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Good Business Sense: Changing Practices in the People's Republic of China*

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I. INTRODUCTION

The lawyer representing a client in an international transaction is frequently called upon to provide more than strictly substantive legal advice. Although it is not unusual for a lawyer to be expected to perform certain quasi-“deal” functions in domestic commercial transactions, it is becoming the standard in international transactions.

That function often manifests itself in the lawyer being called upon to provide advice on cultural expectations, procedures, and norms. In China, it can be such a pervasive issue in negotiations that the lawyer becomes an important participant in the strategic and tactical planning which in other circumstances might be viewed solely as a management function.

II. BACKGROUND CONTEXT

Initially, it is important to recognize the impact of the growing sophistication of Chinese business practices and of the counterparts in China with whom the foreign businessperson will be negotiating. In order to provide perspective, a brief digression summarizing situations frequently encountered during the period immediately after China began opening up to commercial transactions with the outside world may prove helpful.

In the late 1970s and early 1980s, businesspersons from countries all over the world initiated commercial efforts with nearly boundless enthusiasm and optimism. China was often characterized as a country of one

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billion toothbrushes, two billion armpits, and so forth. Many observers cautioned business clients not to allow the newness of the experience and the exotic environment to color hard business decisions.

At that time, China was relatively new to the international market and not fully prepared to deal with it. The lack of preparedness manifested itself in a number of typical obstacles encountered by the interested foreign party. Visas were hard to obtain in a timely fashion. Counterpart negotiators were not always experienced in the subject matter of negotiations. The bureaucratic approval process was not uniform and frequently evidenced its own uncertainty as to correct procedures. Laws were adopted without implementing regulations and sometimes were interpreted on an ad hoc basis. Finally, foreigners were fully expected to understand China's cultural and business practices without any apparent awareness by their Chinese counterparts of the cultural and business practices of their guests.

In recent years, it has become clear that the difficulties experienced in China by foreign businesspersons has led the pendulum to swing to the other side; the previous optimism has turned into a pervasive sense of deep pessimism. The advice given today is the analog of the advice given in the late 1970s. Doing business in China is time consuming, arduous, and uncertain. Nonetheless, persons who are able to cut through the emotion of undertaking such effort and focus carefully on the business and economic decisions which must be made can find it rewarding.

III. THE CURRENT SITUATION

A. "The More Things Change . . ."

In some respects, the current situation is unchanged from the past. Most obviously, China is still a Marxist-Leninist country with state planning playing a pervasive role in its economy. It is unfortunate that relaxations in certain central planning policies led some observers to describe China in neo-capitalist terms. That was not true and no doubt misled many businesspersons into adopting strategies which ultimately led to an eye-opening disappointment. As a result, any governmental actions which have appeared to increase central control have been viewed as a step backwards and have led to disillusionment.

This observation has within it a very positive conclusion: Deng Xiaoping still likes cats and favors those which catch mice. Mr. Deng got into some trouble during the dying stages of the Cultural Revolution by observing that it does not matter whether a cat is black or white as long as it catches mice. His critics took this to be an indication that he

was so pragmatic as not to care whether China were socialistic or capitalistic as long as it is modernized. In fact, Mr. Deng cares a great deal about that issue but his pragmatism extends to the methods for attaining what the Chinese call "socialist modernization." Catching mice is just another way of saying "get the deal done," a sentiment which approaches the status of holy writ in the commercial arena. Knowing that the other side shares the goal oriented view of commercial transactions should reassure foreign business that opportunities do exist.

There has been massive development in the body of commercial laws and regulations in China since 1978. Nonetheless, there continue to be holes in the system, indicating that additional laws and regulations are required. In fact, the Chinese Government does seem to be aware of these needs. The point to be emphasized is that the commercial system in which the foreign businesses must operate in China is still relatively new and it is reasonable to expect adjustments on the basis of experience. Businesses waiting for iron-clad certainty will enter the arena much too late in the game.

B. Management Pool

In many areas the management pool in China remains very thin. Over the last several years, however, there have been major strides in this area. It is a much more frequent occurrence today for foreign businesspersons to encounter technical experts across the table.

In part, this advancement has been the result of a more efficient allocation of talented resources. Advances have also been realized simply as a result of experience. Those who have had the opportunity to work with the same entity over a period of time and a variety of transactions may be more sanguine on the future developments in this area than others have been. Finally, China has benefited significantly from the large number of its students who have studied abroad over the past several years and returned to China to take up positions involving international commercial transactions. Advancements in this area probably will be even more obvious when the students who have stayed abroad after study to receive practical training and experience return to China.

C. Negotiation Experience

China has a very long history of commercial negotiation and should not be seen as having been a neophyte when it began opening to the outside world. To be sure, there has been a pronounced restart period resulting from the isolation of the 1950s and 1960s and the loss of a large

pool of talent during the tumult of the "Hundred Flowers" backlash in the 1950s, the Great Leap Forward in the early 1960s, and the Cultural Revolution in the later 1960s and early 1970s.

More than a few foreign businesses, however, have fallen into a trap by assuming that their Chinese counterparts are entirely unsophisticated. In the negotiation context, few are shrewder or quicker to grasp new ideas than some of the Chinese involved in negotiation with foreign enterprises.

Unlike the early years, it is also more usual today to find Chinese counterparts who have a much greater awareness of the foreign party's own cultural expectations. Notwithstanding that development, it appears that we are still a long way from the time when negotiations and documentation will be conducted solely in English.

D. Negotiation Process

Significant changes have occurred in the negotiation process over the past several years. One has been in the area of the complexity of legal documentation. Several years ago, the rule of thumb in China was that no document should be longer than four pages, regardless of the language it was in. Chinese is a much more compact language than English, which should have been helpful, but it is also a much less precise language (at least with respect to the relationship between concepts and between subject and verb and with respect to such things as time frames). This resulted in a need for greater rather than fewer descriptive provisions in documents. Consequently, the earlier documentation reflected an uneasy accommodation between languages.

The Chinese have recognized this problem and are now receptive to, and in some instances advocates of, greater specificity in contractual relations. In part, that has been the result of experiencing greater understanding in contractual relationships evidenced by more specific agreements than those evidenced by statements of general principles. This development seems limited to the international commercial relations and apparently has not had a similar effect on domestic commercial practices in China. In part, the diversity between domestic and international practices must represent a recognition that there are limitations inherent in long-distance relationships which require some adjustment of the traditional Chinese expectations. Today, it is not unusual to arrive at documentation approaching the prolixity characteristic of documentation typical of domestic transactions in the United States.

With this development has come a certain streamlining of the nego-

tiation process. In the early years, it was not unusual for a foreign party to have to go through at least three stages of documentation: an initial letter of understanding, an interim agreement, and a final agreement. Adding the need for feasibility studies between these stages, it is easy to understand why the negotiation process was on occasion very lengthy.

This process probably will continue to be encountered in dealing with Chinese entities newer to the arena of international transactions. Nonetheless, the interim agreement is a vanishing species in transactions involving repeat players on both the Chinese and foreign sides. This development should be heartening to foreign businesses interested in China, but should not be taken for granted or misunderstood. The negotiation process continues to be used by the Chinese as a process for reconciling different positions and economic goals with their foreign guests. The process will continue to take just as much time as is necessary to achieve that result and any effort to take shortcuts reasonably can be expected to be counterproductive.

E. Bureaucratic Overlays

Anyone who forgets that China invented bureaucracy and has lived with it for thousands of years will be in for a very abrupt awakening. To be sure, China has taken steps which may have the appearance of streamlining bureaucratic overlays. However, it is risky for a foreign business to assume that it fully understands the bureaucratic system and can find the one key person who can make all of the decisions and bind the Chinese side to an agreement.

Prudent individuals involved in a particular project should make a point of visiting with responsible officials at all levels of bureaucracy (municipal or Special Economic Zone, provincial, and central). The "not invented here" syndrome was invented by bureaucracy and is alive and well in the world's oldest bureaucracy. The point to be made here, however, is that it is not necessary for the foreign party to know exactly which level or, even more specifically, which official will be responsible for making a decision. As a defensive maneuver, however, it is important to take reasonable steps to be certain that a project is not derailed by some nameless official at an equally unknown agency. Of course, the further away the ultimate decision is made from the level at which substantive negotiations are conducted, the greater the differences in dynamics, experience, and a variety of other factors at the decision-making level. Foreign parties, therefore, must tailor their strategies to a broader audience than the one they address face-to-face.

E. Role of the Attorney

The role of the attorney in transactions in China has changed in a number of ways. In some early transactions, the role of a lawyer would be more visible than in others, but in all situations it would be as an advisor to someone else who was presented as the decision-maker. In more recent years, the status of the lawyer has changed noticeably. It is not unusual for lawyers to play a more central role in the negotiating process. Some attorneys have adopted a policy of being the chief spokesperson and apparent decision-maker for the client, with notable success. That approach may be used in situations where appropriate but it is certainly not mandatory.

One reason for the initial reluctance to deal with lawyers was the fact that during the Cultural Revolution, lawyers (as intellectuals) were labeled part of the "stinking ninth [or worst] category" of bourgeois counterrevolutionaries. Due to the delays in improving that image, it was unusual to encounter Chinese lawyers on the other side of a negotiating table during the early years. This situation is slowly changing. Growing evidence exists that Chinese lawyers will begin to play an even more important role in the process, particularly as the pool of lawyers trained in international commercial matters increases.

This raises another important point. The day is rapidly approaching when foreign lawyers representing clients in China will need the advice of emerging local Chinese law firms with respect to the impact of Chinese law on commercial endeavors. This will, however, probably require clarification by the Chinese side on the confidentiality of discussion with such local law firms. Nonetheless, as the pool of legal talent increases in China it will become increasingly important for foreign lawyers to take reasonable and appropriate steps not to appear to be engaging in a form of legal imperialism.

F. Other Changes

Some other changes are more obvious. These include the increased experience of China in the world banking system, the improved communication and transportation facilities which assist in the process of doing business in China, and the willingness of the Chinese Government to think about international commercial activities as a two-way street. The Chinese Government now readily acknowledges that these areas still need further improvement, and it is reasonable to expect that they will undertake to achieve that as China continues its modernization and industrialization efforts.

IV. PRACTICAL OBSERVATIONS

United States-China trade is an area in which lawyers must refine their approach and temper their advice by reference to practical considerations. For example, it is important to recognize that much of the recent development in China's legal framework is a direct result of the central government emphasizing its policy of fostering international trade. For example, criticism has been leveled at a number of recent arbitration decisions in China. Although the cases were decided in favor of the foreign party, it was impossible to determine whether the arbitrator's decisions were the result of careful legal and factual analysis or were arrived at simply because it is the policy of the Government to foster international trade. Indeed, the entire legal climate in China is affected by the fact that government policy has such an all-pervasive impact and, in many ways, supplants our own view of the rule of law. At the present time, that is a very favorable condition which results in foreign businesses having a better chance at arriving at mutually acceptable contractual arrangements. Nonetheless, that system is essentially alien to any of our Western legal systems. This observation is, of course, only important as it recognizes the possibility that policy in China could change. In view of the political structure in China, anyone advising that the commercial environment in China is approaching the Western model is simply waiting to step on a rake.

Another practical observation is that many foreign businesses have made things more difficult for themselves by starting with an equity joint venture. Business in China is conducted primarily on the basis of trust established between parties. The equity joint venture method of commercial transactions places a great strain on that relationship. Consequently, a good argument can be made that joint ventures should be the last step taken rather than the first.

Instead, foreign business should begin with a very simple and straightforward import/export transaction which is designed by both parties to be a preliminary stage for later commercial transactions. That approach leads toward, and is good preparation for, the cooperative production form of transaction whereby manufacturing operations are established and the compensation received by each of the parties is an agreed upon portion of the production. If that form of transaction works out, the foreign business could then proceed to the contractual joint venture format that does not include the establishment of a separate legal entity. Even if that stage of the transaction does not occur with the party in China with which the first transaction was consummated, the foreign

business is benefited by having a track record for trustworthiness in commercial transactions in China.

In establishing this initial relationship, foreign businesspersons should arrive in China with a form of agreement which sets forth the kinds of terms they would like to have adopted. That form should also be translated into Chinese. Realistically, that form will not actually be signed but it will do two things. First, it will allow the foreign business to set the direction for further negotiations. Second, it will give the Chinese side a clear indication of the foreign party's concerns. Communications remains the largest single obstacle to successful commercial transactions in China and this is one very easy way to limit that effect. If the foreign business does not start this way, it may expect that the Chinese side will listen to negotiations and (on the basis of almost certainly imperfect understanding arrived at through interpreters) draw up their own form of contract. That document will start with some misunderstandings built into it, will establish the framework from which the Chinese proceed thereafter, and in many cases may be fairly unsophisticated by international standards. From a practical point, once the first form of contract has been produced for parties to examine it is very difficult to start all over again and propose an entirely new form.

The next practical concern is the importance of obtaining a certificate from the Chinese Tax Bureau with respect to the impact of Chinese taxation upon a proposed transaction. It is not unusual for local authorities to assert that all tax matters have been cleared with the appropriate authorities and that the foreign investor will receive certain specified tax advantages. In many cases, those assertions will be correct. In many other cases, however, they are more a statement of hope by local entities than a binding conclusion of law. If this action is not taken, the foreign businessperson may run the risk of never having a contract approved and never receiving a definitive explanation.

More ominous is the possibility that the contract will be approved and the Tax Bureau later will take the position that it is not bound by tax agreements contained in the contract. Indeed, some foreign businesses have been required to make significant payments that were not included in the original calculation of whether the transaction made good economic sense in the first place. Others have been faced with the prospect of being advised by their Chinese counterpart that the Tax Bureau has taken an adverse position and the contract may not be approved unless the foreign counterpart agrees to make certain changes. By that time, the foreign business may have so much money and energy invested in the

project that the economic judgment on whether to enter into the contract in the first place may not be made on the most objective basis.

Another practical issue is the role that international accounting firms can play in the process of commercial transactions with China. Traditionally, accounting firms and law firms often have poached on each other's turf when dealing in international matters. In some instances, this has led lawyers to advise their clients to stay away from accountants. The better position is that there simply needs to be an allocation of responsibility between law firms and accounting firms. Each group of professionals then could perform those functions it is best able to do. Experience indicates that the accounting firms that do their jobs particularly well are also those that make clear allocations between accounting and legal responsibilities. Additionally, the Chinese have been more willing to grant foreign accounting firms greater latitude in the kinds of activities they conduct in China than they have for foreign law firms. Thus, more accounting firms can be found there, engaged in a greater variety of business activities than is the case with Western law firms.

This also suggests a collateral but important matter: the formation of a complete team of advisors for doing business in China. The one critical player who has not yet been mentioned is the person who renders advice on cross-cultural matters. From whichever source it comes (attorneys, accountants, in-house personnel, or others), it is important that the foreign business receive advice in this area. Only a very few foreign businesspersons may reasonably be expected to obtain more than a rudimentary knowledge of the rich cultural history of China. Nonetheless, anyone who demonstrates an eagerness to learn and expends effort in doing so before arriving in China will have a significant advantage over those who do not.

A related issue is the role of so-called "middlemen" in commercial transactions. The overwhelming majority of foreign firms doing or hoping to do business in China have been approached by persons either in the United States or Hong Kong who indicate that foreigners simply are unable to do a deal in China without their services. To be sure, there are a few "middlemen" who really can make a difference in a transaction. Those, however, are clearly the exception rather than the rule. In order for "middlemen" to justify their involvement it must be made clear that they will provide assistance in getting the transaction completed and not merely provide introductions to people and be compensated for assistance actually rendered. The concept of friendship in doing commercial

transactions is important, but the appearance of people trying to buy that friendship through someone else is not well received.

Although the role of the "middlemen" is completely unnecessary at the level of a principal, it may be of use at the middle or lower levels for providing insights and advice on cross-cultural matters. That advice may merit compensation for professional services rendered but almost never merits a percentage interest in the transaction.

More than a few foreign businesses have been tempted to negotiate a contract in China without legal advice. China is an area where such a strategy is very risky and has a very low success rate. The laws in China are complex and are becoming more so. Within that framework, persons not having extensive experience in China may be lulled into a false sense of security in dealing with Chinese enterprises only to discover later on that no real mutual understanding has been achieved. Lawyers in the United States have frequently been asked to review documents that United States corporations believe to be binding contracts but that are actually only ambiguous statements of intent.

One final practical observation is that a number of jurisdictions have been established in China which appear to have a special status but which may or may not actually have it. Four Special Economic Zones have been established and certain flexibilities have been given to the Zone authorities in entering into economic arrangements. In addition, certain coastal cities have been designated as "open," as "free ports," and as "technical development zones." Every one of those locations will involve substantially less bureaucracy than other locations, but the impact of having special status is by no means clear.

V. RECOMMENDATIONS FOR PRACTICE IN THE CURRENT ENVIRONMENT

Foreign businesses interested in China need to obtain a variety of information before starting a program for approaching China. Chinese negotiation practices are designed to reveal the failure of foreign visitors to have identified the bottom-line economics of their proposals. Of equal importance, those practices also reveal when the visitor does not have a firmly established goal. Thus, the Chinese often redirect interested parties into a project more preferable to the Chinese hosts.

Second, foreign businesses have been too willing to do a bad project in the hope of being treated as an "Old Friend" for a later project. While friendship is clearly an important element of doing business in China, it does carry with it responsibilities which must be shared equally. Experi-

ence indicates that the Chinese recognize this point and have greater respect for businesses truly interested in engaging in "mutually and equally beneficial" projects than for businesses interested in buying friendship.

Unfortunately, enough of the latter have occurred to condition the market in China so that it led to some misinformed expectations on the part of the Chinese entities, particularly regarding pricing matters. This makes it more difficult for others to do business in China. It is better to try to overcome such obstacles, however, than to succumb to the temptation to get the first project done at any cost.

Third, one of the most important functions of a lawyer in China is to educate clients regarding the process and the realistic expectations. A novice visitor to China is more prone to "culture shock" or making cultural mistakes, either of which can put a client in the position of making ill-informed decisions.

Fourth, clients should strive for continuity of personnel in repeat visits. This increases the opportunities for developing real friendships and also results in the delegation being well versed in prior discussions. It is not unusual for the Chinese counterparts to keep a very detailed record of previous discussions and note any variances from them.

Fifth, in recent years doing business in China has developed a certain cachet which makes it susceptible to being overly publicized. More than a few American businesses have made public announcements about efforts in China which they later wish they had not made. Among other things, that can increase the pressure to complete a transaction even on terms less favorable than originally contemplated. China itself is a society that values understatement and low-key approaches. Commercial efforts in China benefit from the same qualities.

Sixth, a foreign business will find it practically impossible to initiate business contacts without first revealing the outlines of specific goals they seek to achieve. Such communication, however, should be limited to the description and parameters of the transaction itself and not underlying (and actually internal) corporate concerns. Most importantly, issues of timing not inherent in the project itself should be handled with sensitivity and presented only as a pre-established tactic of negotiation itself.

Finally, foreign businesspersons should remember that China is still a developing country. Obvious as that may seem, it has ramifications that are easily and frequently overlooked. For one thing, it is important not to arrive at generalized conclusions about China's commercial environment that color decisions made in a business context. In view of China's current stage of development it is reasonable to expect a certain amount of fluidity and adjustments as experience dictates change. As

already noted, the legal structure in China relating to international commercial transactions is still relatively new and may be expected to develop further.

China is not now and probably never has been a country which can be easily pigeonholed or for which snap judgments can be made. The foreign business that can be patient in negotiating with China and equally patient in its own analytical processes concerning China is the only business that stands any chance of enjoying a profitable, long-term relationship with China. Lawyers involved in this area of the law bear a responsibility to advise clients accordingly.