

Contracting with a Chinese company: How to make it work^{1, 2}

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ABSTRACT

Because Western firms want to implement themselves in the Chinese territory, or simply do business with Chinese companies, they need a different process than solely dealing with someone of the same localization, language and cultural customs.

This paper aims at understanding how contracting with a Chinese company is different from the Western way of doing so. That is why as a Western contractor, one must adapt and search for some potential solutions to what could become a problem during the management of the project.

In order to identify the causes of such a problem and counter them, we used a qualitative and quantitative analysis that allowed us to rank feasible alternatives on how to avoid contract failure when dealing with a Chinese contractor.

Key words: contract failure, China, Chinese negotiation, Western negotiation

INTRODUCTION

Before the 1980s, China was historically an economically closed country. Different wars and revolutions have put the country into turmoil and did not allow a prosper development within the borders. Society lived based on an agrarian economic model, and the majority of people was poor.

“The China of yesterday exists no more. Following different economic reforms since 1978, it is today the second most important economic power of the planet, overtaking Japan in 2010”³. China is clearly the leader of the BRICS, an aggregate of quickly developing countries, composed of Brazil, Russia, India and South Africa as well. One cannot today avoid China as a growing market and a power not to be messed with. Thus, multiple firms, for instance Starbucks, Ikea or

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³ Liping, H. (2013). CHINA AS THE WORLD'S SECOND LARGEST ECONOMY: QUALIFICATIONS AND IMPLICATIONS. China and East Asia, 35-53.

H&M⁴ have successfully established themselves as new competitors to ancient Chinese firms (HOLA, historical main competitor to Ikea, the Hong Kong-based Pacific Coffee) and their installation in the Chinese territory is a proof of contracting done well.

Unfortunately, time has proven that collaboration between Western and Chinese has not gone well in general. An oil company had their sales executive travel to China to complete a deal with a Chinese company⁵ on which he had been informed of basic Chinese etiquette, only to urge the Chinese company not to take days to sign the contract. The Chinese company then adjourned the meeting and signed a deal with the competitor. Another company sent a low-level executive to negotiate a contract with a Chinese company: the latter felt insulted by it and refused to sign the contract. These examples are representative of a recurrent issue happening when a contract is dealt between a Chinese and a Western company.

Contract failure between a Western party and a Chinese party thus results more often than not in an impossibility to negotiate the terms, come to an agreement and find a way to properly manage the contract. Why is it, from a Western point of view, that difficult to sign a contract with a Chinese company? What Western companies fail to take into account is that Chinese don't sign a contract like them. Because of cultural and social differing viewpoints, if a Western firm tries to go into a contract meeting the same way it would go to sign a contract with Apple or Walmart, for instance, it will not go well. The Chinese function vastly differently, and for a partnership to be signed between a contractor and an owner, Western companies must adapt to their rules, follow Chinese principles and have an accordingly behavior. One could say that to manage a contract with a Chinese firm, you must do it the Chinese way.

This leaves us with our main problem: how to avoid contract failure when dealing with a Chinese contractor? There are some processes that can be followed to successfully sign a contract with Chinese. We will also aim to answer the following question: how to prepare best to make the contract management process as successful and smooth as possible? What is really managing a contract the Chinese way?

METHODOLOGY

Step 1 – Problem identification

For the consequence of a problem in issuing a contract with a Chinese counterpart is the failure of the contract, one must study the possible causes of such an issue. Therefore, we will use a fishbone diagram to determine them.

⁴ Deng, L. (2018, January 7). Western Companies in China, what's their edge? Noteworthy - The Journal Blog

⁵ Graham, J. L., & Lam, N. M. (2003). The Chinese negotiation. Harvard Business Review

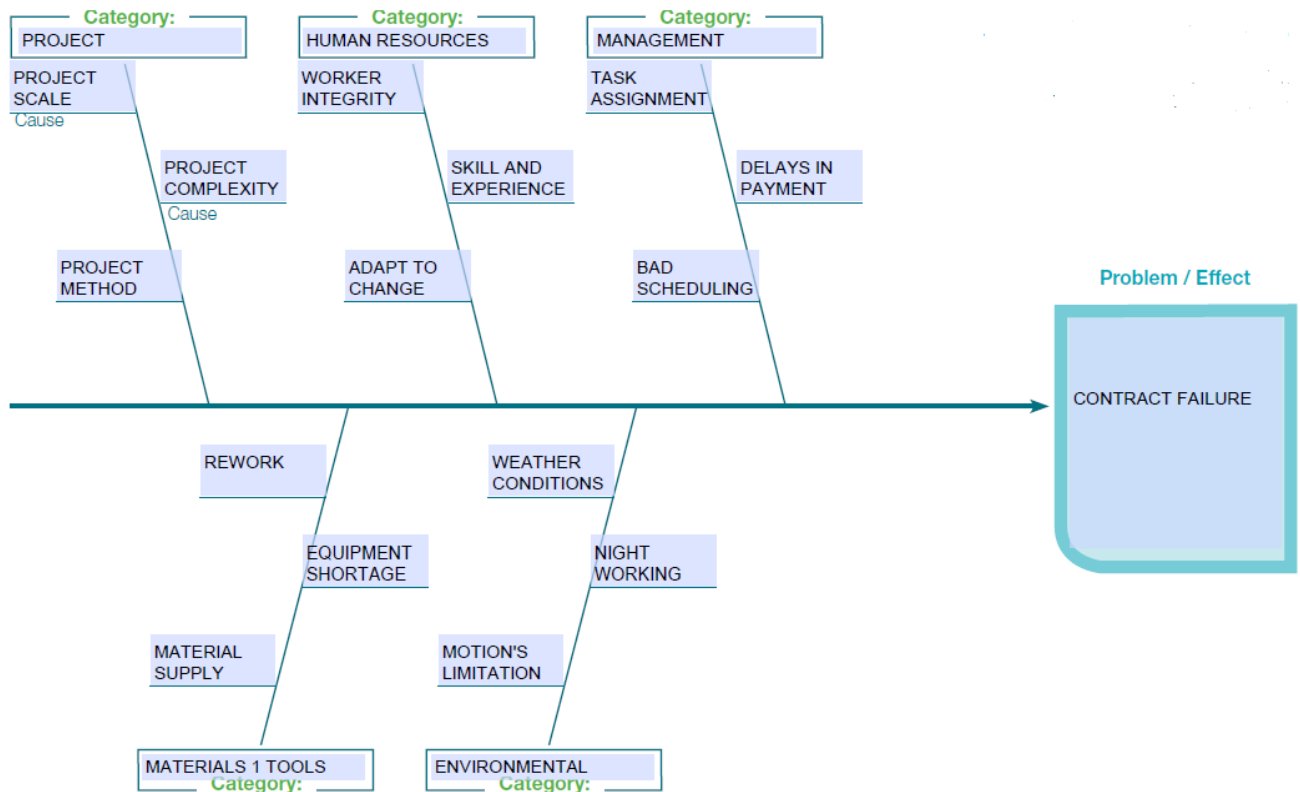


FIGURE 1 – Root cause analysis⁶

These four different causes were taken from G. Robles, A. Stifi, José L. Ponz-Tienda, S. Gentes' work on labor productivity and the different factors causing contract delays or failure.⁷

Let us take a look at each one:

- Project: the authors tell us that the complexity and the scale of the project can become issues when not taken into account by both contractors.
- Human resources: through research, we have been able to pinpoint that communication is not a strong forte of Chinese contracting in general⁸. This can only be emphasized when the contractors do not speak the same language or behave the same way.

⁶ by author

⁷ Labor Productivity in the Construction Industry -Factors Influencing the Spanish Construction Labor Productivity. (n.d.). Retrieved from <https://waset.org/publications/9999560/labor-productivity-in-the-construction-industry-factors-influencing-the-spanish-construction-labor-productivity->

⁸ Mayer, A. (2011, December 20). On poor quality: corruption and construction in China

- Materials and tools: a shortage in their supply, or their late delivery can create a delay in the management of the project.
- Environment: environmental factors such as weather working conditions (rain, winds) or the constraints they lead to (having to work at night, for instance) must be taken into account as well. China faces unstable and risky weather conditions, so much that the Chinese government has acknowledged the issue of weather and has begun providing weather insurance to the Chinese people⁹. When meeting the contractor is so important in the culture, it becomes a major risk of not signing the contract.

Step 2 – Identification of feasible alternatives solutions

In order to avoid any possible failure of contract from the diverse causes previously explained, we can choose multiple ways to resolve the potential dispute.

The alternatives we have decided to choose are the ones proposed by the Guild of Projects Controls¹⁰, and presented in the following figure:

⁹ Calum G. Turvey, Rong Kong, (2010) "Weather risk and the viability of weather insurance in China's Gansu, Shaanxi, and Henan provinces", China Agricultural Economic Review, Vol. 2 Issue: 1, pp.5-24

¹⁰ Guild of Project Controls. (n.d.). Planning, scheduling, cost management and forensic analysis. Retrieved from <http://www.planningplanet.com/guild/gpccar/settlement-negotiations-phase>

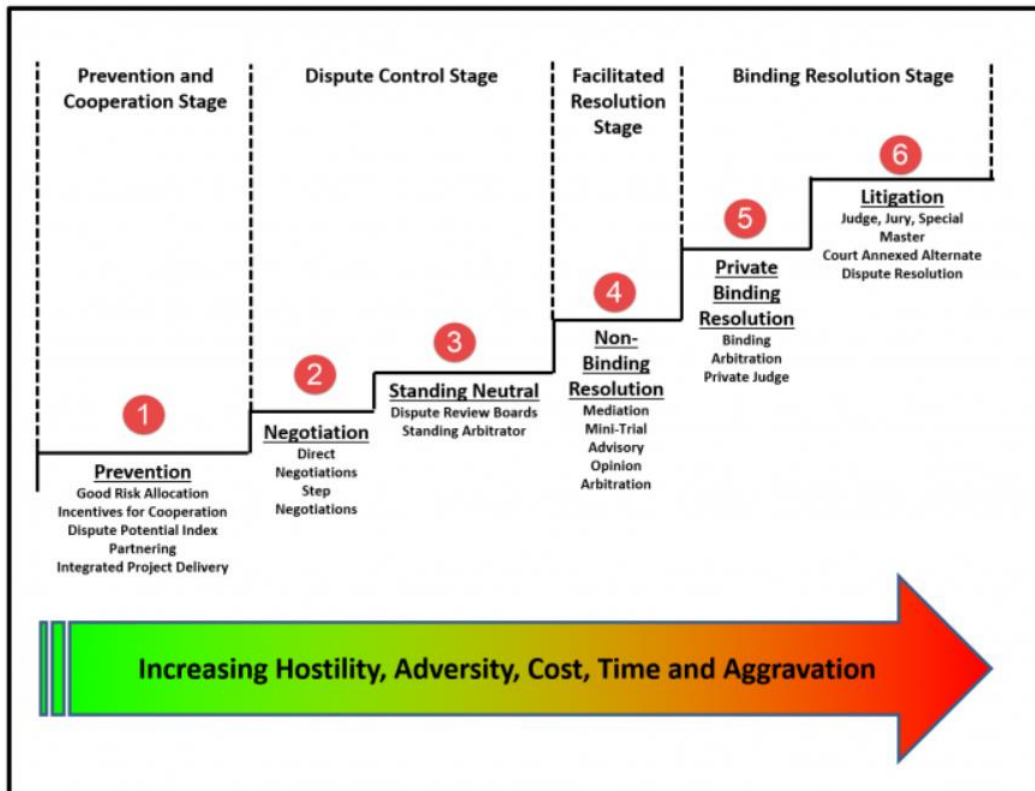


Figure 2 - Escalation Steps in the Alternate Dispute Resolution Process¹¹

These will serve as our feasible alternatives as to how to settle a dispute between a Chinese contractor and a Western contractor.

The attributes we will use to assess each of these alternatives are directly taken from Sherwin, P., Vermal, A., & Figueira, E. in *Proskauer on International Litigation and Arbitration: Managing, Resolving, and Avoiding Cross-Border Business or Regulatory Disputes*¹².

They are the following:

- Submitting disputes to arbitration;
- Success of international arbitration;
- Party autonomy;
- Freedom to choose an objective and competent decision maker;
- Speed;
- Cost;
- Confidentiality;

¹¹ Adapted from Coleman, P. T., Deutsch, M., & Marcus, E. C. (2014). *The handbook of conflict resolution: Theory and practice*. San Francisco, CA: Jossey-Bass.

¹² Sherwin, P., Vermal, A., & Figueira, E. (2016). *The Decision to Arbitrate*. In *Proskauer on International Litigation and Arbitration: Managing, Resolving, and Avoiding Cross-Border Business or Regulatory Disputes*.

- Ability to select the place and language;
- Flexibility of the process;
- Limited discovery;
- Absence of appeal;
- Enforceability;
- Potential need for court intervention;
- Arbitrators' inability to consolidate action.

Step 3 – Development and outcomes of each alternative

- **Prevention:** the contract should necessarily hold clauses in order to avoid potential discord with the contractor.¹³
- **Negotiation:** if there exists a minor issue with the Chinese manufacturer, that the Western contractor feels easy to resolve, he could turn to this option to try and work it out without involving any third party in the process. ¹³
- **Standing neutral:** both contractors could use a standing arbitrator, a neutral individual meant to appease and resolve disputes before their escalation.¹⁴
- **Non-binding resolution:** the contractors could use mediation or external arbitration to settle the issue. ¹⁵
- **Private binding resolution:** the situation could escalate or even begin from seeking arbitration, with supplementary monetary damages to a jurisdiction which would be situated outside of China (if the contractor is American, governed by U.S. law for instance).¹⁵
- **Litigation:** this can happen especially if the Chinese manufacturer breaches the supply agreement, for instance a non-competition clause or if he is not respecting the ownership of the tooling. ¹⁶

¹³ Liu, H. (2015). Analysis on Role of Project Contract Management in Prevention of Project Risks. Proceedings of the 2015 International Conference on Education Technology, Management and Humanities Science. doi:10.2991/etmhs-15.2015.155

¹⁴ Coleman, P. T., Deutsch, M., & Marcus, E. C. (2014). The handbook of conflict resolution: Theory and practice. San Francisco, CA: Jossey-Bass.

¹⁵ Lu, J. (2016, February 5). 6 Tips for Agreements with Contract Manufacturers in China | Cooley GO. Retrieved from <https://www.cooleygo.com/6-tips-agreements-contract-manufacturers-china/>

¹⁶ Lu, J. (2016, February 5). 6 Tips for Agreements with Contract Manufacturers in China | Cooley GO. Retrieved from <https://www.cooleygo.com/6-tips-agreements-contract-manufacturers-china/>

Step 4 – Selection of criteria

To evaluate our different alternatives, we will use the MADM (multi attribute decision model) based on the previously assessed criteria.

	Prevention	Negotiation	Standing neutral	Non-binding resolution	Private binding resolution	Litigation
Submitting disputes to arbitration	Green	Green	Yellow	Yellow	Red	Red
Success of international arbitration	Yellow	Green	Yellow	Yellow	Yellow	Yellow
Party autonomy	Green	Green	Yellow	Yellow	Red	Red
Freedom to choose a neutral and competent decision maker	Green	Green	Green	Red	Green	Yellow
Speed	Green	Green	Green	Green	Red	Red
Cost	Green	Green	Yellow	Yellow	Red	Red
Confidentiality	Green	Green	Yellow	Yellow	Red	Red
Ability to select place and language of arbitration	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow
Flexibility of process	Green	Green	Yellow	Yellow	Red	Red
Limited discovery	Red	Red	Red	Red	Yellow	Yellow
Absence of appeal	Green	Green	Red	Red	Green	Yellow
Enforceability	Green	Green	Yellow	Yellow	Green	Yellow
No need for court intervention	Green	Green	Green	Yellow	Red	Red
Arbitrator's ability to consolidate actions	Green	Red	Green	Green	Yellow	Yellow

Figure 3 – Qualitative analysis¹⁷

In the figure shown above, red represents a negative response to the attribute, yellow global fairness, and green a positive response to it. We have decided not to eliminate any alternative for now.

¹⁷ By author

FINDINGS

Step 5 – Analysis and comparison of each feasible alternative

We will now compare the remaining alternatives. Keeping the same attributes, we will now transform the qualitative analysis into a quantitative analysis. This is the code we will use:

Green = 1,00

Yellow = 0,5

Red = 0

This is the table we have come to create with this code:

	Prevention	Negotiation	Standing neutral	Non-binding resolution	Private binding resolution	Litigation
Submitting disputes to arbitration	1	1	0.5	0.5	0	0
Success of international arbitration	0,5	1	0.5	0.5	0,5	0,5
Party autonomy	1	1	0.5	0.5	0	0
Freedom to choose a neutral and competent decision maker	1	1	1	0	1	0.5
Speed	1	1	1	1	0	0
Cost	1	1	0.5	0.5	0	0
Confidentiality	1	1	0.5	0.5	0	0
Ability to select place and language of arbitration	0,5	0,5	0.5	0.5	0.5	0.5
Flexibility of process	1	1	0.5	0.5	0	0
Limited discovery	0	0	0	0	0,5	0.5
Absence of appeal	1	1	0	0	1	0.5
Enforceability	1	1	0.5	0.5	1	0.5
No need for court intervention	1	1	1	0.5	0	0
Arbitrator's ability to consolidate actions	0	0	1	1	0,5	0,5
SUM	12	11,5	8	7,5	5	3,5

Figure 4 – Quantitative analysis¹⁸

¹⁸ By author

Thanks to this table, we can decide to eliminate both the fifth and the sixth alternatives, which have the lowest overall sums.

We have decided to compare those alternatives by ranking the different criteria and weighting them, thus producing an additive weighing model. This will be presented in the following table:

	Rank	Normalized weighted	Prevention normalized	Negotiation normalized	Standing neutral normalized	Non-binding resolution normalized
Submitting disputes to arbitration	13	0,133	0,133	0,133	0,066	0,066
Success of international arbitration	12	0,122	0,061	0,122	0,061	0,061
Party autonomy	3	0,031	0,031	0,031	0,015	0,015
Freedom to choose a neutral and competent decision maker	3	0,031	0,031	0,031	0,031	0,000
Speed	1	0,010	0,010	0,010	0,010	0,010
Cost	2	0,020	0,020	0,020	0,010	0,010
Confidentiality	6	0,061	0,061	0,061	0,031	0,031
Ability to select place and language of arbitration	5	0,051	0,026	0,026	0,026	0,026
Flexibility of process	4	0,041	0,041	0,041	0,020	0,020
Limited discovery	11	0,112	0,000	0,000	0,000	0,000
Absence of appeal	10	0,102	0,102	0,102	0,000	0,000
Enforceability	9	0,092	0,092	0,092	0,046	0,046
No need for court intervention	5	0,051	0,051	0,051	0,051	0,026
Arbitrator's ability to consolidate actions	14	0,143	0,143	0,000	0,143	0,143
SUM	98	1,000	0,801	0,719	0,510	0,454

Figure 5 – Additive weighing model¹⁹

Thanks to this, we have determined that the prevention resolution is the best alternative to the dispute in our case. Both prevention and negotiation resolution have high scores, while the standing neutral and non-binding resolution score a bit lower.

¹⁹ By author

Step 6 – Selection of preferred alternatives

The additive weighing model can help us produce a true ratio scale, to determine by how much each alternative is better or worse than the others.

Considering that $12/11,5 = 1,043 * 100 = 104\%$, we can deduce that the **Prevention** alternative is 104% better than the **Negotiation** alternative.

We can therefore provide a ranking of our feasible alternatives, going from best to worst.

1. Prevention
2. Negotiation
3. Standing neutral
4. Non-binding resolution
5. Private binding resolution
6. Litigation

Step 7 – Follow-up results

In order to monitor the performance of the contracting company choosing to negotiate in case of a dispute, we could assess the follow-up results thanks to a Before and After Pareto analysis²⁰. If some failures happen after the recommendation is implemented, the company must record each failure and their cause into a written document. The data thus collected will allow a ranking of the issues by order of importance and then scored to group issues by type. The information will serve as a base for an action plan, allowing the company to improve the performance afterwards, and determine the relevance of the recommendation.

CONCLUSION

The process of negotiating, signing and following a contract between Chinese and Western contractors is quite different from the same process with Western-only contractors. Language, cultural differences and geographic matters must be taken into account to successfully wrap a project up in this context.

This paper primarily aimed at answering the following questions:

- How to avoid contract failure when dealing with a Chinese contractor?
- How to prepare best to make the contract management process as successful and smooth as possible?

To answer these questions, we compared different alternatives of resolving a dispute about a contract, according to diverse criteria such as the cost, the speed or the flexibility of the process.

²⁰ Mulder, P. (2012). Pareto Analysis and principle. Retrieved from ToolsHero: <https://www.toolshero.com/problem-solving/pareto-analysis/>

These alternatives went from including prevention in the terms of the contract to potential litigation in court. Of course, every alternative studied could be used by Western companies, but we ultimately determined that the best one was the prevention of the dispute. Indeed, preventing a potential dispute by including clauses in the contract beforehand was deemed as the most respectful of the different criteria to ensure that the project is the most successful possible.

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This paper was produced during the International Contracts Management course she followed under the guidance of Pr. Paul D. Giammalvo, the Course Director, and Pr. Paul Gardiner, the Program Director. Being deeply interested in Chinese customs and international negotiation for having previously studied in China, she deemed interesting to share an analysis on something she could see with her own eyes.

She wishes to work in the project management field, most likely specialized in communication and digitalization. She is closely following topics related to knowledge management, quality management and open innovation.

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