ALTERNATIVE APPROACH STRATEGIES FOR BUYER-SELLER RELATIONS WITH THE PEOPLE'S REPUBLIC OF CHINA

Wesley J. Johnston
Associate Professor
Department of Marketing
University of Southern California
Los Angeles, CA 90089-1421

Abstract

This paper examines the issues involved in buyer-seller relations for industrial product sales in the People's Republic of China. The need is genuine in many product categories including plant technology, high technology, and infrastructure. The problem is that buying policies and procedures for foreign firms are still emerging, and therefore, unclear and confusing. Three approach strategies for buyer-seller relations with China are presented: the authorized "buying group," the "agency" representation model, and joint-ventures with licensing. The buying group model requires a direct sales approach to China's import/export corporations, while the agency model permits formal representation by a Chinese organization. The joint-venture requires significantly more planning and effort, but yields greater control over one's destiny. Each approach has its own advantages and disadvantages. None of the models can be recommended above another but must be evaluated against the seller's goals and objectives and the specific buyer behavior being exhibited.
Introduction

Given the ambitious goals of the 7th Five-Year Plan, selling industrial exports to China should be an easy task. The Plan requires the following to be accomplished:

(1) Under the premise of continuous increase of economic benefits, the total output of industrial and agricultural production in the five years ought to increase by 38 percent; gross national product, by 44 percent; and total investment in fixed assets in State-run enterprises by nearly 70 percent over the previous Plan's five-year period.

(2) Extension of foreign trade will be attempted. It is planned that the total business turnover from import and export in 1990 will be 40 percent, more than 1985; and the scale of foreign loan utilization and introduction of advanced technology will also be enlarged.

(3) Production development will be synchronized with the improvement of the consumption level of both urban and rural residents.

The only way to accomplish these goals is to open up the market for freer trade and to import technology at a fairly rapid pace. Despite all the confusion and inconsistencies in past policy, many analysts feel that opportunities for foreign companies are better now than they have ever been. The 7th Five-Year Plan dampens the free-for-all atmosphere that characterized the China market in the last half of the previous plan. More importantly, however, it promotes a stable pro-growth policy.

Import Trends

The following represents a brief overview of the trends taking place with respect to industrial products being imported into China.

China has developed a vertical pattern of trade, typical among developing nations. It exports mostly primary goods, such as grain, coal, and other raw materials and natural resources. In general, Chinese manufactured products are not competitive in the world market.

Plant Technology. For several years, China has imported billions of dollars worth of plant and equipment, often included were complete turnkey operations. This rapid development of infrastructure is currently being blamed for foreign exchange shortages, and spending has been curtailed. It is unlikely that this sector will revive any time in the near future, however, replacement parts and maintenance, repair and operating (MRO) equipment will continue to be
needed. A major exception to this will be energy production plants, since power shortages are the most critical of China's infrastructure problems.

High Technology. Technology imports are shifting towards smaller items. Personal computer systems and related electronic equipment are targeted as growth areas. This area, in general, has always been of high buying importance to the Chinese. Export controls imposed for political reasons by western countries have limited the types of equipment that China can buy. China is still quite willing, however, to spend its foreign exchange currency to buy high technology products. So willing, in fact, it results in poor purchasing results. For instance, China has imported millions of dollars worth of computers, while lacking the knowledge to operate or service them. In their enthusiasm to buy, the Chinese have purchased thousands of machines they are currently not able to use.

Another error the Chinese have made in buying advanced technology is to always prefer the most recent state-of-the-art technology. This was often too advanced to interface with their other existing technology and difficult to operate or maintain. China still has an eagerness to purchase high technology, but the realization that merely possessing advanced technology is not enough is beginning to have an effect. The emphasis on the level of technology is also beginning to shift from "state-of-the-art" to technology that will fit in with existing operations.

Special buying priorities in the high technology area include: data processing, electronics, and fiber optic technology; another is high grade steel.

Infrastructure. Infrastructure improvement will be a critical area for buying products and technology for the foreseeable future. China is expected to add between 5 and 6 million kilowatts of energy generating capacity per year. Rail, sea, and air transportation capacity will also be expanded quickly. Aviation passenger capacity is to be doubled by 1990, and rail freight and passenger capacity by 2000.

Issues in Buyer-Seller Relationships

Approaching the Market

Thus, while it appears that China is a very attractive market, it would be a mistake to think that penetrating the market would be easy. The Chinese traditionally have emphasized the importance of a developed business relationship. It is also important to establish this relationship by entering through the proper channels when making the initial approach to the market. While there are
more direct methods of entry than struggling with the many layers of bureaucracy, using such an approach too early runs the risk of leaving out someone with veto power from the relationship. Taking the more complicated approach implies sincerity and commitment in dealing with a Chinese enterprise and the trade organizations that represent it.

It is also important to appear to have commitment to the market over the long term. This includes providing the necessary capital for what may be a lengthy period of minimal or nonexistent profits. Entering the China market is expensive, and the costs of maintaining an office there are quite high. Presenting the image that a company is a large and well established firm seeking a long term relationship in China is an important aspect of being successful there.

The product of the company is also a critical variable. While most countries have restrictions on importants, the list in China is extremely long and detailed. Another problem occurs even with products within categories the Chinese want to import. Shortages in power supply and other infrastructure prevent the sale of some desired products. Product life cycles appear to have relatively long introductory stages with high learning curve requirements. Thus, even the strongest products can take a while before acceptance begins. The same loyalty that structures business relationships also applies to brand names. Heavy promotion can help overcome the lack of a previous presence in the market, however.

**Understanding the Bureaucratic Structure**

Perhaps the most difficult aspect of selling to China for many industrial marketers is understanding the numerous layers of bureaucratic structure and dealing effectively with them. The most important point to remember in selling to Chinese enterprises is that all are state owned. Thus, all enterprises have both professional management and government bureaucrats involved in decision making. In addition, various levels of government become involved in business decision making from local trade offices to the Ministry of Foreign Economic Relations and Trade (MOFERT).

Since 1980, when Premier Zhou Ziyang took office, central directives have aimed at increasing the coordination of policy between the regional trade offices. These regional trade offices present a unified foreign trade policy and act as a regulatory liaison between the central authorities and the "free-for-all" atmosphere of the local trade offices. In addition, import/export licensing requirements have been tightened and the Customs Office has been separated into an independent body with augmented powers.
In addition to MOFERT, the central government agencies that administer and promote foreign trade are the foreign trade corporations (FTCs) under MOFERT, and related local and specialized trade offices. Less of a central link, but often crucial as a liaison between foreign business and the FTCs, is the China Council for the Promotion of International Trade (CCPIT).

The following represents a brief description of the key agencies and their responsibilities in regulating trade:

MOFERT. The Ministry of Foreign Economic Relations and Trade is the principal coordinator of foreign trade. Its responsibilities include implementation of state promulgated principles and policies on foreign economics and trade; importation of advanced technologies; and coordination of the activities of the regional and local foreign trade offices in accordance with its other responsibilities.

FTCs. China's foreign trade corporations were created to balance local and central authority. They are the primary link between foreign business and end-users. The FTCs also act as liaisons between foreign business and the central government. FTCs are divided along product lines into ten organizations. They are often the first point of contact for foreign firms trying to enter the China market. The duties of the FTCs include the implementation of the directives of MOFERT concerning the development of the import and export of their respective commodities; the signing of purchase and sales contracts with foreign enterprises and the arrangement of financial settlements; and monitoring of foreign exchange settlements. The central importance of the FTCs has been splintered in several ways. Ministerial and local trading corporations have begun to appear and some individual enterprises have the authority to compete with the FTCs. FTC branch offices, located in the major industrial cities, act as mini-offices for trade promotion, issue some specialized import and export licenses, and conduct market research. The branches are under the control of the head office, but, are supervised by local authorities. They are gradually becoming the center of China's import business.

The CCPIT. The China Council for the Promotion of International Trade is an independent organization under the jurisdiction of MOFERT. The duties of the CCPIT include promoting foreign economic and trade ties; concluding non-governmental trade agreements with foreign firms; and arbitrating economic, trade, and maritime disputes.

Others. Other political subdivisions of the local government are authorized to supervise auxiliary trade services. These offices handle transportation, shipping, packaging, advertising, and other issues. In addition, an increasing number of separate national agencies may provide trade
assistance. Some, like the CCPIT, are under the jurisdiction of MOFERT. Others are independent or related to other ministries. In special cases, large industrial enterprises and designated special projects may be authorized to conduct business within the boundaries of an approved plan, usually limited to a certain value. These exemptions may by-pass the FTCs and local trade offices altogether.

Since China's formal trade structure is still evolving, it is not always clear whom the appropriate contact is, or whether contracts have been properly approved and signed by the correct legal and governmental agencies. The two best sources for contract decisions are the treaty and Law department of MOFERT and the legal department of the CCPIT.

Conducting Detailed Business Operations

In making an industrial sale, finding a buyer is probably not the most difficult aspect of the transaction. There are, however, several hurdles the industrial marketer must negotiate after a potential buyer is located. First, an import license must be secured. The end-user then must sign a contract which is submitted to MOFERT for approval. Payment will depend upon the availability and approval of the expenditure of foreign exchange currency. Before shipping the goods, the industrial marketer needs to resolve a number of issues including trademark and patent protection, political insurance, and legal arbitrations should any problems develop.

Then the actual logistics issues have to be resolved. For instance, how to ship and deliver the goods, where to submit the imports for commodities inspection, and how much to set aside for customs duties. All of these details must be settled before delivery is attempted.

Negotiating through these levels of bureaucracy can be time consuming, confusing, and frustrating. It is a process which requires the proper sequence of procedures to be followed. Leaving out one step of the process or one of the administrative offices responsible for reviewing the contract or approaching end-user too early in the process can lead to problems that may be difficult, if not impossible, to resolve.

Summary

This section presents a summary of some of the problems industrial marketers have to solve in buyer-seller relationships with Chinese enterprises. The points come from the preceding background material and personal knowledge of marketing in China. The following problems or obstacles are often encountered in developing business relationships in China:
(1) Confusion caused by the overlapping bureaucratic organizations and enterprises: The same transaction can be handled by different Chinese business sectors whether it be government level bureaucracy or local business. At this point, an inside-information provider is vital.

(2) Chinese process-oriented buying behavior vs. Western action-oriented selling behavior: When a Western company does business with a government-owned business, or more accurately, a public bureaucracy, the Westerners find they have to sacrifice their action orientation for a process orientation, which is usually a trial of their patience. The Chinese process-oriented buying behavior often involves hierarchical project evaluation, collective decision making on the approval of the project, and other unusual delays, which are part of the reasons for low efficiency.

(3) Chinese indirect, nonverbal cues in negotiations versus Westerners' straight forward yes or no style: This is one of the biggest culture shocks in many business negotiations. The problem is worsened when more than one level of management from the Chinese side participate in the negotiations and Westerners fail to read whose non-verbal cues play a decisive role an whose yes does not weigh an ounce.

(4) Depending too much on a translator: In most cases, selecting a translator from a third party (such as Hong Kong) is unwise. First, s/he is not trusted by the Chinese side. Second, s/he is not familiar with the mainland situation and social or organization norms. Third, s/he has no loyalty for either side. Therefore, a successful translator should be a person at least trusted by one side, while the other side can "read" some information from the way the translator behaves. To judge the reliability of the information provided by the translator, the other side needs to see how well his advice and suggestions are accepted by the decision-makers.

(5) Lack of skills in developing human relationships: There are clusters of interpersonal relationships which are beyond the imagination of the Westerners as well as the outsider Chinese. Japanese are good at picking up various group dynamics occurring in the other negotiating team. When the Japanese do business with a Chinese enterprise, they like to have the buyers around them in a social setting before conducting business. Westerners are often tempted to conduct business first, and then celebrate a successful negotiation. Presenting a "gift" is the norm of Japanese (also a norm of the Chinese).
In a word, although cultural differences are a big issue in doing business with China, they are not the crucial ones. To understand Chinese buying behavior, one has to learn how to cope with China's bureaucracy and red tape. Many companies are often trapped by bureaucracy and red tape. Presented in the next section are examples of three different approaches to cut through the Chinese bureaucracy and get around the red tape.

**Alternative Approach Strategies**

One way to approach the China market is directly. This involves selling to and/or through a local enterprise. This approach is described as the "Buying Group" model, and requires great patience and significant skills on the part of the industrial marketing organization. A second approach, called the "Agency" model, is a case of using a local Chinese organization to represent the industrial marketer in a sales effort to enter the market. This approach requires some understanding of the official organizational bureaucracy, but relies on finding a key public sector organization and, more crucial, a very responsible individual within the organization to handle the marketer's case. The third approach, joint venture, requires both the industrial marketer and a domestic partner to contribute to, manage together, and derive profits from the marketing effort. In the joint venture, two different companies from two different environments are joined together in a business effort in which each may have its own objectives and priorities. Coordinating the two organizations' goals requires open and constant communication and endless compromise from both sides. In this section, each of these approach strategies for buyer-seller relations with the Peoples' Republic of China are developed.

The "Buying Group" Model -- Doing Business with China Through an Authorized Buying Bureaucracy -- BISCIEC

An example of selling directly to Chinese enterprises in the form of an authorized buying bureaucracy involves the Benxi Iron & Steel Complex Import & Export Corporation (see Appendix 1). (BISCIEC is one of the four major iron and steel import/export corporations in China. BISCIEC Benxi Iron and Steel Import & Export Corp.) is a subordinate branch of the China Ministry of Metallurgical Industry of Beijing. Normally, any import transactions should be conducted through the Beijing bureaucracy, however a local corporation, such as BISCIEC, has certain buying decision authority depending on the total cost of the goods to be imported.
China, or more specifically, the Ministry of Metallurgical Industry of China started buying mining equipment from America, Japan, and West Germany in 1977, a year before the Economic Reform. Import priority was given to heavy industrial technology and equipment. Unlike Taiwan or Japan who depend totally on exporting, China is seriously limited by the budget of foreign currency, which is not the problem with any of the industrial sellers. Before a buying group can enter into any negotiation, a local corporation like BISCIEC is allocated a certain amount of foreign currency by the Beijing Ministry. It is very natural for the direct buyer to be extremely price sensitive and focus on the limited budget—trying to get the most out of the least. Here is a case to illustrate what is meant:

In 1983, through the Beijing Ministry, a negotiation was being conducted for the Benxi Corporation on their hot-strip mill project. This equipment was urgently needed by the corporation to modify their hot-strip mill, which was constructed in the early 1970s. The plant had been constructed by the Chinese, but many technical problems could not be solved. That was why technicians strongly pleaded for the right to import foreign technology. Since the foreign currency allocation was made before the suppliers' bids were received and negotiations started, and the technicians had already set the criteria for the proposed product, the buying group was limited during the negotiation to meeting the technical specification with a no-higher-than budget of $50 million appropriated for the project.

The first sellers who provided bids were three American enterprises. The president of one of the three came to China five times during two years for this bid, and conducted dozens of negotiations, but failed to win the bid. Instead, a West Germany business won the contract. Japanese businesses also provided bids, but Northeast Corporation did not even enter into negotiations with them. Several factors contributed to why the U.S. firms missed out on the project. The Chinese wanted to do this transaction with the Americans because of their trustworthy reputation and business credit, as well as their open and straightforward negotiation. The Chinese, however, were unable to accept their price due to the fixed budget. At the same time, no one from the Chinese side could release the information about the $50 million appropriation. Therefore, negotiations became guesswork for the Americans. Also, the American side could not lower the price any further because of more expensive labor costs. The American firms were without government subsidies like those provided to the Japanese businesses and the German one. This case shows how important it is for U.S. industrial marketers to have "inside information" while not violating the Chinese
norms. The result was that the German business took the bid at $40 million, covering all the technical services that would be covered by the Americans.

The Chinese feel that negotiation is compromise, in this case there was less possibility of making a compromise between the American businesses and theirs. As the buyer, they could not get any more money allocated from their government, although they had the decision right to choose from whom they could sign the contract. While the American businesses were private ones and had their own problems in not being able to set their prices below the cost.

A local enterprise like Benxi does have the right to make some direct buying decisions. While the previous example examined buying from foreign countries through the head office—Ministry of Metallurgical Industry in Beijing—there are cases where Northeast Corporation made the buying decision independently.

One case is the import of a Direct-reading Spectrometer which cost $2 million. The reason to buy it was improving technical equipment. Northeast technicians learned that other iron and steel enterprises had imported it, and they demanded that they should be allowed to also.

In a case like this, the importing procedures are much more simpler and efficient than the previous one discussed which went through the Beijing bureaucracy.

Differences in Buying through Beijing and Locally

The first question is how much does the product cost. If it is less than $3 million for the project or the product, then a local enterprise is granted the buying and decision-making authority provided there is appropriated foreign currency available at the beginning of every budgeting year. Every enterprise is appropriated a certain amount of foreign currency at the disposal of the user. If these enterprises do not find ways to spend the foreign currency, they have to turn in to the central government bank when the year ends.

For the Direct-reading Spectrometer product, the buying procedure was as follows:

1. The technicians of a subordinate factory of the corporation first fill in a report form describing the function of the product, the necessity of having it, some kind of feasibility study and other reports. Then they present their proposal to their factory's technology department. After being technically approved there, the technology department presents the proposal to the factory general manager who brings it to a collective decision-making session (composed of several
top managers). Finally, the subordinate factory sends their request for the import to the import/export corporation.

(2) The decision procedure in the import/export corporation is somewhat like that in the subordinate factory. The organizational chart in Appendix 1 only shows the import and export enterprise. But BISCIEC has 150,000 employees with dozens of subordinate mining branches and factories.

Upon receiving the report from the local factory, the corporation followed the following decision procedure: the equipment department managers held an extended meeting composed of the staffs from the planning department, the technology department, and the finance departments from both the subordinate factory and the corporation. At the meeting there was a technical defense of the proposed import project followed by a vote where the majority ruled. Finally, a formal document was developed. If by this time the corporation had foreign currency available, the corporation could directly start inquiries. If no money was available, the corporation would send the formal report to Beijing Ministry of Metallurgical Industry for allocation of foreign exchange currency.

If the corporation had a sum of appropriated foreign exchange currency, the general manager has the final decision-making power after the board of directors has made the decision. Benxi Corporation has nine managers, but the general manager has the final say although in theory the decision should be made by majority rule.

The decision procedures are different for projects greater than $3 million. If started by a local enterprise, such as a subordinate factory, they would provide all the relevant technical data on the product wanted, to the import/export corporation. Then the import/export corporation presents it, after any necessary modification, to the Beijing Ministry of Metallurgical Industry. The Ministry then presents the project report to National Planning Committee for budget appropriation. After the National Committee has approved and allocated the amount of foreign currency, an inquiry will be conducted by another public sector in Beijing, called the China National Technology Import & Export Company (CNTI&EC is a national level public enterprise in charge of all the large transactions of technology and industrial equipment import). The CNTI&EC will invite bids from foreign countries through the Ministry of Metallurgical Industry. The Ministry will inform the local enterprise when the bid is taken. During the business negotiation which is conducted by CNTI&EC, the local enterprise or the ultimate user has the right to reject some contract terms or reject the whole contract or accept the transaction, although it is the CNTI&EC that signs the
contract. Any transactions over $10 million have to go through the CNTI&EC.

Summary of the Buying Group Model

Selling directly to China can be a difficult process. The larger the potential sale the greater the levels of bureaucracy encountered. In the Buying Group model certain corporations are established as import/export enterprises and are empowered to deal directly with the foreign industrial marketers. This power is contingent, however, upon a number of factors: Technological feasibility studies, group consensus votes, availability of foreign exchange currency and other perhaps even unseen factors. The question quickly comes to mind as to whether the profit is worth the effort.

The "Agency" Model
Doing Business with China Through a Public Bureaucracy--TSTECFC

An example of selling to Chinese enterprises through an agency involves the Tianjin Scientific and Technical Exchange Center with Foreign Countries (see Appendix 2). TSTECFC is playing an increasing role in helping foreign businesses market their technology and products to Tianjin, one of the largest industrial city in China.

In 1984, according to an agreement between Tianjin and Philadelphia, a three-member group from TSTECFC visited Philadelphia and some other cities in the U.S. When the group returned to Tianjin after their one-month trip, several business representatives from Philadelphia visited Tianjin and were received by the Tianjin center. The Tianjin center arranged for them to meet with relevant manufacturers and businesses in Tianjin.

While the group from TSTECFC was in Philadelphia, its members visited the facilities of one industrial manufacturer, and were greatly impressed by the technology and services possessed by the factory. Also the highest ranking officials of the factory met with the group and presented them a catalogue of its products. On returning back to Tianjin, the center distributed the catalogues to appropriate factories in Tianjin in an attempt to find potential buyers. The Center then learned that this kind of product (special bearings) was needed by several customers, mostly electrical machinery plants producing different kinds of motor-driven products.

The Center then held a city-wide information release conference to introduce the products of several U.S. industrial manufacturers to other businesses. Present at the conference were representatives form Tianjin's industrial manufacturers, technology centers and concerned colleges. Thus, the special bearings manufacturer and other industrial manufacturers that the group from TSTECFC got to know during
their month long visit were introduced widely to the potential buyers in Tianjin.

Next, the Center presented its suggestions for further business cooperation between buyers and the special bearings manufacturer. The proposal included:

(1) The Center was responsible to advertise the manufacturer's technology and products in China. The benefit for the manufacturer was that they would not have to send representatives or establish an office in China, which is very expensive. Also, the Center had far more influence than the manufacturer's representatives could generate, because a public bureaucracy like the Center has formal relationships with city bureaucracies such as the planning committee, different Bureaus (like local departments or committees), and factories owned by the government. The Center also is able to get accurate information regarding foreign currency appropriation, approvals from superior management, and other government information.

(2) The products provided by the manufacturer must be of advanced quality.

(3) The seller would provide catalogues and samples periodically to facilitate promotion.

(4) The Center was to be responsible for screening engineers to be representatives of the manufacturer. Two candidates were to be chosen with the final selection being made by the manufacturer.

(5) The manufacturer was responsible for covering all of the expenses for the two representatives' 30-day on-the-job training in the U.S. at the company's facilities.

(6) The Center was to provide the two representatives, upon their return from training in America, with an office and office facilities such as telex and other equipment.

(7) The manufacturer was to pay $5,000 to the center for opening the agency, and $10,000 every year to the center for business activities.

(8) The Center was responsible to provide a written report to the manufacturer including: name lists of the customers visited; their interests in the manufacturer's products; the probability of potential transactions, and post-sale service and support required.

Based on these suggestions, the American side had an attorney prepare a formal "Technical Sales Representative Agreement." This agency representation was designed mainly made by the
vice manager of the Center. The vice manager is the person who is responsible to coordinate with every one involved in the program and for the quarterly report to the manufacturer. Identifying a reliable person, like this vice manager, who is familiar with every procedure, responsible, and possesses a key position is crucial for the establishment of an effective agency program.

The required foreign currency must be approved by the national level bureaucracy. A relevant technical feasibility study is a prerequisite for the appropriation of the foreign currency. The Tianjin Science & Technology Committee is responsible for the feasibility study and approval, and the center is a direct subordinate sector of it. The implication here is the center has a much greater chance to have the appropriation granted than any other organization would.

Foreign trade corporations are responsible for signing the contract, and any foreign trade business has to be reported to the national level corporations. Due to the existing overlapping foreign trade corporations, sometimes it is confusing to decide which corporation one should go to and competition sometimes occurs between the FTCs. For example, the import of bearings like this program can be done through Machinery Import & Export Corporation, or by China Technology Import & Export Co. or by a Foreign Trade Corporation and other related ministries. In a word, the higher the level of administration as the three mentioned which all are in Beijing, the more red tape involved.

Chinese buying behavior is so complicated that it is very difficult to list the specific procedures. Even with the listed steps at hand, it is still confusing with all the contingent approaches and the continuously changing situation. Going through a public agent like the Center and having a very responsible subordinate manager may be a more efficient and effective way for industrial marketers to approach Chinese buyers.

The agency model helps to minimize some of the risk and uncertainty involved in marketing to China. The following techniques available through the agency model function positively in helping both sides in the buyer-seller dyad:

Long distance facilitation. If the seller is interested in a project including a joint-venture, technology transfer, or selling industrial equipment, he can send to the Center his catalogue and other related materials. The center will select some enterprises who may be interested in the program and transfer the materials to them. After that, the Center will require a written report from the message receivers which should state: whether this program can be developed; evaluation on the technology of the potential seller; what are the possibilities of establishing a cooperative
relationship, and the relevant qualification of an enterprise; and, their requirements for the program.

After several letters or telecommunications, if both parties are interested in each other, the Center will help send letter of invitation and visas to have the potential sellers come to China to meet with the individual enterprise.

If both parties, having had a better understanding of each other after face-to-face communication, believe there are very good possibilities of cooperation with each other, the Center will use its influence and push to promote and facilitate the business.

**Direct Interface Support**

Another approach to getting the sellers and buyers to know each other is to hold a technology exchange conference for the foreign businesses whose products are required by Chinese enterprises. This is a more efficient and effective way for some larger industrial marketers. The Center will invite all the potential buyers from the entire country to the conference, which can not be done by the foreign businesses themselves, nor by their offices (if they have any) in China. Since the Center has access to all kinds of home businesses and Chinese technicians and other experts, it gets more information and buyer reaction than would the foreigners themselves. The center decides the scale of the conference. The Chinese technicians are invited to the conference to evaluate the technology, the Center may release the news to local or even national mass media. The foreign businesses pay an advertising fee and the administrative expenses for the advertising.

**Summary of the Agency Model**

The agency approach to marketing in China has several advantages for industrial marketers. It permits both direct and indirect representation for sellers with buyers. It also provides buyer and seller directed facilitation. The key question raised in the agency model is the ability of the agency and its representatives. In describing some of the issues the Tianjin Center faced and solved, it becomes clear that the agency model can be a powerful tool for Western industrial marketers if the Chinese representatives are effective business facilitators.

**The Joint Venture Model—Full Partnering with the Chinese to Enter the Market—Supraseas**

Joint ventures have been a popular form of approaching the China market and have been encouraged by the Chinese to increase direct investment in the market. Joint ventures are investments where both a foreign firm and a domestic partner
contribute capital to, manage together, and derive profits from an enterprise. Two forms of joint ventures exist: contractual and equity-based.

Contractual joint ventures are typically service oriented enterprises which last from five to twenty years. The foreign firm generally gives the technology and cash (foreign exchange currency) to get the project underway. The Chinese domestic partner provides the land, building, workers, materials, and natural resources. The foreign investor receives a pre-determined rate of return and constant repayment of principle. After the obligation is fulfilled the domestic partner reaps the rewards of the continuing enterprise. In this form, the foreign investor is just slightly more involved than a typical lender.

Equity joint ventures require both the domestic and foreign partner to invest capital in the enterprise. Each partner provides at least twenty-five percent of the capital. The two companies form a new limited liability corporation with themselves as shareholders. The profits are divided by a pre-determined agreement which usually is reflected in the shares distribution. The rationale behind forming a limited liability company is so that debts, in the case of failure or adversity, cannot be carried back to the founding companies. In this form of joint venture, there is a finite liability and an infinite return possible to each partner.

Supraseas Corporation provides an excellent example of how a joint venture can be structured and implemented to penetrate the China market. The executive vice president of international operations for a large U.S. industrial and consumer products firm became interested in developing a joint venture between his company and the Peoples' Republic of China. The U.S. corporation, however, was a subsidiary of a European conglomerate which was not interested in the China market. The executive was able to structure a compromise which effectively satisfied all parties—the Chinese, the parent corporation, and himself. The deal enacted between the executive and the parent corporation permitted the lease of corporate patents to the joint venture under an established agreement. The authorization to use the patents was for a five-year period at a nominal fee. By the end of the five-year period, the executive was required to have at least one of the joint venture's plants in China completed and ready to start production. After production began, the joint venture was to pay royalties on the venture's revenues. The executive had full authority to enact the joint venture in the Peoples' Republic as he saw fit.

An international attorney who specializes in Chinese law was brought into the joint venture as a partner on the American side. The executive and this new partner determined that the risk factor of the venture should not be internalized.
Instead, to divert personal risk to a legally responsible entity, they formed a company to represent their interests and be the sole contact with the Chinese government. The formation of this company was the key strategic action that brought the deal together. By forming a separate company to be solely responsible for the risks involved in expansion into China, other companies that had previously thought the risk too high were lured into licensing arrangements with the new company. These companies were guaranteed that they had only their initial investment to lose.

The executive bought the rights to the company name, "Supraseas," in Hong Kong and established the company there. Supraseas has three separate but interacting functional divisions. No previous joint venture had been structured in this manner. This structure was an important aspect in the company's success (see Appendix A).

1. **Holding Company.** The first division is that of the holding company. The holding company will hold the licenses of the products which will be produced by the joint venture. The holding company will bear the legal and financial risks associated with introducing the already existing product lines into China. Having the holding company shoulder these risks, the parent companies would not have to formally enter the Chinese market. They could instead record the ventures as one-time profit transactions, a lease of their products to the holding company. According to the executive: "The [the parent companies] can be unreasonable as they want about their licensing demands (costs), because we will say, 'Fine, but we are just going to spread payment over a long period of time.'" The executive intends to contact each company which presently holds the technology that is wanted by the joint venture and offer them a no capital risk foothold in the Chinese market.

2. **Support Company.** The second division is that of a support company. This support company is the line operations that supports the technology of the Hong Kong company. It will encompass all of the Financial, Manufacturing, Marketing, Administrative and Quality Assurance departments. The support group will consist of the people who actually go to the joint ventures' operating location(s) to aid in day-to-day operations. They will be educating the Chinese staffs in Western management approaches and production methods. They will represent the foreign firm to the actual plant/factory workers, just as the holding group will represent the foreign partner's interests to the Chinese negotiators.

The staff will consist solely of Hong Kong Chinese, no expatriates. Hiring only Hong Kong Chinese offers two benefits. The joint venture will save on the $4000/month
apartments and other prohibitively expensive luxuries associated with American and Taiwanese professionals. The Hong Kong Chinese also have the benefit of both speaking and thinking Chinese while speaking and thinking English. Since they will be directly interfacing with the Chinese managers and laborers, fluency and understanding of the Chinese culture is imperative.

An executive board, consisting of the founding executive and other partners, will exist. This group will serve as a consulting group and directional leader to the support company.

3. Development Group. The third and final division of the company is development. The development group is basically another support group, only it is the other side of the support group's activity. Whereas the support group manages and trouble-shoots the existing plants, the development group will plan, develop, and analyze future investment opportunities. They will be the team who will analyze the market/situation/environment in China and develop feasibility plans for both horizontal and vertical expansion. They will coordinate the functions of the basic operations.

The support and development division will be run on a cyclic schedule. The group members will be three weeks on location in China and one week out. Provisions for weekend trips to Hong Kong will also be considered.

The joint venture project follows an eight-phase itinerary for setting up operations in China. Each of these phases covers a different aspect of establishing the project. The eight phases do not follow in a chronological divided manner. More than one phase may be occurring at the same time. Appendix 4 shows the eight-phase itinerary and the steps involved in each phase.

Summary

At the present stage of development, the joint venture looks like it will be successful. Each side is comfortable with the structure and potential profit schedule. The only problem the U.S. partner is concerned about is the uncertainty of the situation. "Are we really dealing with long term stability here?" In developing a new business approach, no "givens" exist. Every factor in the joint venture is an estimate or a guess, and nothing is certain. This is why so much time and effort was spent on the feasibility analysis. The venture was risky, but if everything works as planned, the reward should be tremendous. The founder's partner Lark, and the licensees will have established their claim to one of the world's fastest growing industrial markets.
CONCLUSION

China's industry is focusing on the future and buying new industrial products in addition to modification of existing and out-of-date industrial equipment and technology. If industrial marketers can realize this and develop products that can meet the present needs, China will be a large potential market for Western industrial products manufacturers.

Because of governmental bureaucracy and organizational systems which are not as efficient as those of other developed countries, there are a lot of frustrations and uncertainties in doing business with China. This paper shows how complicated Chinese industrial buying can be and presents three solutions to penetrating the China market—the Buying Group Model, the Agency Model, and the Joint Venture. These three strategic approaches require different corporate skills and offer varying opportunities for developing buyer-seller relations with the People's Republic of China. Three specific organizational examples were detailed to indicate that each of these approaches is currently being used successfully in the China market.

REFERENCES


Appendix 1
The "Buying Group" Model

BISCIEC handles the import of equipment, spare parts, instruments, metres and some special raw and semifinished materials for technical revamp and renewal of equipment to meet the needs for the production and scientific research of Benxi Iron & Steel Co.

It handles the negotiation and the signing of a contract concerning cooperative production, cooperative investment and management, compensatory trade and processing of imported materials.

It handles the export of the metallurgical products and by-products produced by Benxi Iron & Steel Co. and also technical transfer.

ORGANIZATIONS OF BISCIEC

BOARD OF DIRECTORS

GENERAL MANAGER
VICE GENERAL MANAGER

Export Dept. - handling the export of products, equipment produced by Benxi Iron & Steel Co. and technical transfer.

Import Dept. - handling the import of equipment, spare parts, instruments and qualified experts for Benxi Iron and Steel Co.

Dept. of Foreign Economic Affairs - engaging in technical exchange, use of foreign investment, cooperative investment and management, processing of imported materials, compensatory trade, labor export, contracting foreign projects of Benxi Iron & Steel Co. and also handling the business in special economic and developing zones of China.

Comprehensive Planning Dept. - engaging in the business of statistical tables and reports.

Finance Dept. - responsible for the setting of foreign exchange and for the payment of foreign insurance, freight incidentals and internal current accounts.

Transport and Store Dept. - responsible for the business of transport concerning the import and export of BISCIEC.

Market Conditions Dept. - responsible for collecting international market conditions information.
Appendix 2

A BRIEF INTRODUCTION TO THE CHINA TIANJIN SCIENTIFIC AND TECHNICAL EXCHANGE CENTER WITH FOREIGN COUNTRIES (TSTEC)

China Tianjin Scientific and Technical Exchange Center with Foreign Countries is an organization for science and technology exchange and cooperation with foreign countries on a non-governmental level. It was established in 1980 with the aim to organize and promote exchange and cooperation between the scientific and technological circles in Tianjin and their counterparts in various countries on the basis of friendship, equality and mutual benefit so as to promote science and technology, economic and social developments and the mutual understanding and friendship between the Chinese people and peoples of all other countries.

THE MAIN ACTIVITIES OF TSTEC ARE AS FOLLOWS:

1. Building a bridge between scientific research institutes, academic societies, higher educational institutions, medical circles, factories, mines and other enterprises in Tianjin and various countries, so that to establish relations or exchange and cooperation in these fields.

2. Exchanging scientific and technical personnel with foreign countries for joint research and technology development.

3. To handle the business of technical cooperation including joint design research and development and to handle the business of technical trade including the transfer of techniques, know how and patent licenses.

4. To handle joint venture affairs, cooperative production and compensatory trade.

5. Inviting foreign specialists and scholars to give lectures and conduct technical symposiums in Tianjin.

6. Organizing bilateral conduct, multilateral international science and technology conferences and public lectures and seminars.

7. Organizing specific or comprehensive international exhibitions for exchange of science and technology.

8. Organizing overseas visits, study tours, short-term advanced studies and other academic exchanges by scientific and technical personnel in Tianjin.
9. Collecting and displaying catalogues and samples of new products from foreign countries.

10. Promoting exchanges of scientific and technical information between science and technology institutions in Tianjin and their foreign counterparts.

11. Receiving financial and material support provided by friendly personage and science and technology communities in various countries for personnel training and scientific and technical activities for Tianjin.

12. Communicating and cooperating with China science and technology exchange center and other organizations in scientific and technical exchange with foreign countries in various provinces and municipalities or China and in carrying out scientific and technical activities.
APPENDIX 3
SUPRASEAS*

HOLDING COMPANY

Holds licenses for the processes which will be processed in China

Carries all financial and legal risks which are associated with international expansion

Licenses Held:
Sarah Lee
Leonides
Smuckers
Guernsey Dell
Yoplait

SUPPORT COMPANY

Aids Chinese factories in many areas of day-to-day operations

Staff consists of all Hong Kong Chinese

Support Areas
Administrative
Finance
Manufacturing
Marketing
Quality Assurance

DEVELOPMENT COMPANY

Plans/develops investment opportunities, coordinates five functions of operations.

Analyzes market situations and environment.

Develop feasibility plans for both horizontal and vertical expansion.

*Ownership: 20% - Entrepreneur
30% - Entrepreneur
50% Venture Capital Company
APPENDIX 4
PROJECT ITINERARY

Phase I
   Establishing a Joint Venture Agreement
   - Licensing contracts
   - Feasibility study (required by Chinese government)
   - Factory sight study

Phase II
   Develop Factory Plans and Equipment Layout
   - Use U.S. engineers for design
   - Hire Hong Kong engineer to understand the layout
     (for repair and alteration convenience)
     * Nonconsistent power flows are a major problem
   Establish Hong Kong Financing
   - Establish loan agreements (pay back schedule)
   - Establish bank accounts to operate with

Phase III
   Begin Factory Construction
   - Supervise construction schedule
   - Allow plans and construction format to be checked
     by Hong Kong engineers

Phase IV
   Furnish the Factory
   - Purchase, Plan and Layout Equipment
   - Recondition any equipment requiring assistance
     * Phase III and IV occur simultaneously

Phase V
   Employee Training
   - Bring the Chinese management to the U.S. to learn
     the company culture and the U.S. methods of
     management
   - Send U.S. management to the PRC to become acquainted
     with the area and culture

Phase VI
   Secure Raw Material Supplies
   - Secure domestic sources
   - Secure foreign exchange ratios for foreign
     materials
   - Bring in raw materials

Phase VII
   Shake Down Equipment
   - Debug wiring and other potentially faulty areas
Phase VIII

Trial Production
- Run awhile
- Prepare to launch marketing campaign