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Australian Businesses in China: The Political Dimension

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ABSTRACT

This paper develops a model about the political factors Australian businesses should consider when entering China, and then empirically examines the issues by interviewing representatives from 40 companies who have operations in China. The political dimension in this paper comprises the political system, political barriers and risk, relationships with government, Australian government assistance, and Chinese government assistance. We then looked at whether these components of politics influenced entry modes, as stated by our interviewees. We found that political barriers affected entry mode choice, while the remainder of components of politics influenced business implementation and operation.

INTRODUCTION

China’s move into the global economy since 1979 has seen an influx of capital in the form of foreign direct investment (FDI) (Yeung, 2000). China has become Australia’s 21st largest investment destination. In 2006 there was $3 billion worth of investment from Australian businesses (Department of Foreign Affairs and Trade (DFAT), 2007). Despite the attraction of China large marketplace it is not a straight forward market to invest in (Chung, 2006a). Among many influencing factors, the political environment has been a challenging area for foreign investors and cannot be under estimated especially in China because of its one party dominated central administration system and “socialist market economy” (Hu, 2008). The question of this paper is how does the political dimension of China influence Australian businesses’ entry mode decisions to China, and their related strategies. We created a model of the factors related to politics that we hypothesized could influence entry modes (See Figure 1).

Figure 1: Political Factors that Influence Entry Modes.

THEORETICAL FRAMEWORK

Levy (1995) explains that foreign investors will face different levels of intervention, according to their foreignness. So investors who are highly foreign, (i.e. U.S., Australia and Europe), will find themselves with tighter controls, more stringent obligations, and monitoring then closer foreign investors, such as those from Hong Kong, Taiwan or Singapore. This will result in different investment outcomes, depending on the level of

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foreignness (Walsh, Wang & Xin, 1999). Similar to this, Australian firms will want to reduce their resource commitments, and hence risk because of the level of foreignness that they perceive of the Chinese environment. We suggest that consistent with internationalization theory (Johansson & Vahlne, 1977), firms will increase their resource commitment as their level of knowledge, and understanding of the foreign environment increases. The literature on the internationalization process describes the sequence of market entry that firms follow when internationalizing. This sequence reflects a gradual, learning through experience process (Johansson & Vahlne, 1977). Researchers have suggested that entering countries that are “psychically close” reduces the level of uncertainty firms face in the new market; and for countries that are “psychically close” it is easier for companies to learn about (Kogut & Singh 1988). The greater the closeness, the less risk that firms perceive when making an investment decision. For the purposes of this paper we define psychic distance as “a firm’s degree of uncertainty about a foreign market resulting from cultural differences and other business difficulties that present barriers to learning about the market and operating there” (O’Grady & Lane, 1996, p. 330). Given that, we expect that Australian businesses due to their foreignness from China, will face difficult investment outcomes, and will hence use entry modes that entail less risk, because the environment, and especially the political environment, examined in the paper, is “psychically distant” from Australia.

### The Chinese Political System

The way a nation is governed by the people and institutions in power, and the relationships between them is known as its political system. According to the Chinese Constitution, The People’s Republic of China is a socialist state under the people’s democratic dictatorship (The State Council 2004). It is a one party state, dominated by the Chinese Communist Party since 1949 (Linong, 2006). Political reforms have been gradualist in approach, and less dramatic than its economic reforms (Linong, 2006). This is different to Australia’s democratic system, and minimal involvement and intervention of the government in business. Given the “psychic distance” between the political system in Australia, compared to China, it would be expected that firms would choose entry modes that require less equity, and that they would develop strategies for China that take into account the differences in political systems.

### Political Barriers and Risk

For this paper we define any governmental policy, attitude or action that blocks or prevents Australian businesses from participating in free trade with China political barriers. Policies stem from protecting industries, or discouraging and restricting trade in particular areas. These are influential, as a policy may regulate that a business needs to setup as a joint venture or are not allowed to participate in the Chinese market place in full form. There are many definitions of political risk, but for the purposes of this paper we use the definition by Root (1972) who defines it as “any political occurrence, of any kind (such as war, revolution, coup d’etat, expropriation, taxation, currency devaluation, exchange controls, and import restrictions) at home or abroad that can cause a loss of profit potential and/or assets in an international business operation” (p.355). Scholars have recently emphasized that political hazards are a primary determinant of the likelihood of entry (Kobrin, Basek, Blank & La Palombara, 1980). Similar to psychic distance, where the credibility of policy is low, firms minimize commitments to a market, or avoid investment. Hence, political risks or hazards will influence entry modes into China. Past research finds that in countries where the political environment is stable the firm should opt for equity based ventures, where it is politically unstable firms should opt for a mode that does not require equity (Root, 1987). Hence, we suggest for our study that any political risk in China, will influence the entry mode chosen by Australian firms, and will also influence the strategies, operations and policies that the firm pursues.

### Relationships with Government

Relationships with the government has a significant level of importance when doing business in China due to the nature of its political system and its governmental structure (Chung, 2006a). We suggest that Australian firms who have had no experience in China would not have an understanding of the level of involvement the government has in business. Prior to economic reform all enterprises were government owned. In more recent years, state enterprises were privatized and a large number of private enterprises established (El Kahal, 2005). Despite this trend, the government at all levels still control policies as well as influence company processes. In
the case of many Australia-China joint ventures, the Chinese partners are often a section or department of a
government body, for instance enterprises owned by the Ministry of Light Industry were all state owned
enterprises (El Kahal, 2005).

**Australian Government Assistance**

In assisting firms to internationalize, there is a wide body of knowledge that examines export and trade
promotion and assistance. Seringhaus & Rosson (1990) suggest that assistance usually comprises (1) export
service programs, such as seminars for potential exporters, export counseling, how-to-export handbooks, and
export financing, and (2) market development programs, such as dissemination of sales leads to local firms,
participation in trade shows, preparation of market analysis, and export newsletters.

The rapid development of Chinese economy and the ever changing trade relationships between Australia and
China have seen the Australian government putting more and more emphasis on assisting two way trade with
China (DFAT, 2005). Various federal bodies such as Department of Foreign Affairs and Trade (DFAT) and
Austrade promote Australian businesses in all areas of business activities (DFAT, 2007). Austrade has a number
of export grants which assist Australian firms, especially SMEs in their exporting activities in China. At the state
level Invest Victoria and AusIndustry also provide grants and assistance to Australian firms (Invest Victoria,
2007). Invest Victoria has an office in Shanghai which provides Victorian businesses free office facilities and
services. At local city government level, many city councils have sister city relationships with Chinese cities. For
instance, Melbourne City has a sister city relationship with Tianjin as well as a representative office, where
services and facilities are provided. We suggest that this type of assistance given by the Australian government
will smooth the implementation of Australian businesses, operation in this country.

**Chinese Government Assistance**

Similar to Australian Government assistance, we also suggest that the assistance provided by the Chinese
government for Australian businesses in China is important. We suggest that this support lent to the companies
by the Chinese government will reduce the risk that these firms face, hence influencing their investment
decisions, and their entry mode. We suggest that the change of the Joint Venture Law in 2006 and the variety of
local governments' policies make this suggestion more essential. We expect that this support given by the
Chinese government will result in a successful outcome for Australian businesses.

Having covered the literature relating to the various components of the politics, we will now empirically
examine this dimension, through interviews with Australian businesses in China.

**THE STUDY ON AUSTRALIAN BUSINESSES IN CHINA**

Our study was conducted from August 2007 until December 2007 with the support of the Australia China
Business Council (ACBC). Respondents were recruited through the ACBC list and through the researchers'
personal contacts. Invitations to participate were emailed to ACBC members. For non-response, follow up phone
calls were made to encourage participation. We also used the snowballing method of interview participant
recruitment (Burgess, 1987), where we asked interviewees whether they would identify other potential
interviewees from other companies. These people were then contacted. After individuals had agreed to
participate, the aims and background of the study were explained, and confidentiality and anonymity were
assured to participants. A time was made to conduct the interviews. Interviews mainly took place at the
interviewee’s office. Interviews lasted approximately an hour, and were tape recorded and transcribed by a
transcriber. Three participants wished not to have their interviews taped and detailed notes were taken. A total of
42 interviews were conducted in 40 Australian Companies. A qualitative approaching to interview analysis was
taken where transcripts were examined for themes and important events, decisions or occurrences. These form
the findings of our study which will be presented over the following sections. Verbatim quotes are used to
highlight these themes.

**The sample**
The sample consisted of firms mainly in the manufacturing industry (10 out of 40). Other common industries included Agriculture, Forestry and Fishing (3), Building, Construction and Engineering (4), Business and Property Services (4), and Education (4) (See Table 1). We also examined entry mode the firms used (See Table 2). The more popular entry modes included Joint Venture Strategy (17), Wholly-Owned Foreign Entity (WOFE) (10), Exporting (4), or Project or Client based (4).

<table>
<thead>
<tr>
<th>Industry</th>
<th>Firms</th>
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<tbody>
<tr>
<td>Accommodation, Cafes and Restaurants</td>
<td>1</td>
</tr>
<tr>
<td>Agriculture, Forestry and Fishing</td>
<td>3</td>
</tr>
<tr>
<td>Building Construction and Engineering</td>
<td>3</td>
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<tr>
<td>Business and Property Services</td>
<td>4</td>
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<td>Education</td>
<td>4</td>
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<tr>
<td>Finance and Insurance</td>
<td>4</td>
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<tr>
<td>Government Administration &amp; Defence</td>
<td>3</td>
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<tr>
<td>Information Technology</td>
<td>2</td>
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<tr>
<td>Legal</td>
<td>1</td>
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<tr>
<td>Manufacturing</td>
<td>10</td>
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<td>Medical</td>
<td>1</td>
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<tr>
<td>Mining</td>
<td>1</td>
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<td>Publishing</td>
<td>1</td>
</tr>
<tr>
<td>Transport and Storage</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>40</strong></td>
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<table>
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<th>Market Entry</th>
<th>Number</th>
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<tbody>
<tr>
<td>Acquisition</td>
<td>1</td>
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<tr>
<td>Exporting</td>
<td>4</td>
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<tr>
<td>Foreign Direct Investment</td>
<td>2</td>
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<tr>
<td>Joint Venture</td>
<td>17</td>
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<tr>
<td>Licensing Venture</td>
<td>2</td>
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<tr>
<td>Project or Client based</td>
<td>4</td>
</tr>
<tr>
<td>Contract Manufacturing</td>
<td>1</td>
</tr>
<tr>
<td>Used Agents</td>
<td>2</td>
</tr>
<tr>
<td>Virtual institution</td>
<td>2</td>
</tr>
<tr>
<td>Wholly-Owned Foreign Entity</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>44</strong></td>
</tr>
</tbody>
</table>

RESULTS

For political system we asked our respondents how the political system influenced their strategies for entering the Chinese market and operations. Dimensions that respondents mentioned included the political system, political barriers, political risk, relationships with the government, the support provided by the Australian Government and the Chinese government. The following are the major findings from this section.

Political System

We suggested that the political system will influence the operation of Australian businesses in China. To support this point a logistics business in China with a WOFE noted how China’s “legacy from the past” was still apparent today and impacted on their operations “I think it’s just a function of where they’ve come from and their sort of political landscape. And ours - we’re coming from quite different models in terms of communism and democracy. So there are elements of that, that I would say there are significant differences”.

A resources company who exports iron ore and coal to China commented on the control the government had in the market place which effected how their industry and business operated and the profits they make: “There are issues in China, but what do they look like? One is about the desire of the Chinese government to insert itself into the marketplace... the general point is the role of government in markets and pricing in iron-ore negotiations”.

An automotive company, who supplies components to car companies in China, also commented on the high level of control and involvement the government has in businesses in China:

So much of China’s infrastructure and industry is state owned.... So for us, ABC Automobile, our main customer, is state owned - mainly by the Province, but also by the local government, but ultimately they are answerable through to the state. And in the hierarchy, in the Western world, the guy who is the CEO of General Motors is king. But when you go to Wu Hu, the guy who is the CEO and chairman of ABC Automobile is actually the number 2 or 3 or 4 in the hierarchy. The local mayor is actually his boss. Then the local Communist Party Chairman is actually his boss...and the role of government is far greater there than it is here – certainly in the areas where we’ve looked to invest.

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A publishing company echoed the government intervention in their business. They commented that media content had to be approved by the government or bought into line with views held by the Ministry of Propaganda. This publisher had initially decided on a licensing strategy with a local producer, and would decide later if that was successful, they would proceed with a WFOE. The comments are interesting as reforms would imply that the supervising power of the Government in terms of propaganda would have been eroded. In fact, Linong (2006) suggests that the Chinese government have been relaxing controls on media and public opinion. While this may be the case, the above suggests to the contrary.

Political Barriers and Risk

Our participants also talked about the effect of political barriers and how that impacted on what they could do. For instance, changed approval processes for foreign universities are a way that the Chinese government controls the number of foreign players in the Chinese market. This meant that the foreign universities could not be involved in partnership programs, but had to filter students to Australia instead, and long approval process made it difficult for them to do business there. In this case changing approval processes influenced entry modes. The following quote is indicative of this: “If not for all of the universities in China, and mainly because of all the regulatory restrictions, there is only so much that foreigners can do on their own. So in that regard, we are restricted to using representatives over there who have got licenses issued by the Chinese government.”

A law firm mentioned that the Chinese government still restricts what they did and hence, how they were perceived by Chinese consumers. They were restricted on their ability to employ Chinese lawyers, and their ability to call themselves a Chinese law firm. They were seen as a foreign law firm. This type of a perception has a marketing implication for their business. A bank also mentioned how they were not too concerned about short term political events, such as political risk, rather they were concerned about how the processes developed by the Government associated with business operation affected their business. Other businesses also talked about the need to influence the government in China to get things done that they wanted. For example an Australian Bank in China talked about how unfavourable banking regulations for foreign firms made it difficult for them to set up in the form that they wanted to. A logistics business faced barriers that made them do things they would not normally need to do. For example, the law in Shenzhen required the firm to have an accountant to get invoices and paperwork done, which was not practically required by the firm. These differences meant that this firm needed to have “a lot of understanding, tolerance, and patience” to deal with bureaucratic rules laid down by the government. Further evidence of government interference was apparent, as a building firm had to get Chinese government approval for designs. In fact, the government dictated that foreign firms need to use local designers, and the firm suggested that it would make their life so much easier if they did not have this requirement.

Our participants also talked about political risk, and the general finding from the study was that it was not an issue for them. A university informant stated that they thought that China was very stable for what they wanted to do. The law firm also agreed with this, and suggested that they saw China as stable, but that all foreign countries had some sort of sovereign risk associated with them. On the other hand a university did suggest that they faced political risk in China, as the following comments states, “I suppose there is a lot of risk involved, particularly where you are so vulnerable to the decisions of the government”. In summary, the major findings of this section are that political risk is not a salient issue as perceived by the interviewees. We therefore suggest that our data did not capture the effect of political risk on the choice of entry mode, for the firms examined.

Relationships with the Government

In line with the “Guanxi” concept, participants noted the importance of having relationships with the government. A resources firm noted that the relationships between their senior management team, and the Chinese government; “There is quite a lot of interaction, I think, between the top of our business and the Chinese government”. On a different note, an architectural firm mentioned that they believed it would have helped them to be more aware of relationships that existed so as not to stand on other people’s toes. A representative of a company that produces automotive components talked about how it was important for them to have both relationships, and a large enough investment in China to facilitate their business: “I have guys whose companies have been up there for 4 years prior to us and we have some of them coming asking us how did we get this done quickly. Again, I get back to government relationships, the confidence you have in the people you’re dealing with, and in the end, it’s personal. For us to go up there

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we had to have US$29 million — not greater than $30 million because then it has to go back to Central Government. So we had $29.5 million. You have to be above $25 million investment to get a reasonable position in the pecking order in the government structure. There’s no point going trying to see the mayor if you’re only putting $5 million in.

A manufacturer of vats found that it was also important to have some connection with the government, through contacts as articulated in the following point:

Our Chairman had a former colleague who had over quite a long period of time, done quite a bit of business in China, quite well connected and happened to know a number of senior city officials in the city of Quanzhou. He was able to introduce us to those officials who were then able to arrange introductions to the management of a number of engineering factories that might perhaps be partners for us to work with. And we finished up with a joint venture partner as a result of that process.

The findings in regard to this section suggest that it is important to develop relationships with the government and to make an adequate investment in China, to obtain priority in government decisions, so as to successfully facilitate business operation.

**Australian Government Assistance**

Participants also talked about the effect of getting the Australian government to negotiate for them, and said despite their assistance that often did not help much, as the following bank mentioned: *Austrade can help once you get in by directing business in your direction and we always had a close relationship.* An individual from the same bank also suggested that the relationship Melbourne had with Tianjin made it helpful for them to setup their bank:

*The Melbourne and Tianjin sister-city relationship helped, because there is a direct relationship between our mayor and their mayor. Our mayor speaks Chinese, Mandarin, so that helped. But I think at the end of the day, we were very certain about what we were looking for in a partner, and they were very certain about what they were looking for in a partner. And so it just came together quite well.*

An Australian University talked about the confusing support that various Australian Government Departments provided to universities, and how they did not know who to go when seeking marketing support in China: “There is great confusion between what AEI does, what IDP does, what Austrade does, and to some extent these State Government business offices. They are all out there doing their own thing. We have been talking about this for ages. And the Australian government just can’t get its act together on this. It just can’t.....” This suggests that the Australian government needs to work out how will offer its services to the University sector so that it is not confusing for Universities nor wasting taxpayer’s money. An exporter of plants also suggested that it was important to use Austrade in identifying partners, however they pointed out that they were not always positive about Austrade’s services. These findings suggest that it important to get Austrade’s assistance before venturing into China. It was noted that Austrade was not always successful in doing so, and this needed to be taken into consideration when firms devise strategies for China.

**Chinese Government Assistance is Important.**

Our participants also talked about the assistance provided by the Chinese government, and how that was important for their implementation of their business venture. As the following resources company pointed out: *I know the Tianjin municipal government was quite helpful, from my understanding, with our investment there. The people running Suzhou Industrial Park, as we mentioned, have been very, very helpful.* A dairy company talked about how it was important that the government assisted with developing the dairy industry for them.

**DISCUSSION AND CONCLUSIONS**

The results of the study find that an understanding of politics is important when considering entry modes to China. Our data did not capture that the political dimension influenced entry modes, as to what our theoretical perspective on internationalisation (Johansson & Vahlne, 1977) would suggest. For instance, a firm has decided on its entry mode, i.e. a JV, and would use political connections to obtain this strategy. It was not the case, that China is “psychically distant” from Australia, a business chooses a less risky entry mode. It was found that government intervention was strong in Australian businesses in China, which meant that businesses needed to
understand this and incorporate that into the way they operated. In summary, the political system did not affect entry modes, but did affect operations. In terms of political barriers, participants confirmed that rules the government created affected what they did there. Hence, the political barriers were more influential on the type of mode that businesses choose. As our participants barely mentioned political risk, we believe that this was not a salient issue for the participants of our study, nor influenced their entry mode. Similar to the work on culture in China international business research, Australian businesses identified that connections, relationships; and “Guanxi” with Government facilitated them getting their operations up and running. This has been suggested by other researchers (i.e. Chung, 2006a; Linong, 2006). Participants did not specify they tried to influence the government through connections to get the type of entry mode they wanted. Instead they would use relationships to lever and implement the strategy chosen. Our participants mentioned assistance provided by the Australian Government and Austrade, which did not explain entry mode, but assisted with business operation and implementation. This point is further emphasized by the fact that a firm said they had already decided on their model, and they used Austrade to help them find partners. For the University sector, there was confusion as to what Australian Government bodies provided support to Australian Universities, and suggestions were made for improvement of this. Participants also found that assistance provided by the Chinese government did not influence entry modes rather it assisted with business implementation. In conclusion, our main findings from this analysis of 40 companies, was that politics affected entry modes, in as much as the Chinese government created the rules for whether the firm was allowed to have a WOFE, or had to use a JV strategy, or use licensing or agents, depending on the industry. Our expectation would have been that the political system, and the uncertainty operating in that type of political system, would make firms choose entry modes that reduces risk and resources commitment, as per internationalization theory (Johansson & Vahlne, 1977) and the “psychic distance” concept (O’Grady & Lane, 1996). But clearly, as participants did not see high levels of political risk, this did not affect entry modes, but affected their operations. This was the same for other components. In conclusion, we redeveloped our model of the dimensions of politics, and the influences each had on entry modes, and operations. This model is presented in Figure 2:

In summary it can be seen that political barriers have an influence on entry modes, but that other dimensions of politics, such as the political system itself, political risk, relationships with the government, Australian government assistance, and Chinese government assistance, helps firms in implementing their business, and influences they way they operate. We argued, that Australian businesses need to have an understanding of these components of politics, to help better prepare themselves for the political environment in China, and to assist in the successful development of their business in China. The complexity of its political system and operation system can be the make or the break of an Australian firm, in China.

REFERENCES


