

Trust or Law? China's Accession to the World Trade Organization and its Effects on Chinese-Foreign Joint Ventures

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Abstract. After 13 years of negotiations China's accession to the WTO will gradually open the "Great Wall" which still protects large areas of what will one day become the largest economy of the world. Our paper address the nature and functioning of international joint-ventures by investigating Chinese-German joint ventures within this context. For international joint venture in developing countries in general trust seems to be one of the key factors for performance. We applied a model of gradual development of trust, reflecting the dynamic of evolving co-operation between business partners: calculative trust, cognitive trust and normative trust. We also explored, how China's WTO entry influences the competitive position of both partner companies in Chinese-foreign JVs, and the strategic options for coping with that change, depending on their core competences and competitive position as well as on their relative bargaining position.

Statement: This submission contains original work, not beeing published elsewhere.

1. China's World Trade Organization entry

China's accession to the World Trade Organization (WTO) in November last year was an important global event that will have a profound impact on China itself and world trade. Chinas WTO entry is the culmination of 15 long years of tough negotiations that started with China's application for entry into the General Agreement on Tariffs and Trade (GATT), the predecessor of the WTO, which is the largest global organization aimed at setting international trade rules and promoting the expansion of economic exchanges among nations (for further information refer to <http://www.wto.org>).

Lengthy and difficult bilateral negotiations with GATT (and later the WTO) member nations made sudden progress when Zhu Rongji took over as Chinese premier in the spring of 1998. But, negotiations with some countries, particularly the United States, hit snags and came to the brink of rupture several times, due mainly to conflicts over the extent to which China would lower tariffs and remove barriers for protecting its domestic industries, as well as giving foreign companies access to the Chinese markets in sectors in which they boast competitive edges. The United States and European countries demanded that China open its markets as wide as developed countries do, but China insisted that it be allowed to apply easier market opening standards just as other developing countries do. As it turned out, China agreed, as in the case of agriculture, to open its markets almost as wide as developed countries.

By agreeing to the terms of its accession to the WTO the ruling government in Beijing is embarking on a course which will fundamentally transform the Chinese economy. It will give a new boost to the economic reform process and to its proponents whose efforts had come under attack by conservatives in the Chinese Communist Party (CCP) and from managers of previously protected state owned companies who must fear for their existence. Above that, for

thousands of years, China has contented itself with being a self-sufficient country. But its WTO membership means that it has agreed to accept worldwide common trade rules for the first time in its history and completely abandon its closed society. If the reform and opening policy initiated by Deng Xiaoping opened China's door to the world, WTO membership means that China has burned down the bridge allowing it to go back to its own peculiar traditional society.

Nonetheless, China's integration into the world economy involves a huge gable by the Chinese government and by the international economy. The economic reforms that WTO membership will encourage will mean further economic pain for China's 1.2 billion people. The cost will be defined mainly by the bankruptcy of state-owned enterprises, unemployment and social problems resulting from those closures. Moreover, there are concerns that the rise in foreign ownership cause resistance in society. One can, however, expect that it will be precisely the foreign capital threat that will offset many of the negative impacts and the long-term gains of reform will outweigh its short-term costs. In this paper, I will focus on, how the WTO agreement will change the rules of the game and the competitive position of foreign investors in China. During the past years joint ventures are encouraged by the Chinese government, as they present an ideal form for securing rapid access to capital, technology and export markets within an economy in transition. I will therefore concentrate on foreign-invested co-operative ventures which are already active in a wide variety of industry sectors in China.

2. The strategic position of Sino-foreign joint ventures

In emerging economies like China international co-operative relationships are still the most common basis on which co-operation between host country and foreign partners is established, with foreign direct investment usually being incorporated into the equity of such co-operative ventures. In this paper co-operative relationships are defined by combining resources from more than one company to create a new organisational entity in form of a joint venture (JV), which is distinct from its parent companies. For the purpose of our research, we concentrate on international or intercultural joint ventures (IJVs) with at least two parent companies of different nationality.

The operating characteristics and performance of IJVs as an co-operative ownership option of investing abroad have been examined frequently in the literature on ownership strategies in international business (e.g. Yan and Luo 2001; Pausenberger and Nöcker 2000; Matthews 1999; Balling 1998; Herzig, Watin and Ruppert 1997; Chowdhury 1992; Zielke 1992; Geringer and Hebert 1991; Contractor 1990; Contractor and Lorange 1988; Kogut 1988a; Reynolds 1984; Kumar 1975). Compared to wholly owned foreign enterprises IJVs offers substantial economic and political advantages for internationalisation strategies: Investments and risks are shared; some investment requirements can be eliminated through the use of the partners' existing infrastructure, e.g. local marketing and distribution resources. Sales volumes are also likely to be realised more quickly in IJVs than through wholly owned foreign enterprises. In addition, the local partner's political position can be harnessed to great advantages. Overall, IJVs appear to offer greater revenues, lower costs, and less financial risks than other market entry options.

On the contrary IJVs are one of the most sophisticated ownership options in international business: Presuming that the goals of both partner companies connected with the IJV are not conflicting, the performance of IJVs depends mainly upon qualitative variables such as

individual personality factors of the dispatched personnel, organisational cultures, administrative styles, and management philosophies. There are many problems associated with IJV management. For example, issues of staffing, operating procedures, transfer pricing, local and international sourcing, technology selection, product line, pricing cost and investment allocation, market priorities and management control. According to the literature and to the statements of managers in our interviews all those aspects pose potentially fatal obstacles to IJV survival. The hazards of IJV management appear to be numerous. Shifting the focus on Chinese-foreign JVs the problems are even rising. The wide-spread assumption that this phenomenon is a mere problem of mid-sized enterprises foreign direct investment is not true as even major multinational companies operating in China also encounter huge obstacles.

The literature reveals that fundamentally diverging goals of the two parent companies produce tremendous difficulties in interorganisational as well as in interpersonal co-operation in the IJV. Sometimes these goal incongruences might be solely traced back to the unequal political background the companies are arising from. Chinese (state-owned) enterprises – whose were the only possible partner companies at the beginning of economic reforms in China - are used to operate in a socialist plan economy. Their managers often keeps close relations with the CCP. In contrary, the foreign partner companies are investing in China from a market economy background. Their way of doing business is characterised by orientation of sales and competition. While the foreign partner company's focus on China as a market for its services or products the local partner is often following a diametric way: Positioning local products and services on the world market by means of the foreign partner's know-how and advanced technology. Another aspect producing problems in daily JV life is a fundamentally different ways of acting: Leading the staff in a participative or paternalistic way, open-aggressive or consensus-based problem solving (Herrmann-Pillath 1997) or idiomatic barriers due to communication in a foreign language (Trommsdorff 1991). One underlying principle of staffing is implying problems in IJVs in general: The expatriate manager's influence is limited to three to five years according to the individual assignment. As his ongoing career obviously depend on the results of the work during his stay abroad he will tend to act according to his specific objectives set by the foreign partner company. On the contrary, as the Chinese managers will stay in the IJV for a longer assignment they need to orientate themselves towards their mother company, respectively their ethnic group.

A close look at empirical studies dealing with the JV success in China (Hu and Chen 1996; Dong, Buckley and Mirza 1997) reveals the high probability of unsatisfying performance measurable in hard figures (profitability, quality standards) as well as in soft factors (partner commitment, mutual understanding). Yan (2000) reports, that the greater the length of time the IJV has been in operation, the better tends to be its profitability. Especially for IJVs in China, it seems that the accumulated business experience of IJVs increases the confidence of both partner companies in the venture. IJVs which have relatively shorter experience are not expected to have sufficient skills to deal with operational problems in the Chinese market. Therefore their chances of obtaining higher returns and meeting the financial objectives are not as good. This finding is in line with previous research on the performance on JVs by Agarwal and Ramaswami (1992) and Contractor and Lorange (1988).

3. Law or trust?

One important contribution is that the WTO will underscore the rule of law in China. The European Union is setting up a program in cooperation with MOFTEC to support and monitor the compliances to the commitments made by China. Therefore we can assume that the

predictability of the development of the business environment will increase. Such predictability will come too late for many foreign investors, who have already lost large sums in investment because the Chinese government changed the laws, sometimes even in retrospect, as recently the case in the telecommunications sector. Another implication is that the position of independent courts and the reliability of the legal system will improve over time.

A rules-based system like WTO would be worthless without a dispute-settling system to enforce these rules making the international trading system more predictable. The dispute settlement for China's accession is based on a clearly defined procedure with a timetable for concluding a case. A panel makes the first ruling, which is then endorsed or rejected by the WTO members. Appeals are possible but a single country cannot block the final decision by the WTO's full membership. The accession of China to the WTO therefore has a very important impact on China's accountability for its future administrative behaviour. For example, if China might impose technical regulations that in fact can be proven to be motivated by protectionism, the case could be brought before the WTO's dispute settlement body. This authority could then impose fines if China is unwilling to comply with these rules. Similarly, WTO accession includes an agreement on import licensing procedures, which prohibits the government from giving licenses in a non-transparent or arbitrary manner and offers guidance on how governments should assess applications for licenses.

The institutional environment in China still provides only few guarantees to enforce business contracts or to settle disputes between the IJV partner companies. Historically, the Chinese have not been protected by a legal system that was independent of the state and supreme in its own right. In the absence of a codified commercial law, merchants and producers were at the mercy of a system in which imperial officials and their acolytes could exercise arbitrary power through taxes, licensing fees, and restrictions on trade and travel. WTO accession might support changes, but until today, we find a close involvement of government agencies in business affairs. Local governmental agencies have powers to interpret regulations, issue licences and impose taxes, which furnish ample scope for negotiations and corruption. As Child (1998: 256) notes, "the way that agreements are interpreted can depend on the influence or autonomy that the Chinese partner enjoys with higher authorities. The signing of a formal contract does not guarantee the end of uncertainty or even the conclusion of negotiation." As a pure concept of guilt is not existing in China's Confucian culture consequences of an individual's negative behaviour like opportunism can only be analysed in a social context: The threat to feel guilty as a sanction mechanism in Western cultures is replaced by moral failure determined by the peer group e.g. the work unit leading to feelings of shame due to a loss of face (Hermann-Pillath 1997). Being aware of the multilateral dependencies arising from the social "guanxi" web breaking trust with an insider may result in severe consequences while breaking trust with an outsider might have no consequence at all.

The need for trust in IJVs can be described as 'trusting dilemma'. On the one hand, there is an increasing need for trusting co-operative relationships, because issuing legal contracts and their enforcement is much more time consuming, expensive and uncertain in cross-border relationships than in co-operative ventures on a national level. Being separated by long distances it is also difficult to control every aspect of potential opportunistic behaviour. And especially in the Chinese context, where you cannot rely on the legal system and the enforcement of contracts, you have to build up a trustworthy relationship. On the other hand, it is very difficult to build up a trusting co-operative relationship between business partners from different national origin, because both are not familiar with the rules of social interaction and their basic assumptions, values and norms of the other. The fact that both partners may

have different assumptions of what can be taken for granted, places particular difficulties in the way of creating trust-based relationships between them. Therefore it is quite difficult to know from the very beginning, whether actions could be considered as trustworthy. Above that, especially in the changing Chinese situation, until today foreign investors are not sure about the cultural system and the legal institutional framework, whose support and monitor international co-operative relationships.

The fundamental necessity for trust in IJVs has also been recognised in the literature on the subject (e.g. Inkpen and Currall 1997; Inkpen and Beamish 1997; Madhok 1995; Parkhe 1993a, 1993b; Beamish and Banks 1987; Buckley and Casson 1988), and is mostly associated with an improvement in decision making concerning strategic priorities, goals and management systems (Mead 1998). In the international management literature (e.g. Pausenberger and Nöcker 2000; Child 1998; Smith, Carroll and Ashford 1995; Kumar, Steinmann and Dolles 1993; Buckley and Casson 1988; Kogut 1988b), several writers have argued that international co-operative relationships develop through a number of stages. There are feedback loops in this process whereby the partners evaluate their experience and decide whether to continue their co-operation and, if so, in what form (e.g. Ring and van de Ven 1994). This development leads to our assumption that in the same way as international co-operative relationships develop over time, a corresponding evolution of trust will follow. The theoretical differentiation between calculative, cognitive, and normative trust as suggested by Lewicki and Bunker (1996), Lane (1998) and Child (1998) opens a window to analyse this hypothesis on the way that the evolution of trust is integral to this dynamic process of evolving co-operation between business partners.

(1) *Calculative trust*: Calculative trust is characterised in the way that trusting involves expectations about another, based on calculations which weight the cost and benefits of certain courses of action to either the trustor or the trustee (Lane 1998). Lewicki and Bunker (1996) argue that this form of trust is based on the assurance that other people will do as they say because the deterrent for violation is greater than the gains, and/or the rewards from preserving trust outweigh any from breaking it. In this view, trust is an on-going, market-oriented, economic calculation. Its value is derived by determining the outcomes resulting from creating and sustaining the relationship relative to the costs of maintaining or severing it. Referring to Lane (1998) trust based upon calculation is likely to apply particularly to relationships which are new and hence can only proceed on the basis on institutionalised protection or the reputation of the partner.

(2) *Cognitive trust*: A second basis for trust lies in the sharing of cognitions, including common ways of thinking, between the two partners concerned. This sharing of cognitions provides a basis for understanding the thinking of a partner and for predicting that person's actions. Clearly, some cognitive sharing is necessary for a calculative basis of trust (Zucker 1986). However common cognitions provide the further reassurance that one can now reasonably predict other people on the basis of shared expectations. Normally the individual can only be sure of sharing ways of thinking with others by getting to know them well enough. This aspect of cognitive trust is what Lewicki and Bunker (1996) have termed knowledge-based trust: knowing the other sufficiently so well that the other's behaviour is anticipatable.

(3) *Normative trust*: Normative trust depends on people sharing common values, including a common concept of moral obligation. As Lane (1998) points out, common values and norms of obligations can develop in a long-standing relationship where trust was originally created in an incremental manner. Normative trust is likely to find a parallel at the more interpersonal level, what Lewicki and Bunker (1996) call identification-based trust: both parties effectively

understand and appreciate the other's wants. This mutual understanding is developed to the point that each can effectively act for the other, or it enables a person to feel as well as to think like the other.

We will further use the term interpersonal trust to refer to the extent of a IJV manager's trust in his main counterpart in the partner company, or in more concrete terms, the extent to which IJV managers trust the IJV partner company. Interorganisational trust is believed in the literature to have several economic advantages: Above all, trust may serve as an alternative control mechanism in interorganisational relations, where it substitute or at least complement the market mechanism and hierarchical order (Bradach and Eccles 1989). Moreover interorganisational trust is likely to enhance allocative efficiency when it encourages the disclosure of confidential information, and to reduce the costs of interorganisational transaction (Sako 1992). We can assume, that there will be only certain individuals, so called "boundary spanning agents" or "trust guardians" (Child 1998: 253), relating across the boundaries of co-operating companies. Their role in promoting trust between both partner companies is therefore a key one. The trust which exists between both partner companies in an IJV will to a large extent come down to the quality of normative (mutual) trust which exists between those individuals involved. Bromiley and Cummings (1995) pointed out, that optimal expenditures on control, monitoring and other kinds of transaction costs are partially a function of the probability of opportunism which in turn depends on the level of trustworthy behaviour of boundary spanning agents. This confirms our assumption, that trust is actually an interpersonal phenomenon, upon which the quality of interorganisational trust is founded. However it should be noted, that in the case of a frequent turnover of the personnel allocated by the partners to an IJV, the opportunities for developing trust based co-operation between them will be diminished.

The rationale for the working place relationship based on trust is that trust ensures a sound an co-operative working relationship between the partners. The higher the trust, the more efficient the IJV will be in transforming an input of co-operation into a collaborative output (Buckley and Casson 1988). As Madhok (1995) pointed out, a foundation of trust, although time-consuming and expensive to create, can contribute to the sustained continuation of cooperative relationships. Thus, IJV performance should be viewed as a consequence of IJV trust, with more successful partnerships characterized by higher levels of trust (Inkpen and Curral 1997).

4. Survey design and methods

Our study required measures for calculative trust, cognitive trust and normative trust at the interpersonal and interorganisational level. To do this, we reviewed relevant literature to delimit construct domains, developed operational definitions and assembled them for use in semi-structured interviews in Chinese-German JVs in China. We have implemented a qualitative case study approach due to the following reasons: First, German enterprises participating in a Chinese-German JV follow a strategy of local integration and send usually only few expatriates to China. Second, exploring many interpersonal relationships therefore would have also meant analysing many corporate structures leading to distortion due to incomparable surroundings in different companies. Third, to cover the Chinese as well as the German specific perspective of trust using a quantitative way of analysis would have implied pressing the managers into categories possibly not suitable to cover every aspect of an cross-cultural survey.

Two IJV's Beijing and Shanghai based admitted us to do interviews with Chinese managers as well as German managers. Both German partner companies are stock companies arising from the technical maintenance field on the one hand and the automotive industry on the other. The local partner companies were both state-owned and operating in the same industry. In total we interviewed ten German managers and ten Chinese managers in both JVs as qualified informants. Those boundary spanning agents were mainly co-operating in a counterpart working relationship in a shared IJV's area management.

We used the method of half-standardized interviews containing 22 questions aiming at stimulating the employees to describe freely their personal attitudes towards trusting behaviour and working place relationships. This proceeding appeared to be useful to meet the condition of different people coming from a different ethnic and professional background contributing also to a possibly varying time frame set for the interview. All interviews were tape recorded and transcribed. For evaluation we implemented the method of qualitative content analysis as proposed by Mayring (1995).

5. Key Findings

The results gained so far show clearly that all three types of trust exist in Chinese-German IJVs on the interpersonal level. By examining interdependence between the expatriate and his local counterpart on the calculative level, we did not find any evidence for unbalanced relationships. The typical dependence situation found in the group of expatriate managers was the lack of sufficient knowledge of the Chinese language. This situation enables the local counterpart manager to deal nearly exclusively with all business and leadership matters towards the local employees, customers, local authorities or other stakeholders groups. As the access to foreign production technology or product know-how is one of the most important reasons for Chinese companies to invest in an IJV, the Chinese partner company is dependent on the technical knowledge of the foreign company. It is the advantage of the expatriate to control all those necessary links. The manifestation of bilateral dependence creates a balance in the relationship. None of the partners will act opportunistically as the threat of reverse sanction is continuously present.

He needs my help. I have a good relationship and this is really important. Guanxi, guanxi, you know? And it is also the language if you come from another country it is not easy.... Language and relationship. This is important and I know it and have it - and he also know. (V6C)*

He needs my know-how dealing with production technologies... I mean modern production technologies from Germany. (V14G)

As indicators for the existence of cognitive trust in IJVs we searched for positive statements about personality characteristics of the local counterpart or the expatriate manager. In addition we looked for process-based experience about the acceptance of working styles, frequent communication modes and open information exchanges between the managers of both sides. One of the interesting points in this respect is, that positive statements about the working style are only given from the local managers, whereas the expatriates complain about the local working place behaviour, e.g. to be confusing, not efficient, time consuming. Nearly all

* Interviews with German managers are closing with "G" and those with Chinese managers are closing with "C". Spelling and grammar is partly corrected by the authors from the original interview transcription.

interviewed managers quote a positive view of an open communication mode and open information exchange of relevant facts. In the interviews it was claimed that this positive attitude towards information sharing and problem solving serves as a basis for JV performance and success. We found positive statements about expert knowledge and vocational qualification of the counterpart, too. Reliability was another question in the context of cognitive trust. Reliability develops over the time. Nearly all participants we interviewed feel, that after a sufficient amount of time they know their counterpart well, so that the other's behaviour is anticipatable and predictable. However this does not mean that the actions of the other's are always positive recognised. In this context it was often referred to loyalty and dependence structures of the other's to their social network, which seems not acceptable under all circumstances.

We talk about difficulties very frankly. Besides the professional part we also once discussed his personal problems. Our offices are very close together so it is also the small local distance enabling us to easily exchange. (V18C)

He told me also confidential information. I often thought this is a part one should not talk frankly about as it is confidential. Information which would be rated highly confidential from the German perspective at least. This was really influencing my trust in a positive way in the way to think that a certain trust relationship with him could arise. (A7G)

We are interpreting statements concerning respectful and co-operative behaviour, the positive accomplishment of loyalty expectations and the development of friendship as indicators of the development of normative trust.

There have been situations in daily work life I thought. ... Now the colleague will leave me in the difficult situation, e.g. if I ordered something without talking with him about it in advance which also happens sometimes and I was so surprised that he still supported me in this moment and I would have never thought that he would do so. (A2G)

And when he returned to Shanghai he brought a lot of presents to our office. He gave me a pen signed with my name. This made me really happy and I was so surprised. This was really rising my trust in him ... because he accepts my work. Because he shows understanding for my work and he realizes my efforts. (V19C)

The positive findings are contrasted with statements back shadowing also negative impacts on trust. The partner's behaviour sometimes is interpreted not to be co-operative. The interviewed managers perceive three types of action negatively influencing the co-operative relationship: Breaking of contracts, missing inclusion in decision-making, and wrong cultural behaviour.

And then he said he would deal with the subject and I asked him not to deal with it. And then I went to a meeting which was cancelled and when I returned after ten minutes he was dealing with the subject and I got extremely mad at him. (A3G)

I know the Germans. They are always on time, stingy and hate people from other countries. It is bad if they act rude without thinking. If they are arrogant and do not appreciate our effort. (V19C)

Apart from negative impacts on the trusting relationship we could clearly identify fields of mistrust of cognitive and normative character between Chinese and German managers. On the cognitive level of trust Chinese managers suppose the expatriates to be unable to think integrally and to behave according to Chinese society's requirements. Their German counterparts on the contrary tend to criticise the perceived insufficient analytical skills of the Chinese. It seems to be more the German attitude watching the local partner with mistrust from the very beginning. Especially the 'guanxi' web adds complexity to the social relationship and is closely connected with mistrust concerning a parallel loyalty, the keeping of contracts, the transfer of relevant information, and financial aspects.

I do not like to rely on him. If he does himself he will fight his way...and I do not want to rely on him. Sometimes if he deals with these things I later have to...he makes something...and I have to...correct him. I have to be the trouble shooter. I would do better. (...) Some bad things happened (...). (A4C)

But it is still a dependency even if the Chinese colleagues have the same view as oneself. They get orders from above which they will not tell us. (...) There is going on a lot behind one's back. (V11G)

In terms of normative mistrust we evaluated incongruences concerning goals, expectations and values. They are perceived from Chinese as well as from German managers.

Concerning work we do not share the same values. Quality of work or thinking in terms of quality ...it is difficult for the Chinese to change that. (...) Therefore they stick to the level reached without changing anything. That is our advantage that we take the chance, talk about it for improving in any way. (V11G)

I think this is related to our goal to take more management responsibility. We started early to localise management here. And we had five German general managers here and I think now it is time that Chinese staff can take it over. (V16C)

On the calculative trust layer the representatives of both partner companies know exactly the reciprocal dependency of their mother companies' on the interorganisational level. Both Sino-German JVs were established in the 1980s. Due to governmental regulations at this time, IJVs were the only entry strategy in the Chinese market. In all cases investigated the strategic aim of the German mother companies was to enter the foreign market. On the local side, it is mentioned by all companies that the German companies possess specific product technology or production process know-how which is actually not available in the host country and which offers a gain of competitive advantage for the local partner against local competitors. From the Chinese perspective the access to foreign capital seems also very important.

We want to do business in China and without the Chinese side we will not get into the market, no chance; it is simply no free market economy. (V11G)

You know, now the local Partner is going down they have big losses ... but now with our new ability we can get step by step as we also have foreign customers. (A4C)

By questioning aspects of cognitive trust on the interorganisational level, we found statements in the interviews concerning superior technology, advanced management systems and well reputation of the partner company. Astonishing is the fact that all of the German executives

had argued towards mistrust against the Chinese partner companies, whereas the Chinese managers seems not to mistrust the foreign partner companies.

But in the world, in the co-operation the brand of the foreign partner is quite popular - so for this I think it is a continuous co-operation.
(A1C)

And that is why I trust the foreign partner. Also there are Germans: They have a very good understanding of the product and the quality. You must say this. (A10C)

Concerning internal payment e.g. if they have top pay 40 million they approach us two days later saying 'Sorry, we do not have the money - we cannot pay'. On the contrary they pretend to support us but the local partner is eager for impeding us in daily life. I have to admit that I do not trust anybody of the local partner. (A8G)

... and after we had approved the internal payment of the money they said okay we can do it but without a bill. We told them that we need a bill to prove where the money has gone to but they said no only without bill otherwise we will not support you. (A3G)

Elements of normative trust on the interorganisational level could not be identified in our samples.

6. Discussion

The primary goal of our research was to explain how trust in co-operative relationships develops over time, how trust appears at the interpersonal and interorganisational level, and how those two levels of trust are interrelated. We also explored, how China's WTO entry influences the competitive position of both partner companies in Chinese-foreign JVs, and the strategic options for coping with that change.

6.1 The interpersonal working environment in Chinese-German JVs

In our survey we could identify all three forms of trust on the interpersonal level between German expatriates and Chinese senior managers which we could fit into the layers of calculative, cognitive and to less extend normative trust. Our theoretical assumption that calculative trust is dominating interpersonal relationships at the beginning could be verified in our interviews. In IJVs, in which boundary spanning agents are closely working together, it is first the knowledge about reciprocal dependency which gives them security to work and not being mistrusted by the others. There is clear evidence from our interviews, that all managers are aware of this reciprocal dependency. Whereas the German expatriate brings in his expert knowledge and his close relationship to the German mother company, the local manager possesses all the necessary information about the local staff, the local infrastructure and the relationship to the Chinese side. Both boundary spanning agents are also part of the larger network of their own ethnicity, with informal information sharing among their groups.

Cognitive trust is based on continuous accumulation of information about the other. In this sense it is understandable, that all participants in our survey feel that they can trust the other, because they assume, that they can anticipate the behaviour of the other. The statements given

are supporting our assumption that cognitive trust will emerge after an indefinite amount of time. It takes time to acquire detailed knowledge about the capabilities, the working attitude and the personality of the counterpart managers. Nevertheless our data indicates also the emergence of trust towards the counterpart manager because of personal characteristics apart from the working place relationship, such as social background, hobbies, family etc.

Arguments for the existence of normative trust are mentioned rather seldom in our survey. We explain this fact, that the development of normative trust will take much more longer than cognitive trust. However overseas assignments of expatriates are often limited in duration. International assignments of German companies last in general between 3 to 14 months on the short term and 3 to 8 years on the longest. China is for German companies still considered as a developing country with hardship conditions for expatriate managers, which leads to much shorter international assignments. It is therefore not surprising that the normative level of trust was mentioned seldom in the Chinese-German JVs investigated.

It is primarily the German staff expressing mistrust in our survey towards the working behaviour of their Chinese colleagues. They fail in bringing the perceived bureaucracy, inefficiency and laziness into a motivational context. Without much reflection they seem to project the traits of the "modern" Western business culture onto the Chinese working environment. The Chinese managers on the other hand heavily complain in the interviews about the behaviour of the expatriates to be culturally not suitable. Expatriates generally see their role as being to introduce Western management expertise into Chinese-German IJVs, which does not allow for informal local management practices. In fact some Western management practices can make difficulties in establishing relationships with the local counterpart in China or the staff of the IJV. These include confrontation during meetings (leading to loss of face by local participants) and insistence on local managers assuming individual responsibility for actions which exert pressures on local staff. Both tendencies reflect insufficient intercultural training programs before assignment resulting in negative impacts on trusting behaviour and performance.

Our findings of our research suggest so far, that especially within the context of a local culture which attaches high value to transactions based upon personal relationships as in China, trust-sensitive management of co-operative ventures should focus on the interpersonal level. This might be possible through careful selection of personnel, intercultural training, longer assignments or a policy of human resource management in which repatriated managers could be further in charge for questions dealing with 'their' overseas IJV. Without continuity on the top management level there is the risk of "corporate amnesia" (Inkpen and Beamish 1997; Turpin 1993), which is characterised in the way, that executives in both parent companies forget their original motivation for this international co-operative alliance and past lessons from their personal relationship.

6.2 The interorganisational level of co-operation in German-Chinese JVs

Trust on the interorganisational level of co-operation in German-Chinese JVs is emphasised rather seldom in our sample. Statements of the Chinese managers about the transfer of personal trust towards the technical knowledge of the German expatriate due to interorganisational trust towards the high technical standards of the German partner company are mentioned sporadically. Cultural insensitive or inappropriate personal behaviour of the expatriates leads to mistrust on the Chinese organisational capacity from the local staff, because it is assumed that German mother company has carefully selected his expatriates. The German expatriates for instance, do not normally consider "guanxi", or face-saving to be

acceptable norms of business practices. Within IJVs the exercise of "guanxi" in China may require favouritism in the selection of new employees or in the allocation of contracts for supplies, and it may embrace what foreigners regard as corruption.

We can therefore partly confirm our hypothesis that interorganisational trust derives from interpersonal trust. Statements of Chinese managers indicate that the quality of work of individual employees of the partner organisation is transferred to the interorganisational level. Obviously trust is generalized in some cases. On the contrary deficits in the personal interaction also influence the organisational level of trust. To demonstrate the insufficiency of the assumption that the influence of the interpersonal on the interorganisational level is a "one-way-street" we need to have a closer look at the interpersonal level again. At first sight two statements of one and the same individual employee concerning trust in the interpersonal relation appeared to be completely diametric expressing a specific subtype of trust on the one side („I am sure he also pass over all relevant information" (A3G)) followed by a statement filled with the equivalent mistrust on the other ("If information concerns employees he always suffer temporary Alzheimer disease."(A3G)).

Analysing this bewildering phenomenon we evaluated the organizational framework influencing the interpersonal relationship. We discovered that an incongruence of strategic goals between both partner companies heavily influences the trusting personal relationship on the management level. In general, disagreement between both partners companies about the mission of the IJV leads to a lack of direction, and hence to some extend of mistrust on the interorganisational and interpersonal level. Such a conflicted situation can only be extremely dysfunctional. Neither the foreign nor the local values about work or interpersonal relations are controlling the situation in the IJV. There is no clear set of short-term or long-term goals for the individual managers and the IJV. Rather, uncertainty prevail as each group of managers is sougiting to impose its assumptions about human behaviour and proper working place practices upon the IJV. In addition to those clashes at the management level, the local employees reported in some cases in our interviews to be ambivalent as to what is expected of them. Should they do business as usual under customary local norms, or should they attempt to adapt to these sometimes strange and different German practices. Such an environment in an IJV is expected to be unstable, laden with mistrust and likely to be ineffective.

Taking also two moderating variables - a parallel loyalty of the managers and the temporary character of an expatriate's assignment into account - it is possible to evaluate the interorganisational impacts on interpersonal trusting relations. Loyalty is directed toward the counterpart manager as well as toward the own ethnic group respectively the company of origin. Regarding the temporary cooperation, loyalty towards the own ethnic group naturally is the stronger tie. Problems arise if a strategic goal incongruence is effecting the personal relationship from the top management in either the German or the Chinese partner company. As claimed in our interviews interpersonal agreements or oral contracts on the interpersonal level have to be readjusted frequently due to organisational constraints. With regard to theoretical considerations, we were assuming at the first sight that such cases will lead to a climate of lower trust or even mistrust. After turning into mistrust a reestablishment of trust might even be impossible.

However our findings are not supporting this assumption: Breaking individual contracts and agreements in our survey do not lead to mistrust on the interpersonal level automatically. To get the rationale, remember the close distinction between confidence and trust. While breaking of trust is attributed internally, the consequences of unsuitable confidence are attributed externally. Von Rosenstiel (1988) describes the determinants of an individual's

acting to be not only depending upon its ability and intention but also upon social environment and situational factors. Obviously the manager affected by a breaking of an agreement takes these factors into account attributing the problem externally. In the run of the time a kind of continuum is developed including levels of trust and mistrust concerning the same field of co-operation regarding external factors to determine the counterpart's behaviour.

On the calculative level of interorganisational trust we find clear evidence for strategic decision making by the German mother companies concerning market entry strategies, partner selection criteria, the appropriate level of technology, use of capital and the reputation of partner companies. In the beginning stage of going international it is extremely important through careful planning to get the basic calculus for the IJV correct. This careful planning takes time and thus provides an opportunity for a degree of mutual confidence and respect to develop between the main negotiators at the interpersonal level which leads to trust at the interorganisational level, when the IJV turns in operation. The Chinese partner usually contributes the local knowledge from the beginning. During IJV formation, he deals with legal, official planning and domestic financial matters. When the IJV is in the operation stage, the contribution of the Chinese partners is closely linked to operational networks, such as domestic sales, supplies, human resource management and infrastructure. However, once a IJV is in operation, the German partner progressively gains sufficient access to the local knowledge. This implies for the reciprocal dependency on the calculative level, that the Chinese bargaining power will gradual diminish, depending on both the criticality of that knowledge and how fast the Germans learn.

The astonishing emergence of mistrust on the cognitive level towards the Chinese partner companies in our research might be explained by the fact, that they are still state-owned enterprises. The German expatriates claim, that the Chinese partner companies are still providing a broad spectrum of social services ranging from housing to medical care to funerals. This practices of human resource management are transferred to the IJV, which results to a bloated payroll, sometimes unnecessarily high-wage payments, problems with overstaffing and difficulties in personnel recruitment. All these factors contribute to the image that the foreign investor has to provide the "iron rice bowl" for the employees of the IJV and to some extend to the personnel of the Chinese mother company, too. To choose a IJV partner from the new emerging private enterprises might be a partner selection strategy, coping with this problems.

For a foreign company, that is interested in maintaining a stable long-term IJV, our findings clearly suggest, that goal discrepancies on the interorganisational level should be avoided and aimed at compatibility in operational and technical capabilities. The German companies mentioned gaining a strategic position in the Chinese market, the attraction of the domestic market and the opportunity for long-term profit as their main strategic objectives. The Chinese companies on the contrary are seeking for technology transfer, production techniques and management expertise. Such differing goals and objectives might be the critical issue in the Chinese-German IJVs investigated. Goal integration in a trust sensitive management of IJVs is therefore a must for successful IJV management and refers also the goodness of fit between the organisation's individuals and those of the IJV itself. This means both IJV partner companies need to understand the culture, goals and values of the other party, and use that information for a trustworthy collaboration. This widening of the trust sensitive management of IJVs increases the likelihood that the more important goals of both partners and IJV profitability can be achieved.

6.3 Strategic implications of China's WTO entry for Chinese-foreign JVs

China's WTO membership is certain to seriously effect many Chinese industries, in which foreign-invested companies are already active. The impact correlates on the one hand with the globalisation of the industry, which simply translates into: Can the world markets offer better and cheaper products of equal quality than Chinese-foreign JVs manufacturing domestic? On the other hand it is a matter of the extent of current protectionist tariff and non-tariff barriers, which will be teared down due to WTO accession. The pressure and the implications will especially be felt in those industries where protection is not only strong for end products, but also for the entire value chain and where the local suppliers have been protected from international competition through local content requirements on tariff and non-tariff barriers, as for example in the automotive industry. Highly affected industry sectors will come under immediate price pressure, as lower tariffs and abolished non-tariff barriers will make imported products more competitive and attractive for the Chinese consumers, especially if the quality or the branding of the products is better perceived than that of locally manufactured products.

The immediate results of such an increase in import competition will be a lowering of prices for local manufactured products. If imported products are of higher quality, the price decrease for locally manufactured products must be greater than the decrease in import duties. This effect should not be neglected given the Chinese quality standards today. Already locally manufacturing IJVs will be forced to close the quality and technological gap between imported products and domestic production. This may in turn make new investments necessary, especially for those foreign investors who went into China a couple of years ago with product concepts, some of which were already outdated at the time. The era for foreign investors is over to act according to the conviction that for the Chinese consumers the previous product generation is just right as it is less sophisticated, certainly cheaper and requires less investment for setting up domestic production lines. Today, the latest models of consumer products are flooding onto the Chinese market, like mobile phones, DVD recorders, digital cameras or PCs – often before European markets have seen them. The same process has already started and will gather momentum in other industries, like automotive, machinery and pharmaceuticals as soon as WTO regulations will put into effect.

As many IJVs with state owned Chinese partner companies operating today are not breaking even, a strategy of cost reduction and product improvement is no easy task, within the old bureaucratic structures. Those IJVs which are still enjoying high margins, will be forced to cut prices and to give up their current comfortable margins. The management of IJVs has at least the following options to cope with the new competitive situation in order to survive WTO accession (v. Keller, Mönter and Drinkuth 2000): (1) To increase productivity in manufacturing. (2) Consolidating production lines and redundant sales organizations and the subsequent reduction of employment in administration and other non-productive departments. (3) Passing on the cost pressure to their suppliers.

(1) Productivity of foreign and domestic firms operating in China is according to a survey by Roland Berger & Partners typically between 50 and 70 % lower than the average productivity in comparative sectors in Europe, Japan or in the United States (v. Keller, Mönter and Drinkuth 2000). Even though the hourly rates for labour are comparatively low, the disadvantages in productivity partly compensate or even over-compensate for the cost advantages of manual labour. To realize productivity gains, IJVs have to optimise their production processes. Quality training and the reduction of scrap rates, which are in China higher than anywhere else, play an important role in restructuring activities. As already

mentioned above, careful introduction of western style management methods such as quality related incentive systems as well as productivity related payment systems is another possibility for increasing productivity.

(2) One of the results of the waves of investment in China during the 1980s and 1990s was that many of the investors are today active with several JVs in different regions across China, sometimes with overlapping production and distribution networks and sub-optimum logistics or inefficient warehouse operations and multiple administration and accounting structures. Streamlining and restructuring these operations – especially the non-productive functions like purchasing, logistics, accounting, administration and distribution – is necessary to consolidate business activities in China. Foreign partner companies in IJVs have to start work on these issues, even though it usually takes some time to convince the Chinese JV partners that these measures are inevitable.

(3) The third option for already local manufacturing IJVs is to pass the cost pressure on the their local suppliers or to reconsider the purchasing policy in order to realize cost advantages. The latter will be possible as the requirements on local content will increasingly be relaxed and finally abolished through the WTO agreement. Many components may then be purchased more easily, at higher quality and cheaply from abroad, specifically those components which are easy to handle from a logistical point of view and are relatively small in number. If the purchasers do not want to lose their Chinese suppliers, they have to exert price pressure, not in a lethal way, but the time for relatively comfortable profit margins is definitely over – and seen from the perspective of the end consumer.

Among the contractual agreements for China's WTO accession the elimination of sales and distribution related non tariff barriers are of specific importance. They have an impact on all sectors of foreign investment and they will enable foreign companies to gain direct access to their customers or to go into completely new fields of business activity. Until now, even domestic manufacturing IJVs, with few exceptions, have had limited possibilities to run their own sales and distribution networks or to organize maintenance business under their ownership. Only Chinese companies were eligible to be licensed for such activities. Under WTO membership China has now agreed that within the next three years foreign firms will be treated equally and allowed to run trading and maintenance activities under their full ownership and without any geographical limitations. These amendments will open the option in IJVs to switch from their Chinese sales partners to their own sales and distribution organizations and/or maintenance network. Another strategic option is to keep the existing sales partners, but to amend the relationship so as to allow the build up of a parallel sales organization as a second sales channel. It might be possible as a third option either buying in or buying out the Chinese sales partner and taking over their sales operation and organization. The advantage of such a move is that some of the considerable investments in training and technical support, which many firms have undertaken to secure a reliable and functioning sales network can be recouped.

From the above mentioned considerations it becomes clear that the strategic implications for Chinese-foreign manufacturing JVs and for Chinese-foreign distribution JVs will be dramatic. With WTO accession the days of legal protection from competitive threats in China are gone. The strategic choices of the foreign partner companies depends on their core competences and competitive position as well as on their relative bargaining position towards their Chinese JV partners: (1) If the value the Chinese side can add to the company is restricted more or less to an equity participation and a good network of personal relationships with the government and local administration, a possible buy out of the Chinese partner should be examined. (2) If the

core competences of the Chinese JV partner plays a major role in the success of the JV and if this core competence advantage is sustainable under the changing competitive environment, the foreign partner should carefully watch out that it does not become the minor partner, and should try to lock the Chinese partner in or, if that is not possible, prepare will for a possible power struggle.

7. Acknowledgements

I like to thank Niklas Wilmking, who conducted the Chinese interviews. Our thanks goes to the expatriates and local managers of the IJVs in China and Germany who provided the data on which this study is based. Without their co-operation there would be no research findings to report.

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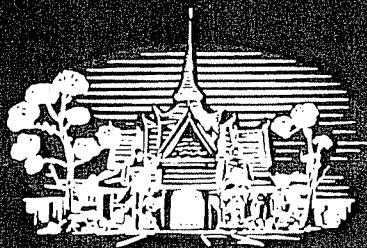
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