (1985).

<sup>35</sup>"Foreign Economic Trends and Their Implications for the United States," American Embassy Beijing in October 1986.

Table III-2 indicates that U.S imports from China in 1985 were concentrated in "mineral fuels & lubricants," "manufactured goods," and "miscellaneous manufactures," which together represented 84.8 percent of imports from China. U.S. exports to China in 1985 were concentrated in "crude materials" and "machinery & transport equipment," which together accounted for 65 percent of exports to China. Compared with the early years of the "open-door" policy where agricultural commodities were a dominant factor in U.S-China trade structure,<sup>36</sup> this significant change in bilateral trade structure reveals China's substantial progress in the promotion of industrial output. It is believed that with the development of its economic structure, coupled with its low labor costs that China might replace the four small dragons of Asia: Korea, Taiwan, Hong-kong, and Singapore, in supplying more and more low and middle level products to the American markets. On the other hand, America's exports of chemicals, specialized machinery, computers, energy generating equipment, transportation and communication equipment will continue to boost the Chinese need for further economic development.

#### **Obstacles to Trading with China.**

While the business environment has been improved especially in the area of hardware construction by the

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<sup>36</sup>In 1981, for example, agriculture represents 54.4 percent of U.S. export to China and 35.6 percent of total value.

Chinese government, and bilateral trade has reached a historic high of \$8.3 billion, more and more American companies are beginning to complain that the Chinese government has not paid enough attention to improve its software in the business environments. Specifically, negotiation style, bureaucracy, foreign exchange rules and the legal environment are problems. Because Chinese government inattention to these factors American companies have experienced increased difficulties in doing business in China.

#### 1. Negotiation & Bureaucracy.

As the first step in entering into and trade with China, negotiation may be the toughest hurdle for foreign companies to surmount. Negotiating in China is confusing because China often does not clearly identify its authorized negotiator. Furthermore, successful negotiations do not always receive approval.<sup>37</sup> In recent years, many American companies have been frustrated with the length of time required for their Chinese counterparts to make decisions, and have been puzzled about with whom they are to make contact. "Indeed, it wasn't unusual to negotiate for months without ever knowing who the real Chinese buyer or seller was,"<sup>38</sup> said by one veteran foreign trader.

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<sup>37</sup>"Foreign Economic Trends and Their Implications for the United States," American Embassy Beijing (October 1986).

<sup>38</sup>The Wall Street Journal Wednesday, April 3, 1985.

Bureaucracy is one of the major reasons why negotiations in China often prove to be inefficient. Since the "economic reform" from 1979, there has been a more open and realistic business atmosphere in China, but it doesn't mean doing business there is any easier, even for the Chinese themselves. With regard to the world's oldest bureaucracy, an officer of China's National Light Industrial Products Corporation complained, "It takes us months sometimes years--to do what other countries can accomplish quickly, because we common people have little power against bureaucratic regulations."<sup>39</sup> On the other hand, even though decision-making has been decentralized in recent years, many local authorities and units which might have the full authority to make a trade decision, are still confused about what approvals must be obtained before a deal is completed. As a result, this tends to make negotiations long and difficult.<sup>40</sup>

## 2. Profit Retention.

A rising problem in U.S.-China trade in the two most recent years is the retention of profits in China. Funds shortage, for most developing countries, has always been a major problem in their economic development. China has faced the same problem. Its foreign exchange which is necessary for

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<sup>39</sup>Fortune (December 31, 1979):51.

<sup>40</sup>Richard H. Holton, "Marketing and the Modernization of China," California Management Review (Summer 1985).

foreign trade has been substantially decreasing in recent years. During the past two years, many American firms have complained about the difficulty of converting profits made in China into the hard currency.

In China, most consumers spend only nonconvertible domestic currency--Remminbi--for goods found in local stores. This Chinese currency cannot be traded in the international currency markets. Under this condition, for those American companies which sell successfully in China, the acquisition of more and more remminbi has been a big burden for them. George Liu, president of Asian Operations for General Foods exclaimed

We could be selling three to four times more Maxwell House instant coffee in China, but the more I sell, the bigger the hole I dig for myself . . . I'm ending up with a lot of renminbi.<sup>41</sup>

To solve this problem the Chinese government has encouraged American companies to reinvest their profits and expand their production in China and wait for China to earn enough foreign exchange to trade for local currency.<sup>42</sup> In addition, some American companies also has been induced to go into unrelated export businesses such as Pepsi Cola's entering the Chinese marble export industry.<sup>43</sup> Through buying and selling Chinese goods, especially raw materials in

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<sup>41</sup>"Playing the China Card," Forbes (April 7, 1986).

<sup>42</sup>"China's Open to the World," Problems of Communism (Nov.-Dec. 1986).

<sup>43</sup>"The Long March," Forbes (December 15, 1986).



the international markets, American companies are allowed to hold the hard currency they have earned, thus enabling them to convert their excess renminbi.

Such encouragement, however, can only make the situation worse. American companies are left with the uncomfortable feeling of being forced to keep their profits in China as well as having to deal with the uncertainty of entering into unrelated industries. For a coffee or soft drink company, can you imagine asking it to sell Chinese coal in the international market? There are marketing problems, storing and shipping problems, pricing problems and quality problems, which they have never met before. The big question for such a company is can they sell the product successfully?

### 3. Legal Environment.

Until the new emphasis on law that began in 1979 with "open-door" policy, there were no fixed legal systems in China, especially during the period of the Cultural Revolution. During this period, law was subservient to party policy and in response to Chairman Mao's assessment of the "revolutionary situation." Even in 1980, according to a report, there were only twelve lawyers in Beijing. That equated less than one lawyer for every 200000 people.<sup>44</sup>

To attract foreign investors, numerous laws such as the "joint venture law" and the "law of the PRC on enterprises

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<sup>44</sup>Peter and Alexis Nahenkis, "China's Law on Joint Ventures," California Management Review (Summer 1980).

operated exclusively with foreign capital" have been enacted during the past seven years. However, they are still not explicit enough to make foreign companies feel secure in terms of what is to be expected.<sup>45</sup>

American companies complain that the Chinese laws are "too vague and too general."<sup>46</sup> They also complain that current Chinese legal institutions cannot provide them the guarantees and rights that accompany a comprehensive or complete legal process. Furthermore, they argue that the laws are not detailed enough to cover all issues and contingencies encountered in doing business.<sup>47</sup>

In general, the absence of qualified lawyers, proper courts, predictable and guaranteed judicial procedures, coupled with the lack of intellectual property protection<sup>48</sup> has shaped an uncertain legal environment for foreign companies. This lack probably result in the lowering of Americans' confidence and deters American companies from doing business with China.

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<sup>45</sup>Rudy L. Rnggles, Jr., "The Environment for American Business Ventures in the PRC," Columbia Journal of World Business (Winter 1983).

<sup>46</sup>The Asian Wall Street Journal (March 17, 1986):4.

<sup>47</sup>"China's Open to the World," Problems of Communism (Nov.-Dec. 1986):68.

<sup>48</sup>Business America (May 11, 1987):22.

#### 4. Business Costs.

Cheap labor doesn't necessarily guarantee low business costs. Due to a rapidly increasing inflation rate, relatively high wages which result from excess labor and low productivity, and incomplete market structures, the cost of doing business in China today has increased significantly. Moreover, the office rents in China are extremely expensive. In fact, they are almost twice as high as those charged in Hong-Kong's central business district.<sup>49</sup> As a result, many foreign companies have quietly begun retrenching. Notably, in recent months, both IBM and Westinghouse have either reduced staff or closed up offices outside Beijing. "We were spending too much on office leasing in Shanghai . . . . You could go bankrupt if you don't retrench with the times" says Westinghouse China's L.C. Saunders.<sup>50</sup>

#### Future Prospects of China-U.S. Trade.

Specific areas of discontent in trading with China, including lengthy negotiations, complex bureaucratic procedures, uncertain and changing regulations, high business costs and unconvertible profits, all of which have been mentioned above, coupled with the shortage of foreign exchange and extremely low per-capita income (\$350 in 1986), dim future prospects for American investment in and trade with China. Today the Chinese population, whether living in

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<sup>49</sup>Business America (June 23, 1986):7.

<sup>50</sup>"The Long March," Forbes (December 15, 1986).

urban or rural areas, no longer lives in starvation. The Chinese people live better, eat better and dress better. Nevertheless, in terms of consumer products market, it is unlikely, at least in the short terms, that China will be a significant market for most American companies. Obviously, since most Chinese earn an average of thirty U.S. dollars per month, it is very difficult to afford American-type consumer products such as compact cars, elaborate stereo equipment, or microwave ovens. On the other hand, it is also not very easy for China to penetrate the world's largest and most competitive consumer market--U.S.A--overnight. It will take a long time for China to develop products attractive to the American consumer and to develop competitive marketing skills.<sup>51</sup>

However, there are also some bright spots for American companies. Because of America's technological leadership and given China's continued commitment to the development and technological modernization of its economy, potential exists for the growth of U.S. exports in the priority areas of energy, transportation, telecommunications, computer technology, chemical fertilizers, specialized machinery and lumber.<sup>52</sup> "Those are areas in which American industry is particularly competitive and where the Chinese have expressed

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<sup>51</sup>"China's Law and Joint Ventures," California Management Review (Summer 1980).

<sup>52</sup>G.A. Thoma, "The Structure of Trade Between the U.S. and China," Business Economics (October 1986).

a clear preference for U.S. equipment and technology" states Eugene K. Lawson, deputy assistant secretary for East Asia and the Pacific, U.S. Department of Commerce.<sup>53</sup> From a viewpoint of long-term strategic consideration, it is probably a good strategy for American companies to remain in China and increase their efforts to strengthen relationships with various Chinese authorities and units, with the goal of reaping rewards from this market when the time is ripe.

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<sup>53</sup>Philip Maher, "Outlook Brightens for Trade with China," Business Marketing (July 1984):106.

## Chapter IV

### Chinese-American Trade Negotiation

As the first step in attempting to enter the Chinese market, negotiating has proven to be the most severe problem faced by most American companies in seeking to establish a trading relationship with China.

Since China announced its "open-door" policy in 1979, many American companies have rushed to knock on the door of this huge but unfamiliar market. Unlike Japanese and Hong-Kong companies, most American firms have unfortunately more often than not failed to reach real contractual commitments since they have little or no knowledge of Chinese negotiating practices, particularly of the role played by Chinese cultural factors in their negotiating process. In fact, this weakness in negotiating skill is not unique to American firms attempting trade in China. According to an estimate of the U.S. Department of Commerce, for every successful American negotiation with the Japanese, there are twenty-five failures. One of the major reasons for this extremely high

failure rate is most American companies' ignorance of the Japanese cultural background.<sup>54</sup>

Unquestionably, successful agreements will prove the beneficial to both the interests of the Chinese and American companies. However, the impasses in negotiations which result from the differences in priorities and cultural backgrounds of both sides can also impede successful transactions.

Briefly, negotiation is the process in which two or more entities with different needs and viewpoints come together to reach an agreement of mutual benefit through a series of introduction, explanation, discussion and mutual compromises.<sup>55</sup> In fact, a successful commercial negotiation could be viewed as an art because it includes the interplay of various physical and psychological skills to reach a "win-win" situation in which both sides feel they are the winner in the process. This situation is not easily achieved. Many factors such as a negotiator's notion, attitude, behavior and methods he uses may change the outcome from a "win-win" to "win-lose" or even worse to a "lose-lose" situation in the negotiation.<sup>56</sup>

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<sup>54</sup>Lennie Copeland and Lewis Griggs, Going International: How To Make Friends and Deal Effectively in the Global Marketplace (1985):72.

<sup>55</sup>Philip R. Harris and Robert T. Moran, Managing Cultural Differences (Gulf Publishing Co., 1979):55.

<sup>56</sup>Ibid. p. 59.

### Cultural Influences on Negotiation.

No doubt, negotiation is profound. However, negotiating cross-culturally is more complicated.

A negotiation becomes cross-cultural when the parties involved belong to different cultures and therefor do not share the same ways of thinking, feeling, and behaving. All international negotiations are cross-cultural.<sup>57</sup>

There are many differences in negotiation style from culture to culture. There is no uniform negotiating style that can be used effectively in every cultures. Negotiating style varies with the various cultural conditions which one encounters. Culture, according the anthropologist, is "that complex whole which includes knowledge, belief, art, law, morals, customs, and any capabilities and habits acquired by a man as a member of society." Culture also is

the collective programming of the mind which distinguishes the members of one human group from another . . . the interactive aggregate of common characteristics that influences a human group's response to its environment

in some managers' eyes.<sup>58</sup> As a product of their own culture, peoples' thoughts, attitudes, behavior, and value concepts are varied. It is difficult at best to isolate cultural factors as a separate category when involved in commercial negotiations since they influence all actions of the counterparts in the process. As an example the negotiating style of

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<sup>57</sup>Nancy J. Adler, International Dimensions of Organizational Behavior (Wadsworth, Inc., 1986):151.

<sup>58</sup>Ibid. p. 8-9.



an Arab is necessarily different from that of a Japanese. Likewise, the negotiating style used in capitalistic countries also cannot be fully applied in communistic countries.

Since cultural differences between two entities can lead to misunderstanding and lack of trust, cross-cultural understanding has become very essential for success in conducting international negotiations. By identifying the specific cultural differences which might affect the negotiation process and contrasting the cultural biases of both sides, a negotiator may be able to make proper adjustments of attitude, behavior and tactics. If adopted at the right time a negotiator may be able to eliminate the contingent misunderstandings inherent in the cross-cultural negotiation process.

In recent years, American companies which have negotiated with the Chinese have begun to understand the differences between the negotiating style in China and that in other countries. Unquestionably, the negotiation process between American companies and Chinese enterprises is complicated. This results not only from the difference between the political and economic systems of these two countries, but also is a result of the impact of cultural differences between them. According to Dr. Lucian W. Pye, a specialist on Asian affairs and also an expert in negotiating with the Japanese and Chinese,

the largest and possibly the most intractable category of problems in Sino-American business negotiations can be traced to the cultural differences between the two societies. Inevitably, frustrations and misunderstandings arise in the meeting of representatives from two such different cultures as China and America.<sup>59</sup>

Basically, unlike the American culture which is thought of as highly individualistic, efficiency and legally-oriented, the Chinese culture tends to emphasize broad base harmonious personal relations. The outgrowth of this cultural characteristic in the negotiating process is the Chinese negotiator's emphasis on group loyalty, sincerity, trustworthiness, friendship and mutual benefit. The emphasis placed on all of these cultural factors by Chinese negotiator can lead to a lengthy and inefficient negotiating process. This in turn results in a direct conflict with American cultural values which are reflected in the American negotiating style. As a result, misunderstandings, frustrations and complaints arise.

#### **Special Cultural Differences & Suggestions For Dealing With Them**

##### **1. Collectivism.**

The Chinese, like most people in communist countries, are generally seen as collectivist, while Americans are thought of as stressing individuality over conformity. Individualism is a philosophy wherein people think of themselves and their immediate families as individuals and of

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<sup>59</sup>Lucian W. Pye, Chinese Commercial Negotiating Style (Rand Co., 1982).

paramount importance. Individualism tends to thrive in cultural environments where social frameworks are loosely knitted.<sup>60</sup> People in such a society rely on less social or group considerations in their decision-making, and have more authority and greater latitude in pursuing their individual values. On the other hand,

Collectivism is characterized by a tight social framework in which people distinguish between their own groups such as relatives, clans, and organizations and other groups. People expect their groups to look after their members, protect them and give them security in exchange for members' loyalty.<sup>61</sup>

For example, in a collectivist culture, people easily obtain jobs because they come from the right family or social class while in a individualistic culture people obtain jobs because they have the right education and work experiences.<sup>62</sup>

Based on the difference between collectivist and individualistic cultures which are typically reflected in the negotiation process, the Chinese negotiating style inevitably tends to be more lengthy, secretive and tougher than the American negotiating style. Chinese negotiators, in contrast to American negotiators, have less authority and must consult with their superiors more frequently. Some of their decision-making must also be guided by national priorities and

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<sup>60</sup>Nancy J. Adler, International Dimensions of Organizational Behavior, p. 36.

<sup>61</sup>Ibid.

<sup>62</sup>Ibid.

interests. On the other hand, American negotiating style places greater stress more on efficiency and is expertise-oriented. Decisions for American negotiating teams are often made by the person who has the most experiences and authority in a given area. American negotiating teams see group decisions and bureaucratic approvals with which their Chinese counterparts must adhere as inefficient and unnecessary impediments to reaching agreement.<sup>63</sup>

Obviously, with the influence of collectivist and individualistic cultures, the authority of decision-making can be varied. "For American negotiators, anything is O.K. unless it has been restricted."<sup>64</sup> However, for Chinese negotiators, the rule of thumb seems to be "nothing is permitted unless it is initiated by the state."

In dealing with this philosophy of collectivism of the Chinese negotiator, patience is the best policy for American companies if they truly desire to enter into successful agreements. Although American companies may be frustrated with the length of time required for their Chinese counterparts to reach group decisions and concomitantly may be confused as to who has the decision-making authority on the

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<sup>63</sup>Edward Beliaev, Thomas Mullen, and Betty Jane Punnett, "Understanding the Cultural Environment: U.S.-U.S.S.R. Trade Negotiations," California Management Review, Vol. XXVII No.2 (Winter 1985); and Philip R. Harris and Robert T. Moran Managing Cultural Differences (Gulf Publishing Co., 1979):672.

<sup>64</sup>Philip R. Harris, and Robert T. Moran, Managing Cultural Differences, p. 76.

opposite side, it is not very useful to complain that the Chinese are tough, bureaucratic, or inefficient. American companies should realize that the decision-making style of Chinese negotiators are frequently influenced by the state or state ideology. Any delay on the Chinese side might not be the result of personal negligence or willful sabotage but result solely from constraints inherent within the system.<sup>65</sup> On the other hand, impatience on the part of its negotiators can lead American companies to a misunderstanding of a Chinese negotiator's real intent thus queering a potential deal.

## 2. Time.

Sense of time may be varied in different cultures. Some cultures pay much attention to time while some do not pay heed to time at all. This difference in time concept can also influence the negotiating pace. Interestingly, American say a clock "runs," but for the Chinese, a clock doesn't run, they say a clock "walks." Most American managers who have had dealings with the Chinese would agree that somehow a clock runs slower in China.<sup>66</sup>

Generally speaking, Americans are seen as time-conscious. They treat time as a valuable, tangible and

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<sup>65</sup>N.T. Wang, China's Modernization and Transnational Corporations (D.C. Heath and Co., 1984):127.

<sup>66</sup>John Frankenstein, "Trends in Chinese Business Practice: Changes in the Beijing Wind," California Management Review (Fall 1986).

limited asset<sup>67</sup>. Americans always think "time is money." Therefore, they arrange time, budget time and set deadlines for various activities. Most Americans attempt to do their best to meet these deadlines. In contrast, time does not seem so important to the Chinese. In fact, Chinese lack the concept that time is money. Furthermore, they take pride in being patient. Even in the Confucian Annalects, it is stated that "the faster you speed, the less you achieve." In Chinese daily life, the people use many vague terms such as "the time for finishing a cup of tea," and "already a while" to describe a length of time. Americans typically use more clear and concise words such as "a couple of minutes," or "ten minutes ago" to describe a length of time. In Taiwan there is a joke, "if you arrive at a banquet or party at the time designated on an invitation, you are not a real Chinese." All of these customs relating to time reveal that the Chinese attitude toward the value of time is much more lax than that of Americans.

The difference of time concept between Chinese and American negotiators make the American side look particularly impatient in the process of negotiating. American negotiators often expect the negotiation process to be completed as quickly as possible. They think that the Chinese take an inordinate amount of time before consummating

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<sup>67</sup>Lennie Copeland and Levis Griggs, Going International (1985):8.

a deal. To the American this is wasteful. However, for the patient Chinese negotiator, any quick decision-making represents carelessness. If decisions are reached quickly the Chinese feel they may forget something or may fail to gain more favors from their American counterparts. Chinese negotiators seldom set an exact schedule or deadline for themselves in the negotiating process. Time is very flexible for them as long as they can take advantage of it. This is also a major reason why American companies should take much more time in negotiating with the Chinese. According to a survey of U.S. firms which conducted business in Beijing in 1984, 66 percent of the American managers agreed that the U.S. did not have any control over the time and pace of business negotiation. Furthermore, 60 percent felt that the Chinese did not keep well informed about schedules.<sup>68</sup>

To cope with the Chinese slow pace and the home court advantage held by the Chinese, American companies should allot sufficient time for the negotiation process to be conducted pursuant to Chinese custom. American negotiators, instead of setting a strict deadline for themselves, should attempt to maintain a flexible time plan to cope with any contingent delays in the negotiation process. For most American businessmen who are used to driving a car in the United States, it may be necessary to park the car and ride a

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<sup>68</sup>John Frankenstein, "Trends in Chinese Business Practice," California Management Review (Fall 1986).

bicycle in China. If an American businessman's pace is not slowed down he will find that he is distancing himself from his Chinese counterparts.

### 3. Communication.

All negotiation activity involves communication. In the negotiating process, both sides exchange meanings through words, language, and body signs. Cross-cultural communication occurs when people from two distinct cultures attempt to communicate. The greater the difference between these two cultures, the greater the chance for cross-cultural miscommunication.<sup>69</sup>

Due to its complex character structures and its extreme variety in nuances of meaning, the Chinese character and language are generally seen as a mystery to Americans. In many cases, it has been discovered that translation from Chinese to English and vice versa are extremely difficult. This difficulty has led to misunderstandings and misconceptions between Chinese and American negotiators. For example, in the Shanghai Communique of February 28, 1972, which was issued jointly by the United States and China, the key word "acknowledge" used therein resulted in a disparate meaning for both sides. The English version stated that "the United States acknowledges that all Chinese on either side of the Taiwan Strait maintain there is but one China and that

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<sup>69</sup>Nancy J. Adler, International Dimensions of Organizational Behavior, p. 51-53.



Taiwan is a part of China." According to the interpretation given to this word by the United States it was intended to merely take note of the Chinese position without necessarily agreeing to that position. However, in the Chinese version, the word "acknowledge" not only means American understanding of the Chinese position but also implies that the United States agreed with this position.<sup>70</sup>

Body language represents another communication style. The signals it conveys are also varied under different cultures, and frequently lead to misunderstanding. In the process of negotiating, to give face to American negotiators, the Chinese may nod frequently and say "yes, yes" while Americans talk to them. This probably means "yes, I have heard you" but not necessarily "yes, I agree with you" or "yes, I understand you." On the other hand, the Chinese "No" does not necessarily mean the same as an American "No." For example, to answer a question such as "Don't you agree?" or "Don't you understand?", in Chinese, in a person does not understand he will say "yes" while in English the answer would be "No."<sup>71</sup> In general, there is a tendency for Chinese to be indirect and vague when conveying their meanings in face to face negotiations while Americans prefer a direct and clear communication style.

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<sup>70</sup>N.T. Wang, China's Modernization and Transnational Corporations (D.C. Heath and Co., 1984):114-73.

<sup>71</sup>Ibid. p. 114-15.

To eliminate the possibility of miscommunication in negotiating with the Chinese, it is suggested that an overseas Chinese.<sup>72</sup> who is familiar with the English language and American business practices be included on American negotiating teams. While an American may study the Chinese language and attempt to understand more about Chinese culture in an attempt facilitate communication with the Chinese, it is doubtful whether an American could ever communicate better than could a Chinese person. According to Lin Yiu Chu--a consultant of Chinese government in international business, an overseas Chinese has an edge over American businessmen for the following reasons. First, communication is easier and misinterpretation can likely be eliminated because both parties speak Chinese. Second, misunderstandings and misperceptions are not so likely to occur when communicating since both parties share a common cultural heritage. In negotiating, an overseas Chinese can easily understand some particular silent Chinese languages and certain shades of meanings. American negotiators on the other hand can not fully understand or glean such meanings from a "guide book." Too, the Chinese side has a tendency to privately seek out any ethnic Chinese associated with an American team who they believe is likely to want to see China prosper and who would

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<sup>72</sup>The Chinese who live in the overseas countries, such as the Chinese in Hong-Kong, Singapore, or the United States.

possibly be sympathetic to China.<sup>73</sup> Under this condition, having an overseas Chinese on an American team would probably provide a short-cut in coping with the communication gaps in negotiating with the Chinese.

#### 4. Legal Concepts.

Chinese, traditionally, are averse to litigation. "It is better to be vexed to death than to get involved in a lawsuit," said Confucius. Instead of viewing the legal system and litigation as a protection of ones interest and a resolution of disputes, lawsuits are seen as shameful, face-losing, and dishonorable to the Chinese. American companies seeking to do business in China have found that they lack sufficient legal protection in their business dealings with the Chinese. When contracting with the Chinese, instead of using strictly legal words to regulate the duties and obligations of both sides, the Chinese prefer more harmonious and gentle phrases such as "negotiate and consultation" and "amicably settled through negotiation."<sup>74</sup> When disputes occur, the Chinese believe that their resolution should be sought through the negotiation process in order to achieve conciliation. They do not desire nor do they seek to resolve their disputes in the legal forum. The decision as to who is right or wrong is not left in the hands

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<sup>73</sup>Lucian Pye, "Chinese Commercial Negotiating Style" (1982); see summary xi.

<sup>74</sup>Peter and Alexis Nehemkis, "China's Law on Joint Venture," California Management Review (Summer 1980):37-41.

of the courts. Although more and more institutionalized legal systems have been developed in China, the cultural practice of stressing harmony and conciliation still reflects the Chinese anathems for litigation.<sup>75</sup>

In business negotiations, Americans prefer to base the rights and obligations of the parties on written contracts. This preference is predicated on the fact that they believe in and trust the legal system to enforce their written agreements assuming of course that the contract sought to be enforced has been signed by all parties involved. According to Richard N. Cooper--an officer of Commercial Department of the United States, "Americans want to write everything down; we are a very legal-minded society."<sup>76</sup> In fact, Americans make more of an effort to procure executed contracts than they do to develop meaningful relationships with their counterparts. On the other hand, the Chinese do not see a signed contract as the most important achievement at the end of the negotiation process. The Chinese like to establish long term relationships with their counterparts since they see the stability of a contract not so much in terms of the power of strict regulations nor in the enforceability of its terms but in the strength of the human relationships between both sides. In the Chinese concept, commitments between people, not commitments to contracts are of paramount

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<sup>75</sup>Ibid.

<sup>76</sup>Business Week (May 28, 1979):133.

importance. The major element involved in the honoring of contracts is their trust of and respect for the people with whom they are doing business.

Since China does not have a strong legal system to govern the enforceability of contracts, American negotiators, instead of being rude by insisting on their own contract terms, should be flexible and attempt to adapt to Chinese norms and practices. An American negotiator's ultimate goal should be the establishment of long-term relationships. When negotiating with the Chinese, business should not be the only topic discussed, Americans should discuss other topics such as Chinese art, history, culture, scenery, and especially the progress of current Chinese economic development. Americans should also view luncheons, dinners, receptions, ceremonies and tour invitations during breaks in the negotiation process as a time for the building interpersonal relationships.<sup>77</sup> Since the Chinese place great emphasis on trust and mutual connections, it would behoove American companies to negotiate not just for a one time deal. The potential of establishing long-range relationships would be much more important and valuable than merely inking one contract.

#### 5. Face-Saving.

While the concept of "face-saving" is important in most cultures, the Chinese culture is much more sensitive to it.

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<sup>77</sup>Nancy J. Adler, International Dimensions of Organizational Behavior, p. 168.

To the Chinese, "face" not only means pride, dignity and respect, it can be more important than life. In a Chinese proverb, there is a saying, "A man can be killed, but cannot be shamed." Shame has traditionally been used by the Chinese as a way of making someone "lose face." The Chinese can probably can afford anything, but they just cannot afford "losing face."

The concept of "face-saving" varies significantly between different cultures. A little mistake or a feeling of inadequacy on the part of an American, might be deeply felt, be shameful or be humiliating to a Chinese.<sup>78</sup> For example, when American companies send a low or middle level management personnel to take part in a negotiations with the Chinese, Chinese negotiators might feel angry and "lose face" even though the American negotiators have been given full authority by their company to make a decision. This negative feeling may be particularly reenforced when there has been a higher executive involved in negotiations on the Chinese side. Too, reasonable claims which are viewed as normal business practices by American firms, such as returning a defective product, may also be taken as a hurt of pride and dignity by the Chinese, thus making the Chinese side feel that American companies do not give them face.

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<sup>78</sup>Lennie Copeland and Lewis Griggs, Going International, p. 11.

In addition, the Chinese notion of "saving-face" can also influence the Chinese response in the negotiating process. To save their face while they are seeking concessions from their counterparts, and to give the opposite side face while they are intending to reject a deal, the Chinese tend to respond indirectly and vaguely. This response from the Chinese most definitely can give rise to confusion and misperception among the American negotiators when negotiating with the Chinese.

With more understanding of Chinese sensitivity to the problem of "face-saving" in the negotiating process, it is believed that American companies could more easily build a better relationship with their Chinese counterparts in the negotiating process. By helping the Chinese negotiators to win face, American negotiators could effectively put themselves in a better position. On the other hand, a potential deal can be lost if the Chinese negotiators feel that they have been affronted or slighted during the negotiating process. This result may occur even though the American side had the best of intentions.<sup>79</sup> Negotiators for American companies should be very careful in their attitudes and words in order to avoid making Chinese negotiators feel uncomfortable, defensive, and worse yet lose face. In fact, a successful negotiator, according to many experienced

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<sup>79</sup>Lucian W. Pye, Chinese Commercial Negotiating Style (1982):89.

international negotiators, is the one who treats the person on the other side with respect and fair play.<sup>80</sup>

## 6. Friendship.

Friendship is a very important factor in the establishment of business relationships around the world. This is especially so in China, as friendship implies a very special meaning for the Chinese. In fact, friendship to the Chinese can sometimes be more important than the relationship between a husband and wife or between parent and child. The Chinese attitude of placing greater emphasis on friendships can be proved by many Chinese history and proverbs. Such as "never reject or regret going through fire and boiling water to save a friend" and "for friendship, it is worth it to have knives inserted in both sides of your rib cage." Also, "A friend coming from afar is one of life's most happy events" and "let friends share your carriage and furry coats for free, and never regret sharing them even if they are wore out when returned" are sayings attributed to Confucius and Yen Hui, one of the most respected disciples of Confucius. These too, reflect the traditional Chinese attitude toward friendship.

Since China opened its doors in 1979, many American executives in China have perceived that the Chinese are very serious about the spirit of "friendship first, business second" when doing business with foreign companies. For

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<sup>80</sup>Going International, p. 91.



foreign companies, "friend of China" implies sincerity, trust, patience, understanding, and sometimes certain sacrifices. This is always the first step in establishing long-term business relationship with the Chinese.

Since the difference in the way of viewing friendship between Americans and the Chinese in terms of attitude, value, and expectation is so dichotomous an understanding of this difference can have a great impact on the business negotiations between Americans and the Chinese. American executive in China would probably agree that it is easy to make friends with the Chinese and to call them old friends rather than new friends after even a short acquaintance.<sup>81</sup> The Chinese are very sensitive about how foreign companies treat them. They desire to be treated as equals and with respect like they treat their own friends. Under this condition, the best policy for American businessman to adopt when conducting business in China would be to attempt to become the kind of friend the Chinese admire. This would include being and doing what a Chinese person would do for a friend. On the other hand, in the negotiation process, Chinese expectations of what friends should be willing to do for each other frequently lead Chinese negotiator to make exaggerated demands on their counterparts. If the Chinese negotiator is not satisfied with the way in which he is being

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<sup>81</sup>Steven R. Hendryx, "The China Trade: Making the Deal Work," Harvard Business Review (July-August 1986).

treated or even feels that he is being mistreated his reaction will be one of anger and hostility.<sup>82</sup> This result benefits neither side of the bargaining table.

Nevertheless, winning of "Waigou Penyou" (foreign friend) in negotiations with Chinese is to be highly recommended. American firms should understand and accept the Chinese offer of friendship in the spirit in which it is extended.<sup>83</sup> Through patience, sincerity, trust and respect for the Chinese side, and the granting of more munificent terms in relation to price, service, or parts, American negotiators could effectively build a friendly relationship with their Chinese counterparts. Efforts made by American negotiators to this end might result in American companies obtaining an exclusive niche in the Chinese business community as a reward from the Chinese side. Such a niche, in many cases, has proven to be worth more than the time and money taken to obtain it. However, as stated by an executive of First Chicago Bank in China, "the Chinese recognize, and are very serious about one thing: If you are their friend they will not forget you."<sup>84</sup>

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<sup>82</sup>Lucian W. Pye, Chinese Commercial Negotiation Style (1982):20.

<sup>83</sup>Harvard Business Review (July-August 1986):80.

<sup>84</sup>Management Review (May 1983):18.

## Chapter V

### Conclusion

Regardless of market size, cost-saving or global competitive strategies, to American companies, trading with China is attractive, and in fact, unavoidable and will prove to be lucrative in the long run. Thus, understanding China, which includes understanding its economic condition, trade policies, business operating environment and cultural traits which profoundly affect business negotiation is absolutely a key requirement for American companies seeking entry into and trading with China.

China is not a "big sleepy dragon" any more. This big dragon has awakened and is taking big, ambitious strides toward the twenty-first century. Due to the failure of the Stalinist type centrally planned economy, and the painful experiences stemming from the "Cultural Revolution," China decided to adopt "open-door" and "economic reform" policies in 1978. Through giving more autonomy to enterprises and introducing market elements, foreign funds, technologies, and modern business management, China expects to invigorate its depressed economy and achieved the goal of four modernization.

Since 1979, there has been tremendous progress in China's economy. Over the past eight years, the real average growth rate in foreign trade has been twelve percent while the annual growth rate in GNP has been six percent.<sup>85</sup> The living standard in China has improved significantly. However, irrespective of those praise worthy achievements, China has faced some problems including the lack of hard currency, low productivity, insufficient energy and infrastructure, arbitrary pricing system, ideological resistance from conservative group, and foreign competition. All of these may substantially impede the further development of China's economy, and reduce the confidence of these American companies considering entry into China. Unless the "open-door" and "economic reform" policies are further promoted and the business operation environment is continuously improved, China may not achieve the performance which it has experienced heretofore. However, these policies seem to have been guaranteed by the China government. According to Premier Zhao Ziyang, "In terms of opening China to the outside world, our guiding principle is not "closing" but "opening," is not "staying still" but "moving forward." The already opened door of China can only be opened wider and will never be closed again."<sup>86</sup>

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<sup>85</sup>Joseph Battat, "China in 2010: Strategic Considerations," Business Horizons (July-August 1987):5.

<sup>86</sup>Zhao Ziyang, "The Opening of China," Atlantic Monthly (December 1984):24-25.

Based on the "open-door" policy and the establishment of diplomatic relations, the U.S-China trade has grown rapidly. Although China may not provide a market for most American type consumer products in the short-term, with Americans' leadership in technology and market share there exists a broad range of opportunities for American companies in the area of computer technology, energy generation, transportation and communication, and chemicals. Although entry into the Chinese market may prove to be profitable, it must be recognized that there exist some obstacles which have shaken the confidence of American companies in this market. There are, notably, lengthy negotiations, unconvertible profits, an immature legal environment, and high business operating costs.

To enter into and trade with the host country, cross-cultural negotiation may proved to be the most important and the most difficult hurdle to surmount for a foreign company. After all, any ambitions or plans of corporate management may become illusory if negotiator fail to win an agreement at the bargaining table. In the process of negotiating, cultural differences between both negotiating teams can have a deep impact on the outcome of negotiating. Since various people adopt different attitudes and behaviors to survive under their particular circumstance, cultures vary with the environment. There is no "good" or "bad," and "weak" or "strong" cultures. Each cultures has its own

logic, so it is necessary to understand that any melding of two cultures is not achieved through conflict but through compromise.

When negotiating with the Chinese, American negotiators should put themselves the shoes of their Chinese counterparts. By adopting this approach of imagining what the Chinese mind is thinking in American negotiators can learn to cope with and succeed in bridging the cultural gaps which most assuredly influences the negotiation process. Basically, the Chinese culture is human relationship-oriented. The Chinese place a greater emphasis on harmonious group consensus and long-term relationships. With this in mind, six elements--collectivisation, the Chinese concept of time, legal environment, friendship, and face-saving, all of which influence Chinese negotiating style, are delineated analyzed and compared with these inhering in American culture. These cultural traits, reflected in negotiating process, frequently result in lengthy, inefficient negotiations, the ignoring of the legality of a contract, vague and indirect communication style, and exaggerated demands on a friendship.

To cope with these cultural gaps, it is suggested that American companies should show greater respect for the Chinese decision-making process, be patient with the Chinese pace, accept and understand the Chinese philosophy of friendship, give face to the Chinese negotiators, and

establish a lasting business relationship with honesty, sincerity, and equanimity. In addition, having an overseas Chinese on American negotiating team to help facilitate communication in the negotiating process should strongly be encouraged.

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