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In Control in China

This article, also published in 'Tijdschrift voor Organisaties in Control' expresses the findings of a study by Arjan Zweep, director of Adbeco Ltd and Jaap Koelewijn, independent advisor and lector in Corporate Governance. The outcome of the study aims to provide academic and practical answers to questions which Western companies working with or owning companies in China might have.

Exercising control of Chinese businesses from the West is a difficult task. The foreign owner will have to become well-acquainted with the large cultural gulf between the Netherlands and China, adapt policy accordingly and try to make the cultural differences work in the parent company's favour. A clear difference exists between Western companies which are largely involved in importing goods to Western markets and companies which are involved in exporting to China. For the latter in particular, creating a good control environment is extremely important, as these companies are more dependent on local management to be successful in China. This article elaborates on several suggestions, based on theoretical concepts, which can serve to create an appropriate environment.

What is different in China?

Conducting business abroad inevitably means having to reconcile differences in economic and legal systems. It goes without saying that such differences exist in China. Formally, China continues to be a state-controlled economy in which the government – particularly the communist party – has considerable influence. Various sources show that there are also major cultural differences. Differences so substantial that doing business in China can be

very difficult if one is not acutely aware of them. This section will consider these differences from a number of perspectives.

What are the differences?

In principle the control exercised by the European parent company is directed at both internal and external administrative measures intended to ensure that the Chinese subsidiary's objectives are realised in a way that is consistent with the standards and limiting conditions set by the European parent company. The parent company's principle mechanism of control over a foreign subsidiary is, of course, its majority ownership of the shares. On a more practical level, control can be carried out in a number of ways, namely through power, authority, rules and procedures, culture and informal mechanisms.

The way an overseas subsidiary is controlled from abroad depends on several factors, such as the parent company's strategy, the setting in which the subsidiary operates and the subsidiary's own competencies. When a subsidiary is in the development phase, is active in a dynamic market and has the competencies it requires for research and development, the control exercised by the parent company will be less strict than if a subsidiary is operating in a mature market in a static setting,

with the intention of keeping the costs as low as possible.⁽¹⁾ Research has shown that Chinese managers employ systematic and formal planning far less than Western managers. Instead, they work more with extrapolations based on experience and intuition. Chinese managers tend to examine causal relationships non-linearly and on the basis of a number of cause and effect relationships. Management information systems in Chinese companies are not equipped to generate timely and accurate relevant information. There also seems to be little segregation of duties at the executive level of businesses. Chinese businessmen prefer to keep their information to themselves or within a select group of trusted employees instead of disclosing this information for use elsewhere in the organisation.⁽²⁾ This approach has great consequences for the control of a Chinese subsidiary. Western enterprises are nearly forced to adjust their system of control to suit the local circumstances and working methods. In Europe and the USA, control is mainly exercised by means of finance and accounting processes, in which the various measures described by Administrative Organisation and Internal Control (AO-IC) theory are applied. This entails generating operational control information and information required for the creation of an

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1. Gupta, A., Govindarajan, "Knowledge flows and the structure of control within multinational corporations".

nual reports from the administration.

The question is whether the control measures prescribed by AO-IC theory, (namely internal organisation, analytical review, relational control, external documents and internal reporting, prescriptive data, comprehensive auditing and intelligence related to the auditee), can be applied in Chinese subsidiaries. As pointed out above, there is little segregation of duties at the executive level, little formal planning and limited recording of information. In Chinese companies, coordination and control is carried out on an informal, implicit and relational basis. The scholarly literature offers explanations for these differences.

How can these observed differences be explained?

The American E.H. Schein⁽³⁾ and Dutchman G. Hofstede are the leading theorists on organisational culture. In his research into culture, Schein distinguishes three levels: basic assumptions, values and artefacts. These will be illuminated below in the Chinese context.

Basic assumptions are unconscious, deeply rooted perceptions, thoughts and feelings. A group shares a collective preference for a particular way of doing things. For 5000 years, the Chinese people have been united by a number of key cultural characteristics (such as a shared script and moral principles) based upon the writings of Confucius.

Two important *values* in Chinese society are the concept of *guanxi* and the importance of family ties. *Guanxi* literally means relationships, and refers to all types of relationships. In the Chinese business world, it mainly applies to the network of relationships between various parties who cooperate together and support each other.

The essence of *guanxi* is therefore to do business by using valuable contacts.⁽⁴⁾ In a centralised, bureaucratic state, the only way to achieve goals is by making use of personal contacts. *Guanxi* is thus the analogue of a commercial legal system, and considering the latter is less fully developed in China, using *guanxi* is all the more necessary.

The importance of family is a second essential value in Chinese society. The family in Chinese culture is a natural extension of the individual.⁽⁵⁾ To understand the Chinese family business, one must accept that in China, the family forms the basis of all organisations. Chen (2001) describes a number of fundamental differences between traditional Chinese businesses and Western businesses which are a result of the differing importance of family ties within the two cultures:

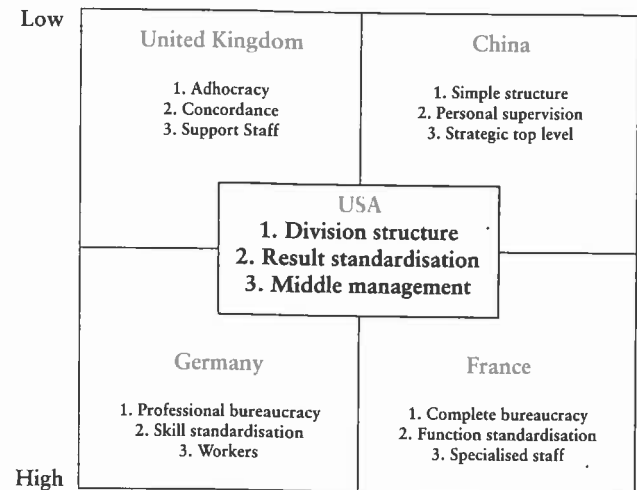
The objective of a Chinese company is to serve the family's long-term interests and enhance its prestige. A Western company's objective is to maximise shareholder value, with the focus on the short-term. Most often, this concerns profit maximisation in the short-term and the company's market value.

Chinese companies keep their financial data as confidential as possible. In Western companies, control and publication of annual accounts are obligatory. Chinese companies cannot be purchased due to the obligations to the family. Western companies can change ownership through mergers and/or takeovers.

In a Chinese company, managers are recruited from the family. In a Western company, managers are recruited from outside and selected on the basis of their knowledge and skills.

The third level identified by Schein as the most perceptible is that of *artefacts*. Artefacts

Uncertainty Avoidance



Source: Hofstede (2002), *Allemaal Andersdenkenen*, p. 191.

are the visible organisational structures and procedures. These are all the phenomena encountered upon entering an organisation. The most common organisation form in Chinese society is what Mintzberg identifies as the 'simple structure.' The coordination principle that applies to this structure is personal supervision by a superior. The most important part of the organisation in this form is the strategic top level. The culturally determined significance of the family business is evident here. Compared to other cultures, the following picture develops: The Dutch researcher Geert Hofstede distinguishes four dimensions which can characterise a culture. These are:

Collectivism versus individualism: Thinking in China is very collective; individual interests are of secondary importance to the interests of the group. People are expected to look after their fellow man, consider their wishes, treat them respectfully and protect them from losing face.

Power distance: Chinese society exhibits a high power distance. The whole system is autocratic in principle, based on

hierarchical principles and status differences. This way of working is considered the ideal way to shape relationships.

Uncertainty avoidance: This is the extent to which members of culture feel threatened by uncertain or unknown situations. This feeling is expressed in nervous tension and in a desire for predictability: a desire for formal and informal rules. Hofstede's research established a low level of uncertainty avoidance in Hong Kong and Singapore, which suggests that the Chinese do not need that many rules in order to function. The fact that information is so highly context-based supports this suggestion. However, the Chinese fear of direct interaction with foreigners conflicts with a low level of uncertainty avoidance.

Masculinity versus femininity: This dimension refers to the extent to which gender roles overlap each other. A society is masculine if social gender roles are clearly distinct. Men are expected to be assertive, tough and focused on material success, whereas women are supposed to be modest and focused on the quality of life.

2. Wong, S.L., 1985: 'The Chinese family firm: A model', *British Journal of Sociology* 36, 58-72.
 3. Schein, E.H., 1992: *Organizational Culture and Leadership*, 2nd edition, San Francisco, CA: Jossey Bass, p. 17.
 4. *Chinese Business Culture; Golden Hints for Doing Business in China from the British Embassy in Beijing*.
 5. Allison, R.E., 1989: *Understanding the Chinese Mind: The Philosophical Roots*, Hong Kong: Oxford University Press, p.6.

Confucian Dynamism:

Canadian researcher Michael Bond, affiliated with a university in Hong Kong, distinguished a fifth dimension, based on a values research study set up by Chinese researchers. Of the four above-mentioned dimensions, only the dimension of uncertainty avoidance was considered irrelevant to this study. Instead, another dimension based on the teachings of Confucius was considered to be highly important, that of long-term orientation as opposed to short-term orientation. It should come as no surprise that the study characterised China, Hong Kong and Taiwan as the most long-term oriented societies in the world. Long-term orientation is characterised by values such as persistence, awareness of status (ordering relationships based on status and respecting this order), thrift and a sense of shame.

It is striking that the fifth dimension was only included at a later stage based on research questions formulated by Chinese researchers. Without the cultural insight of these local researchers, this dimension would not have been distinguished. This emphasises the fact that Chinese culture is fundamentally different to Western cultures and has a very strong character of its own. Ambiguity is ubiquitous in Chinese society. 'Yes' does not always mean yes and 'No' does not always mean no. This is a complicating factor for Western companies. On the other hand, the Chinese are flexible and keep several options open. How can Western companies make use of these insights in controlling their Chinese operations?

Applying insights to stay in control of a Chinese operation

There is a clear difference between how a Chinese company operates when – from a Dutch perspective – it has an importing position as opposed to an exporting position. Just as in European companies, culture and segregation of duties remain the groundwork for control.

Import-oriented companies are better able to employ traditional Western control methods, as they are less dependent on Chinese management. Information is less context-based in these businesses. An appropriate control environment (as it is called in the COSO model) must be created for export-oriented companies in particular. The subsidiary must be able to operate independently in this environment, so that it can operate effectively in the Chinese market.

Selection of executive management that mutually understands and values the culture. With regard to critical processes (namely sales for export-oriented businesses), it is highly advisable to find someone local who is in the business that you can trust and with whom you are already acquainted. Preferably someone who was educated in the West, so that he understands Western culture. Although Chinese people who have lived abroad can also run up against cultural differences, they will face fewer problems than a western manager. For export-oriented businesses, it is important that this person be able to present himself to the outside world as someone with enough status to be taken seriously by the local environment. Having personal trust in the managing director decreases the need for various kinds of formal documentation, such as contractual obligations, account management et cetera. In such cases, control can be executed to a greater extent by means of what Simon describes as *belief systems*.

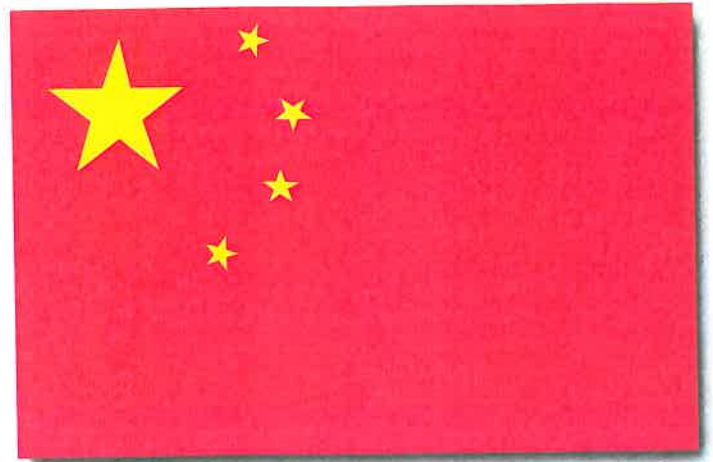
Agreement on long-term objectives: The European parent company and those in charge of the subsidiary in the Far East must have congruent long-term objectives. Giving the latter shares in the company is one way of ensuring this. It is also important to articulate a common vision for the long-term, certainly when operating with Chinese management. Make sure to take advantage of the Confucian way of thinking

and use the strength of the Chinese culture. There is no such thing as instant success in China.

Control through talking to customers: The most effective method of control for export-oriented SMEs is for the European parent company to be personally represented in the market. The personal network

it easier to handle the implicit, informal and context-based situations than their German colleagues for example.

Set-up of the organisation: The management of the subsidiary and the European parent company have to communicate frequently and openly. This is particularly true for export-oriented companies. The sub-



in China will need to be expanded and maintained. In the West, contacts are established through transactions that take place over time. In the Chinese market, a relationship must first be made before business transactions can take place. A relationship of trust has to develop with the Chinese customer. Most end customers in the Far East will appreciate someone from the European parent company taking an interest. Through good communication with customers you can actually control the subsidiary. Be wary if the Chinese managing director seems reluctant to take you along on visits to end customers or other contacts. This could be a sign of a *guanxi* relationship that may not be to the advantage of the company.

Use Dutch culture to your advantage: One advantage for the Dutch parent company is that Dutch culture is characterised by low avoidance of uncertainty. Dutch managers are more adept at dealing with different cultures than the majority of Western countries. Dutch managers find

subsidiary's management should have a certain level of participation in the European parent company's decision making process. This is also desirable if a large percentage of the company's profit is earned in the Far East. The personnel in a Chinese company expect an autocratic style of leadership. Delegation and participation will be uncommon within the subsidiary. In Chinese companies, not much is formally defined; all information is context-based, and little use is made of information systems, while the potential advantages of such systems are great. The main coordination mechanism is personal supervision by executive management. One of the potential dangers of such a set-up is that executive management can become overburdened. Another problem is that clear segregation of duties must be introduced into executive management. This goes against Chinese corporate culture, but is essential in order to keep the organisation under control. ©