CHALLENGES FOR INTERNATIONAL JOINT VENTURES IN POST-WTO CHINA

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Abstract

China's recent entry into the World Trade Organization has given foreign companies greater opportunities to expand their customer base and increase their global market share. With high hopes many foreign firms are jumping into this unique market without really knowing the difficulties that lie ahead. China's cultural traditions have the potential of causing more barriers to the success of these US firms than the country's entire system of foreign regulations. Foreign investors are largely choosing to enter China's market through joint ventures with Chinese partner firms. Assuming such an alliance will only help assimilate the foreign firm's into China's marketplace, their managers neglect to examine the possible problems that can exist for joint ventures involving companies of these culturally dissimilar countries. Not only will this paper will expose the relative pitfalls for foreign firms when engaging in joint ventures with Chinese firms as partners, it will also address why these problematic issues exist.

1. Introduction

China's vast market and huge supply of cheap labor have been attracting foreign investors for years. Since 1978, when Deng Xiao Ping declared his Open Door Policy, China began its gradual reversal of its long time isolationist and anti-capitalist economic ideologies allowing foreign companies to participate in China's business realm. Its rapid economic growth has increased the purchasing power of the Chinese people, thus transforming the country into a sizeable consumer market, with over 1.2 billion people or 25% of the world's population.

With China's recent entry into the World Trade Organization (WTO), the number of foreign firms planning to enter China's market is expected to increase dramatically. According to latest statistics released by China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC), actual foreign direct investment (FDI) in China reached a new high of US$46.85 billion in 2001 (outdoing 1998's record of US$45.46 billion), as investors build up confidence in the market following its accession to WTO. [1]

Any foreign investor's major goal is likely to be maximizing profits and market share with the least amount of risk. Although many foreign firms would like to operate with total control via a wholly owned subsidiary, the laws, politics, cultural differences and uncertainties associated with Chinese business operations tend to make joint ventures with local Chinese partners a more attractive entry strategy. After all, studies have suggested that there are many benefits of cross-border joint ventures, such as their ability to provide opportunities for rapid geographical market expansion, creating economies of scale, risk reduction, learning new skills and technologies, and facilitating effective resource sharing.[2]

Many of the benefits associated with joint ventures can be attributed to the synergies formed between each firm's competencies. What one firm lacks, the other may be able to contribute. In this sense, differences among the firms may actually be beneficial to the joint venture. Besides reasons associated with low cost supplies and ease of business setup, a fundamental premise for foreign firms entering China is that a domestic Chinese partner will be able to provide the core skills and knowledge of Chinese business practices that the foreign firm would find very difficult to obtain on its own.

What obstacles do foreign, particularly western, firms encounter when they adopt joint ventures for entering the China market? Why do such problems exist? These are the main questions that the present study seeks to answer. Much has been written about the problems faced by foreign companies that joint venture with state-owned enterprises in China. These problems include: choosing the wrong partner, misalignment of business vision or strategy, unanticipated costs due to government and foreign exchange issues, human resource issues and weak management controls.[3] The present study, however, suggests that the problems facing joint ventures with Chinese enterprises stems from fundamental differences in culture. Such differences, in turn, may cause the other problems, such as those mentioned in the other studies.

This study will start with a brief overview of the culture in China. Against this backdrop, the study will review the research on joint ventures in China, particularly those that addressed the cultural issue directly or indirectly. Next, the cultural differences between China and the West are highlighted using a popular cultural framework. This paper will show how cultural differences can lead to problems in a joint venture. Furthermore, it is argued that China's status as an emerging market may aggravate the underlying cultural problems. The study will conclude with some salient lessons for U.S. and Western managers on how to view and evaluate joint ventures in China.

2. The Chinese Culture

China remains a mystery to many investors, particularly from the West. Its social, governmental and economic systems appear particularly complex to Western businessmen. Many of the organizational systems in China have been founded upon, and continue to be influenced by Confucian ethics and tradition. Therefore, an understanding of Confucianism is extremely important in the firm's assimilation into Chinese societies. The influence of Confucian values on Chinese culture and practices is highly significant because it has created an environment very distinct from that of the West. Confucianism is not so much a religion as it is a code for social conduct that is highly dependent upon trust. Confucian beliefs cover broad principles in the interpersonal relationships among family, society, and political and business matters. In brief, the Confucian ethic cultivates a different type of capitalism, emphasizing the sense of personal discipline, personal cultivation, cooperation and consensus formation. As relationships guide the understanding of Confucianism, they have also come to be of great importance in understanding Chinese business practices.

Chinese business dynamics are highly impacted by the cultivating, maintaining and developing of guanxi (connection or relationship) by the Chinese people. Guanxi binds people through the exchange of favors and often enables one to get what one needs, which would otherwise not have been available. As one author wrote, "Chinese guanxi construction can be characterized as an ego-centered social engineering of connection network building."[4] It provides a kind of convenience and benefit that is often not available through official systems. Guanxi networks bind millions of Chinese firms into social and business webs, largely dictating their individual success.[5]

There is a strong inclination on the part of the Chinese to trust only people related to them by way of family of guanxi.[6] The Chinese typically do business only with people that they know and trust, foreigners are therefore hindered from such networks. Guanxi remains a dominant strategy that the Chinese consciously and unconsciously emp loy to maximize their resourcefulness in business operations. Being an outsider to such networks, US businesses should realize the invaluable asset that guanxi can provide for their ventures in China, thus making a domestic Chinese partner even more attractive.

China's social uniqueness has not prevented foreign businesses from investing in their business markets. A large portion of China's economic development can be attributed to the many international joint ventures established within the past few years. In 1999, China was actually the world's most active joint venture market.[7] The alliances formed through these ventures have greatly helped the country in adopting new technologies and management skills. But the results have not been as beneficial for many of the U.S. firms that participated in these past joint ventures. Besides their reported high dissolution rate, U.S. businesses also reported other adverse affects such as involuntary loss of potential revenue, uncompensated transfers of technology, and many operational difficulties. Such publicized results have prompted U.S. firms to doubt their reasoning that joint ventures are the best way to enter China's business world. With more and more US firms considering entering the China market because of the country's admittance into the WTO, firms need to be well informed of the risks, as well as the benefits associated with their potential entry strategies. Therefore, before relying on the assumption that joint ventures are the wisest entry mode, managers need to further explore the negative aspects of joint ventures for U.S. firms as they choose to compete in China.

3. Review of Literature

Prior research relating to joint ventures in China has revealed that "differences in culture" is viewed as an issue of primary importance. For example, one study stated that, "cultural difference may create ambiguities in the relationship, which may lead to conflict and even dissolution of the venture."[8] The main objective of the study was to determine which differences in national culture were most disruptive for international joint ventures (IJVs). The study cites that the incidence of IJVs increases with cultural distance (as explained through Hofstede's dimensions – see discussion below).[9] This was confirmed as there was a significant cultural distance between U.S. and China, thus explaining why there were an overwhelming amount of joint ventures involving the two countries. The study concluded that the effects of uncertainty avoidance and long-term orientation had the greatest impact on decreasing the chances of a joint venture's success. The study also stressed that differences in values embedded in national cultures continue to lead to dissolutions of IJVs.

Another study focused on the effect of national culture on joint venture dissolution as well, but it incorporated organizational complementarity and economic motivation as other contributing factors.[10] The study's purpose was to illustrate that the more culturally distant two firms are, the greater the differences in their organizational practices, economic expectations, and interpretation of strategic issues. The study addressed other hindering factors such as differences in the two firms'sizes, ages, and technology contributions. But its basic findings reaffirmed the importance of the firm's national culture as being a primary cause of asymmetry in various parts of an international joint venture.

Conflict resolution was the focus of a joint venture study by Lin and Germain.[11] It too suggested that how IJV partners manage daily operations resolve internal conflicts was largely affected by how similar the partners were culturally. But, this study stated that the success of the IJV was determined by how effective the partners could resolve their conflicts. The study found that when the cultures between partners were more similar, they were able to adopt a more cooperative, problem-solving strategy to resolve disputes. On the opposite end, culturally dissimilar partners hesitate to communicate and exchange information and thus rely more on legalistic forms of conflict resolution such as involving formal institutions or using legal and written documents. The legalistic forms of conflict resolution were said to reinforce a lack of trust between the partners, causing further problems regarding issues of control. It was also reported that because legalistic forms of conflict resolution have a "win-lose" orientation, they seemed to cause more dissatisfaction among IJV partners. The interviews for the study revealed the general opinion of IJV managers that, "frequent reference to legal contracts was viewed as coercive by the other partner and as poisoning what may have been a trusting environment". Thus by connecting conflict resolution to culture, this study also reaffirmed the findings that IJVs are more likely to be successful when partners perceive themselves as culturally similar.

Other studies were more focused and concentrated on culture in terms of its effect on joint ventures in China specifically. In looking at the influence of national culture on firm performance, one study cited specific characteristics that were common to typical Chinese firms. The study noted that because East Asian culture is characterized by "long term orientation", or focusing on the future more than the present, there is a strong preference for long term rather than short term business relationships. It was noted that this may cause problems for Western firms, as they may not care to invest the great lengths of time in developing such relations, instead they expect immediate action. Another great difference noted was that firms from Oriental cultures may operate with a higher debt to asset ratio, because of their networks with local banks. Other characteristics such as importance of family, value of moderation, pursuit of harmony and external center of control support the study's hypothesis that joint ventures with partners from similar East Asian cultures experience better communication and working relationships than those with Western partners.[12]

Not all of the previous studies' findings relate to the problems caused by general cultural differences in joint ventures. A study by Si and Burton noted that dissatisfaction with the results of joint ventures in China is rising, and suggested that this may be caused by "lack of understanding of the knowledge needs of the partner companies."[13] The study found that Western partners' new information needs differ substantially from those of their Chinese counterparts. After conducting extensive interviews, the study found that Western firms seek to learn about the Chinese market and how to compete in it, while Chinese firms desire knowledge about relevant new technologies or management skills. The differing knowledge goals were said to be influenced by the presence of different classes of businesses within the same industry, a legal system radically different from those in most Western countries, and the influence of guanxi (personal relationships) in China. Therefore, if the partners were not willing to agree on the amount of time to devote to meeting each other's knowledge acquisition goals, poor performance is likely to result.

More than anything, the above studies underscored the importance of culture in the performance of international joint ventures. Of course, government regulations, previous experience, and the type of industry involved are important factors that will also affect the success of an IJV. But these are issues of fact, they are parts of the country or the company that do not require a decision. On the other hand, a US company considering entry into the China market has options with regards to entry strategy. The above studies imply that international joint ventures may be a recipe for poor performance rather than success if China and the US are culturally dissimilar. Knowing that these two cultures are in fact quite distinct, managers of US firms should carefully evaluate the implications of adopting a joint venture strategy with a Chinese partner firm.

The study by Si and Bruton addressed only one problematic issue for such ventures, thus leaving many others to be examined. The present study will not focus on one specific type of problem associated with U.S.-Chinese joint ventures in China; instead it will provide a general evaluation of their potential pitfalls.

4. Hofstede's Cultural Dimensions

As the above studies suggest, cultural differences may cause many problematic issues for international joint ventures. Therefore when considering U.S.-Chinese joint ventures in China one must first look at the various ways in which the two cultures differ. Only after understanding their cause, can the specific problems associated with these ventures be examined. A widely used framework for analyzing and understanding cultural differences is Hofstede's four primary dimensions of culture: power distance, individualism, masculinity, uncertainty avoidance.[14]

By examining the cultural differences between the United States and China through Hofstede's dimensions, we can address specific business problems that they may cause for an IJV. In addition to these dimensions of cultural difference, it is important to recognize that China is classified as an "emerging economy". This may also have an effect on the goals its domestic companies have when becoming a partner in a joint venture with a U.S. firm. Therefore it is another issue that must be explored as a potential for further problems in such alliances.

Power distance can be described as "the extent to which the less powerful members of organizations and institutions accept and expect that power is distributed unequally." The United States has a low power distance, whereas China has a very high power distance. The United States with its foundations from Protestant ethic, has produced a society built upon the beliefs of equality and freedom. China, with its Confucian foundation, has developed a society in which there is a father figure at the head of every organization. The people of the Chinese Confucian society act according to the father, or leader's direction, and it is expected that they will not contradict his authority.[15] This primary difference in culture is reflected in leadership styles of typical U.S. and Chinese firms.

Based on their traditions of hierarchy, Chinese managers predominately make decisions using the "top-down" approach and maintain considerable distance in relations with their subordinates. This may cause managerial problems if the U.S. manger prefers to use a more "bottom-up" approach, which allows for the consideration of the opinions of varying levels of staff when making decisions. And, how will the venture decide which managerial style to adopt? A study by Yan and Gray found that firms that contribute more critical resources will have more bargaining power, and therefore more control of the joint venture.[16]

But, even if the U.S. firm in the IJV is the partner with the greater majority power and is able to control the management style, there may still be problems that stem from the difference in power distance. Considering joint ventures operating in China, the employees available will most likely adhere to Confucian ethics and demonstrate behavior that supports the ideals of high power distance. Chinese are very loyal to individuals rather than the firms itself. This may cause problems if the U.S. partner replaces a former Chinese manager with one from the US, as the Chinese employees are likely to still adhere to the direction of the former manager rather than accept the authority of the new one. Thus power distance alone can be the source of many managerial differences among U.S. and Chinese business leaders.

Individualism is another dimension of cultural differences that may have a great impact on U.S.-Chinese joint venture success. This dimension describes "the degree to which individuals are integrated into groups." The United States is described as "individualistic", in which a community is seen as the total of its individuals, the rights of the individual are of utmost importance, and there is a strong resistance of an omnipotent government. China is seen as just the opposite, "collectivist". Unlike individualistic societies, from birth people are integrated into strong, cohesive groups. In collective societies like those of China, the needs of the community come before those of the individual, there is a greater emphasis on social duties rather than on individual rights, and the governing body defines the needs of the community as well as provides for their fulfillment.

These tight-knit relationships are main components of the Chinese culture. Reinforced with the teachings of Confucianism and its collective character, China is characterized as a "low-trust" society. Its primary route to socialization is through the family structure; the culture as a whole has a great deal of difficulty including outsiders in their groups. The majority of economic endeavors in China actually start out as family businesses. They continue to be owned and managed by family members. Associations with others come through guanxi networks, in which much time is spent cultivating relations before business interactions can proceed. US firms will likely struggle from such traditional Chinese behavior that is so different from their fast paced, quick decision-making, domestic environment.

Because Chinese business mangers are accustomed to working with family members or businessmen with whom they are very familiar, many of the terms for business arrangements are built upon trust and often do not include legal documentation. US managers are much more accustomed to dealing with outsiders on a regular basis and thus regularly conduct dealings with legal forms and contracts. The Chinese business will use contracts, but the US firms will have to accommodate their negotiating tactics to even begin a joint venture. The US firm must be willing to spend a great deal of time developing relationships with potential partners and clients to establish themselves in China. Negotiations may take months or even years, as the Chinese believe they are establishing an ongoing relationship, not a mere business arrangement. They conduct negotiations in teams and in stages so that information can be collected and fully evaluated. The Chinese prefer compromise rather than conflict, and greatly avoid legal action. Another issue U.S. mangers may not find easy to accept is that, even after terms have been agreed upon, the Chinese often feel that the terms are alterable, given unknown future occurrences.

Only after a friendship type of relationship is built will the Chinese consider the business matters at hand. The Chinese way of making decisions often relies on guanxi rather than rational business concepts. For example, there are no credit report agencies or standard lending policies; credit in China is granted based on a firm's level of trust and reputation in the guanxi network. Such networks can provide IJVs with preferential access to government services and contracts, favorable tax treatment, and priority to material supplies and market access. US business managers will often disagree with the lengthy negotiating style and even find the concepts of guanxi unethical. The reality of business operations in China may simply seem "unfair". U.S. managers will not find laws binding and protecting the rights and obligations of partners. Nor will they find negotiating a fast-action process. Failure to succumb to the Chinese networking practices and slower business pace can be detrimental to the joint venture because of the extreme importance that such traditions play in China's day to day operations.

The dimension of *masculinity* defines a culture upon its aggressiveness or competitiveness. It also encompasses the distribution of the roles between the sexes. Masculine cultures, like the United States show a high need for achievement, or self-actualization. Feminine cultures, like China, are more interpersonally oriented, benevolent and less interested in recognition. The values in a masculine society vary greatly between the two sexes, whereas in feminine cultures the values of men and women are very similar. Because of their shared values, women in China live according to the lifestyle that has evolved from Confucian teachings. Women are obedient to their husbands and assume the role of household caretaker after marriage. High levels of authority have traditionally been reserved for males. The U.S. has evolved in its treatment of women in the workplace, such that it is no longer rare for women to hold managerial positions. But, most Chinese women still respect and aspire to marriage with the expected housewife duties, and the scarce job opportunities do not leave them with much choice. Thus when U.S. companies aim to partner with Chinese firms there may be problems for female members of the U.S. managerial staff. Such female staff members may feel lack of respect causing further tension in business dealings.

Uncertainty avoidance indicates to what extent a culture programs its members to feel in unstructured situations. Uncertainty avoiding cultures try to minimize the possibility of unstructured situations by adhering to laws and rules. China is a highly structured society with hierarchical codes for all relationships in society. Uncertainty – accepting cultures, like the United States, are more tolerant of behavior and opinions that differ from their own. The

Chinese live largely according to their prescribed actions for a harmonious life as advised in the Confucian ethic. They find security in their routine and unwritten rules for living. For Chinese employees, the ways of a new US manger may disrupt the harmony that formally existed before the joint venture. Chinese mangers and employees are not as willing to accommodate change as their U.S. counterparts and therefore disagreement may arise when considering operational practices for the IJV.

As touched upon earlier, Hofstede did add a fifth dimension of long-term orientation, or "*Confucian dynamism*". This is not well recognized or accepted by other researchers as they feel it merely expands more on the values already discussed through individualism. It is hard to compare the classifications of China and the U.S. within this dimension, as it is comprised of specific elements that Western cultures do not exhibit. Examining this dimension can help address more intricate details of the Chinese culture. Some of the values addressed in this dimension are ordering relationships by status and observing this order, and having a "sense of shame". Both are extremely important to Chinese society and are demonstrated through the country's social structure of hierarchy that is strictly "obeyed" by its members. Such an extreme difference in cultures only reinforces the probability that many of the problems suggested will exist between U.S. and Chinese firms when they try to combine in a joint venture.

5. China - An Emerging Market

Along with cultural differences, China's current status as an "emerging market" may also negatively affect the success of a joint venture with a U.S. firm. The United States is a well-developed market, whereas China is at the start of its growth, undergoing rapid changes (such as entry into the WTO) which creates an environment of uncertainty. The partners of each country enter the joint venture at different "starting places", and because of this they also have different goals. The US firm seeks market penetration, whereas Chinese firms aim at acquiring technological and organizational skills. A study by Luo *et al* cites the outcome of these goal differences stating, "they [Chinese firms] are little concerned with the overall outcome of IJV operations such as profitability and market expansion in China."[17] Operating with different agendas will obviously affect the strategy that each manger would like to pursue. With different goals, the partners will view the joint venture's performance differently as well. Thus even if the venture fails to meet projected profits, the Chinese manager may still feel pleased about the IJVs performance as he has gained the technological insight desired from merely being in the joint venture. The study also find that incongruent goals will likely result in one partner resisting control by the other. Specifically it was found that the U.S. partners tend to view control by the Chinese firm as detrimental to the IJV performance. Thus differences in goals for the IJV may prompt distrust and further conflict between the partner firms, causing more potential problems for the IJV's success as viewed by the US firm.

6. Managerial Implications

What practical lessons can U.S. and Western companies draw from this study? First and foremost, managers need to question whether a joint venture is really the best mode of entry into China's marketplace. Previously a joint venture was seen as the only realistic way to create a viable presence into this strange market. Managers should look thoroughly into other possibilities for establishing themselves in China's network system in their strategic plan. This is especially so now that the rules for entry have been relaxed under WTO requirements.

Frustrated by the limitations and poor performance of IJVs, many companies are starting to adopt wholly foreign-owned enterprises (WFOEs) as an entry mode. Through the gradual liberalization of China under WTO guidelines, more sectors are beginning to open for foreign direct investment. Thus companies should look at the benefits of this often mode of entry. Obviously there is the issue of greater risk and difficulty of independently trying to establish a foreign company within China's political and social connection networks. The manager needs to decide if these obstacles are really any worse than the pitfalls associated with a joint venture. WFOEs are actually faster to establish than an IJV. Another benefit of WFOES is that there is no requirement to have a board of directors.[18] Many of the problems and conflicts associated with cultural differences that may impede the success of an IJV never even become an issue for a WFOE.

Others continue to support IJVs, as one article attested: "China's vastly different culture, language, business climate, and political environment will continue to plague foreign investors for some time to come, and the joint venture is still the best way to acquire the necessary familiarity with China's market conditions."[19]

Even if a U.S. company has decided that a joint venture has the best outlook for entry into China, the information presented in this paper can still be useful. US companies can use the information to improve their relationships with their foreign partner and begin the venture by trying to address some of these potentially problematic issues before they occur.

One final aspect may help a U.S. manager decide whether his firm should attempt entry through a joint venture despite the risks that accompany this entry mode. Firm size has been shown to affect a firm's ability to succeed in IJVs. Smaller firms typically have weaker bargaining power and are more likely to have a minority equity position in overseas joint ventures, and therefore have to concede greater amounts of control to the foreign partner. On the other hand, larger firms are able to capitalize on the differences in resources across countries, and achieve economies of scale, scope, and learning. Because of their limited financial resources, small firms are more sensitive to short-term changes in the foreign country's economy. Larger firms have the necessary resources that allow them to survive during hard economic cycles. In addition to these findings, a study by Pan and Li determined that large firms possess the ability to raise the necessary resources required to obtain the majority equity stake in a joint venture in China.[20] With the benefit of majority control, the larger U.S. firm has greater chances of directing the operations of the venture and therefore may also increase its chances of overcoming many of the problems cited throughout this paper.

Thus, foreign managers must not only examine the risks associated with China's marketplace. A thorough examination also needs to be performed on the foreign firm itself in order to find out if it is capable of withstanding the potential problems of joining with a Chinese partner in an international joint venture.

7. Conclusion

This study provides support for the conclusions reached in some of the previous studies done on joint ventures. Specifically, the case of foreign, particularly western, joint ventures in China with Chinese partners illustrates that cultural asymmetry is a fundamental aspect in the success of IJVs. We find that western companies cannot succeed in China's market by applying the typical strategies and practices used in western settings. When cultures show tremendous differences in the fundamental aspects of social relationships, as seen when comparing the West and China, these differences are also displayed in managerial operations. Thus, when entering China, managers see an attractive potential for growth but are faced with an extremely difficult course in obtaining this goal.

Added to this is the fact that the Chinese company is likely to have very different goals and expectations from creating the joint venture. With so many differences, is it possible for a western-China joint venture to succeed? This is a question that cannot be taken lightly when considering entry modes. By presenting the problematic side to such joint ventures, managers can be better informed when making this strategic decision, rather than blindly entering the foreign alliance.

This paper looks at potential difficulties for the foreign firm. As illustrated, the cultural and economic differences cited are likely to cause conflict between the two partners. But are the problems that result from these issues the same for both partners? Are the Chinese firms as affected by these cultural differences, or do their focus on technology rather than profits lessen their concerns? Future studies should be done to consider the specific impact of these cultural differences on the Chinese partners in joint ventures with foreign firms that operate in China.

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