NEGOTIATING WITH THE CHINESE: A CASE STUDY

By

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China is the U.S.’ second largest trading partner, yet many Americans are stymied when negotiating with the Chinese. Lawyers call it getting “localed” and it is not unusual for even experienced international business people to get caught up by their own ethnocentrism. The fact is that Western and Eastern cultures are based on different foundations. Westerners, and particularly Americans, value individual success, while Easterners value the community and relationships. Americans like direct speech and action. Chinese use subtext to communicate indirectly. Both sides can end up thinking the other side is lying or rude.

Other writers have described and analyzed how cultural differences impact Chinese and American communications. But, in the midst of a negotiation, particularly during a dispute, lessons on cultural communication can be forgotten as ingrained responses take over. Hindsight is crystal clear as the cliché goes. In this article, I will use an actual construction contract dispute between a local Chinese contractor and a US based manufacturer to illustrate how cultural differences led to misunderstandings and lawsuits.

How It All Began

A US manufacturer (called “USM” in this article) had been doing business successfully in China for a dozen years. When it decided to build a second manufacturing plant in one of the foreign enterprise zones, its global engineering group based in the US initiated the design and build process. The lead engineer, Bill, had been managing global projects for many years including a few in China. Bill wrote the specifications (US style), contacted some local connections to get recommendations for contractors for this project and was assigned a US based lawyer to draft bid documents. As the US lawyer, I took the standard company contract (based on AIA forms) and sent it to Chinese counsel to have it reviewed for issues under Chinese law. Based upon the advice from a top tier international law firm, some minor changes were made to the terms and an RFP was issued. After considering four bids, a local company (called “CC” in this article) was awarded the bid. Few legal issues were negotiated up front although there was some haggling over the price. CC presented a 10% performance bond as required and work commenced. The contract called for lump sum payments based upon progress.

What Went Wrong

Although based in the US, Bill visited frequently, staying for a month at a time until there was an organizational change at corporate headquarters and the global engineering group was disbanded. Bill retired. No one from USM was on hand locally (and definitely not from corporate) to take his place until the project should have been substantially completed. The plant manager at the existing plant, Dave, tried to take on that role but had another full time job. He thought the Chinese supervisor was looking out for him. Due to Chinese legal requirements, another local Chinese company was hired to supervise the project. They did not really supervise construction, but occasionally ran interference with various government agencies. Payments were being made regardless.
Finally, USM hired Jerry as plant engineer for both the existing and new plants. Jerry was not pleased with the quality and progress of the construction. He managed to bring the project back on track for the most part, but some significant mistakes had been made: the elevator was under powered and would not hold the load it was required to carry; and the roof leaked horribly causing both cosmetic and structural damage. There were also a significant number of minor defects.

USM started withholding payments and holding defect review meetings with CC. In all, over a dozen defect review meetings were held where CC did not argue that the defects existed or that they should be fixed. They agreed to send workers to fix them. But, if the workers actually showed, they didn’t fix the problems. The elevator would require a total rebuild which was never attempted. Eventually CC argued that the elevator, which was used in the manufacturing process, worked fine even though it could carry material on only one third of the surface area of its floor without unbalancing and shutting down. Hay and tar were applied to the roof leaks which would wash away as soon as it rained. Eventually realizing CC was not going to fix the building, USM tried to execute on the performance bond so that it could use the funds to make the repairs themselves. CC sued its bank to stop payment and sued USM for payment under the contract. The matter was referred to CIETAC (China International Economic and Trade Arbitration Commission) for resolution per the contract terms. The parties eventually agreed to a confidential settlement.

The Role of Guanxi

Many Westerners think that Guanxi is just bribery. While gift giving is part of it, it is a much more complicated concept. It is the network each Chinese person develops that allows them to get things done in their society. The people in the network are family, school mates, business colleagues and others they match in the social hierarchy. It is not closed. New people, including foreigners, can become part of a Guanxi network. In order to connect, favors or gifts are exchanged. Meals and social events are shared. Favors are expected to be repaid. It is the concept of reciprocity that makes things happen. But it is a personal network, not a company-wide network. Just because USM and CC signed a contract, that did not create Guanxi between the companies.

During the Cultural Revolution and for decades afterwards, Guanxi was the only way anything got done. Since the mid 1990s, the Party has tried to make the rule of law supreme over Guanxi, but its evil offshoot, corruption, is still rampant. Public executions of high and low government officials caught extorting large amounts are frequent and highly publicized but seem to do little to change the system. CC had good Guanxi with the local agencies that provided building inspections and occupancy permits which served them well.

While CC and USM had not done business before, Bill was familiar with the basic concepts of Guanxi and did the right things to bring CC to the table. He was the lead contract negotiator. Per Chinese protocol, Dave only got involved in high level issues directly with the owner of CC during the negotiation as the senior manager. Lawyers were not at the negotiating table.

The project did not start going downhill until Bill retired and no one took his place. USM knew this was a problem but did not have a solution. More importantly to CC, now there was no individual relationship between the company representatives on the ground, no Guanxi. In fact, Chinese companies
and government agents understand that most foreigners are not in China for the long haul. This means they may promise future favors or concessions freely with the assumption that an individual foreigner will no longer be there to collect. CC didn’t walk off the job, but without an owner representative they were free to interpret the contract how they saw fit.

**Traditional Expectations**

Chinese society is hierarchical and workers expect to be given detailed instructions on how to do their work. Most laborers are young and poorly educated, newly imported from the provinces. When given broadly written construction specifications (which are common in the US but not in China), the Chinese contractor thinks he has it easy. He does not have to worry as much about quality and does not send his best workers to that project. Without an owner representative watching, the CC supervisor will do what he thinks makes him look better to his management - cut costs. This is not unique to China. Construction projects often suffer due to poor owner management all over the world. But, when combined with a corrupt building inspection system, problems are bound to occur. Without a solid partnership, a Chinese contractor will be less concerned about what is written in the contract and will look to his governmental connections to let him take additional profits where he may.

**Indirect Speech: A Culture that Can’t Say No**

There is no direct translation into Mandarin for the word “No”, or “Yes” for that matter. The answer is always situational. If you ask a Chinese person if they would like to have lunch, and he would, the most direct answer would translate as “I want” or “I like”. But “No” is much more problematic. Rejecting someone’s offer causes that person to lose face. But clearly not all offers can be accepted, so the Chinese have other ways of communicating rejection which may be missed by westerners used to direct communication. Phrases such as “I hear you”, “That is an interesting idea”, “That is not very convenient” and “That will be difficult” may actually be indirect ways of saying no. Westerners must learn how to interpret not just the words but the context of the speech. A nod accompanying one of those statements is not adding agreement. The conversation needs to continue to discover what is behind those statements. Probing questions may reveal a method which actually makes the action convenient - or the total inconvenience will be explained and understood by both parties.

In our case study, the defect meetings followed a predictable pattern. The list of defects was reviewed with CC’s project manager, who was no longer on-site, and primary subcontractor, Chen. Jerry interpreted CC’s responses as acceptance of their responsibility for correcting the defects, but nothing got fixed. Jerry’s attitude rapidly grew to one of exasperation. Instead of asking probing questions, he called in Dave who invited CC’s owner, Jin, to the meetings.

Here is an excerpt of their conversation:

Dave: We’ve showed your superintendent these problems multiple times. Look at how the roof leaks are damaging my walls! We’re almost in the rainy season. If our production equipment is ruined we’re talking about millions of yuan!

Jin: I hear you.

Dave: So when will you fix it?

Jin: I don’t know. That will be difficult.

Dave: I expect it done by next Tuesday when we meet again.
Jin: That will be very inconvenient.
Dave: I don’t care if it’s inconvenient for you. You need to do it before it starts raining!

Dave left the meeting thinking he’d made his point very clearly. So did Jin.

**Actions Speak Louder Than Words**

Dave is Jin’s client so he would not insult him by saying he would not do as he asked, even though Dave was violating all the rules of Chinese etiquette by dressing him down in front of a group. Instead, Jin instructed his team to stop doing work and left Chen, the prime subcontractor, to deal with an increasingly frustrated Jerry. Since USM had withheld payment to CC, CC had withheld payment to Chen. This did not make Chen feel sympathy for USM. Jerry understood Chen’s predicament but was confused by what he thought had transpired during the meeting with CC’s ownership. But finally USM got the message. CC was not going to fix the building. USM had CC’s performance bond and decided to use it to do the repairs themselves.

Once USM took that step, CC saw no reason to worry about saving face. They sued to stop payment on the bond and for payment on the contract. Both sides fought hard throughout a lengthy and expensive arbitration process. Not surprisingly, no written correspondence from CC agreeing to fix the defects was found.

**Language Barriers**

While English is the international language of business, that does not mean all players in a negotiation speak it equally well or can understand each other’s dialects. The Chinese parties in this case study were a mix of ethnic Chinese that had grown up in China, Singapore and Hong Kong. Their mixed backgrounds meant widely differing educational and cultural experiences and English proficiency. The westerners came from the US and the UK and did not speak Chinese. The USM team included a Singaporean lead counsel with an upper class British accent, two Scotsmen with heavy burrs, two Midwestern Americans and a native Chinese. Add unreliable telephone connections and USM had some challenging times even communicating internally. USM’s local Chinese counsel spoke no English and communicated with its client solely through translation by the lead Singaporean international counsel.1 Many of CC’s senior managers did not speak any English and relied upon Jin’s translations.

Translators are human and are not created equally. Reliance upon the other party’s translator could be very dangerous. But recognizing that there is more to translation than the actual words is also critical. A Singaporean’s interpretation of a Chinese statement will be more western due to the culture and political system in which he was raised. While China was wallowing in the isolation of its Cultural Revolution, Lee Kuan Yew was transforming Singapore into a modern nation dependent upon international trade. Rule of law is supreme in Singapore, not Guanxi. Many ethnic Chinese live in Singapore and speak Chinese fluently. If they migrate to China, however, they often find themselves out of sync with the local culture. This was the case with USM’s bilingual counsel.

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1 Many foreign law firms have offices in China but are not allowed to practice law in China due to rules which only allow native Chinese persons to be licensed. These firms provide other types of legal services to multinational companies with the advantage of superior English skills and understanding of western business practices, but not always a perfect understanding of the local legal system since they are excluded from it. In this case study, USM hired its existing international law firm to manage the arbitration. The lead counsel was an ethnic Chinese man who grew up in Singapore. His firm brought in a local Chinese construction defect litigator to be the representative at the hearings.
The contract documents were negotiated in English and then translated into Chinese per Chinese law. During the arbitration, CC management appeared stunned at some of the contract clauses they had signed. The building inspection documents were in Chinese and didn’t get translated into English until the end of the arbitration. There were some unfavorable surprises for USM management in them. Neither would be the first company to sign documents they did not read, but it is more likely to happen when the document is in an unfamiliar language.

The Resolution

Although CIETAC has grown in influence and reputation, it is nothing like a US arbitration tribunal. Antiquated evidentiary rules were enforced by three arbitrators who clearly thought the parties should not be wasting their time (even though they were paid by the hour). Taking testimony at a hearing where both parties must confront each other is contrary to the Chinese culture of maintaining relationships. After two painful days, the arbitrators would not rule. Instead they separately told each party they had problems with their case and must settle.

So, we settled. We should have settled many dollars and months earlier. Cases are settled on the courthouse steps in the US all the time, but after hearing presentations of the evidence in the US, judges will rule and the arbitrators will deliver an opinion. That is not the Chinese way.

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